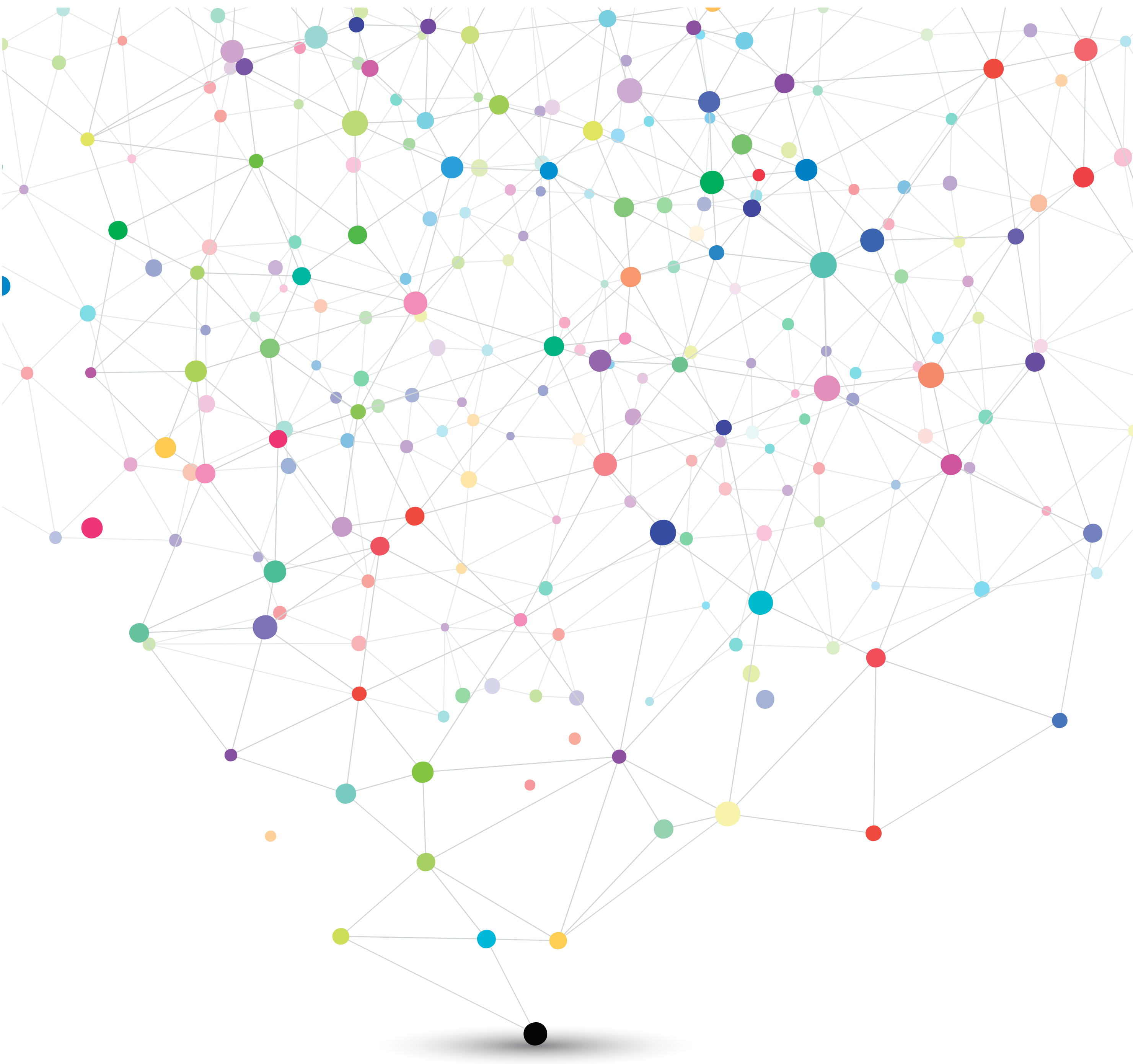

Digital Trust Program

A global trust program to offer
entry into the global digital economy

Paper by TAQANU

EXECUTIVE SUMMARY

Digital Trust is designed, primarily for the global disenfranchised populations, to offer temporary political recognition with the single right to access a limited banking account from the recognizing country.

The Challenge - Stability, Identity, and Finance

The broad landscape of financial inclusion initiatives and announcements distort the reality tha**t over 1.7 billion people lack access to formal financial means**. Over the past decades, financial incumbents gathered under the flag to unravel financial inclusion; however, - besides the successful development of the ominous microfinance industry primarily generating returns for investors - small levels of progress can be reported. In the meantime, accessible technology became a global phenomenon, ever more accessible and affordable, providing a platform for globalized service delivery. Yet, interventions intended to offer financial inclusion remain local, failing to deliver, and are not built to scale.

As we consider technology as one of the most impactful enablers of our time, we are yet to recognize the same opportunities when we look at finance. Finance and the financial ecosystem at large are among the most regulated industries. At its core, the rules introduced to limit the "creativity" used to leverage finance in support of illicit trade and scandalous return-oriented means. The measures to combat the fraudulent use of the financial sector are in a constant cat-and-mouse game with the actors it was initially supposed to alienate. **However, the introduced and heavily enforced set of barriers created requirements that systematically bar a significant portion of the population from accessing any forms of finance.**

These limiting regulations are one of the leading factors why our globalized world still accounts for - an estimated - 1.7 billion people, who still lack the formal means to store and safeguard wealth. **This population of the "unbanked" significantly overlaps with the 1 billion people who are unable to prove their identity.** The introduction of Know Your Customer requirements, along with Anti Money Laundering regulations are intended to solve problems of mitigating trust; the same rules continuously generated negative consequences for the most vulnerable and limited populations.

The requirement curbing access to finance is primarily centered around the ability to prove someone's identity, to provide the foundation of trust between the service provider and user. The lack or missing credentials left populations exposed to dire limitations in opportunities and the inability for social scaling. Among this group of barred populations, Forcibly Displaced Persons ('FDPs') are among the least serviced community. FDPs often lack or lost the papers and proofs required to meet the criteria for financial access. Their ambiguous legal status creates an additional complication. This community faced hardship; their lives have been disrupted by ongoing violence, famine, and the growing effects of humanity's biggest challenge, climate change.

Experts estimate that by 2050, 25-1000 million people will become victims of climate change-related consequences. **The rapid migration of people fleeing territories which were rendered uninhabitable by various causes, will weigh adversity on host communities to the point of - potential - systematic failures.** The collapse of local ecosystems will further complicate the situation, rendering responses ever more complicated.

The Solution - Digital Trust & Financial Access

As part of the long-awaited measures to develop capacities needed to deal with the inevitable hardships of our civilization, novel approaches are required to provide the frameworks necessary to tackle issues that stem our culture, now and as a preemptive measure, in the future.

The program described below is an outcome of multi-year research and experimentation on creating a viable way to offer financial access on a global scale, starting with the most vulnerable. The authors of the paper recognize that regulations are foundational for the financial sector. Therefore, the proposal follows the current guidelines rendering the project a viable, yet also scalable solution. While the programme intends to create an example, it has the capacity to solve most regulatory and technology-related circumstances currently stemming from the sector, making it a potential foundational piece of global collaboration and efficient service delivery.

The global landscape of finance is a cluttered set of frameworks built around shared principles implemented in different ways eliminating the ease for interoperability. Furthermore, most countries have different constitutions or legal foundations for individuals and their opportunities. The combination of the regulatory gap between countries has been stemming from the possibility for umbrella solutions that offer cross border solutions without the need for complicated negotiations that are continuously exposed to the political changes in the regions.

To bridge the gap in the regulatory landscape to solve financial inclusion, the project team proposes to lift the problem out of context and remotely offer solutions. This principle has been part of the toolkit used by the tech industry. For example, the introduction of the cloud provided a solution that can streamline and speed up the scaling of a service.

This paper is proposing the introduction of a remotely issued digital trust programme. A Lichtentesin has the means to create a legal environment where such digital trust can be legally issued and accepted in a remote manner. This digital trust program, however, has a different function from a Passport held by citizens of the country as it does not provide the broad set of rights a Passport would do. This digital proof is issued with a single goal, to offer the receiver a limited recognition as a person. The importance of this limited recognition - identity - is critical for the service.

The other innovation the paper proposes to implement, in alignment with the digital trust program, **the legal framework for the use of these newly created identities for - limited - financial access.** A sovereign country can enable financial institutions overseen by its regulatory authority to recognize this identity framework as a means to fulfill the identification requirements of the country, thus creating a path for legally attainable access to finance.

Implementation Aspects

It is important to note that FATF, the Financial Action Task Force - an iNGO with a purpose to combat money laundering and terrorism financing - recognizes the use of a tiered customer due diligence processes. By implementing this tiered process, the concept of a digital trust combined with limited financial service offerings creates the avenue for a successful product line to solve financial inclusion.

The digital trust is explicitly limited to the ability to enable the holder to open a limited bank account legally; it would not provide any additional rights beyond this scope. By implementing both a tiered KYC and the digital trust program, the country can empower financial institutions in the country to undertake progressive risk mitigation and remote onboarding for populations previously barred from any system.

The implementation of such legal frameworks is possible. Many of the different components have already been tested and have historical proof of their efficiency. **However, the combination of these frameworks with technology is unprecedented**. Yet, the project already accumulated interest from some of the most significant initiatives working on the problem. At the same time, the solution is complex. It requires political considerations, a project that is legally capable of introducing a framework for a global financial inclusion that can improve the lives of millions of people who need access the most.

The positive, long term impact of the project is mainly due to its inclusive and flexible nature. The right combination of technology and policy enables a framework that advantages beneficiaries, organizations working with them, and the legal framework's provider (sovereign country). **Recipients become empowered and gain back their dignity through identity and inclusion into the global finance ecosystem.** The digital, reusable recognition, along with the established self-reliance, beneficiaries will have meaningful ways to interact through both financial and digitally-enabled social means. Organizations gain the ability to simplify their principles of interactions with the beneficiaries while increasing the potential for an interoperable identity framework that can further reduce the workload when beneficiaries receive support from multiple organizations. One of the most significant gains can be found in the possibility of the simplified and shared financial aid mechanism made possible with the transparent and regulated inclusion into finance.

Last but not least, the benefits of the regulating sovereign country is the capacity to become a trendsetting regulator with global recognition of offering the position to elevate millions from being left behind.

> The opportunity for the government is to lead the way as a real change maker. To become the body that uses finance as a tool for transformation and the enabler of humanity and equality.

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BACKGROUND

Growth of Global Displacement

There are currently over 70 million forced migrants in the world fleeing wars, hunger, persecution, and a growing force: climate change. UN forecasts estimate that there could be anywhere between 25 million and 1 billion environmental migrants by 2050. Moving either within their countries or across borders, on a permanent or temporary basis, with 200 million being the most widely cited estimate. This figure equals the current estimate of total international migrants worldwide, and is, therefore, an alarming prediction that should act as a further wakeup call for public opinion and policy efforts aimed at addressing the climate emergency.

Understanding the climate change-migration nexus will prove instrumental in the effort of addressing it.

Financial Inclusion among FDPs [GPFI]

Forced displacement in its various forms is a critical and rapidly evolving global development issue. Thus, more people than ever are affected by forced displacement today. Developing countries bear a large burden in this context: with respect to refugees alone, approximately 84% live in developing countries. At least half of all refugees today have been displaced for more than ten years without any lasting solution in sight. These numbers are trending upwards and show no signs of abating. Forced displacement has turned into an acute crisis of global proportions that affects developing and industrial nations, with some countries being strongly affected.

The protection of FDPs and the socio-economic perspectives of both FDPs and their host communities is not only the responsibility of host states (and perhaps neighboring countries), it is the collective responsibility of the international community. Moreover, the increasingly protracted nature of displacement can no longer be viewed solely or even primarily as a humanitarian issue. It is a development challenge to which we must all rise and which requires a significant collective effort.

Leveraging opportunities to help FDPs and their host communities to build self-sufficiency and boost individual, household and community resilience. Indeed, it has become increasingly clear that if we want to mitigate the social and economic strain caused by the global forced displacement crisis, this vulnerable and diverse population has to be enabled to contribute productively to, ideally, regulated economies and markets and, at a minimum, to develop socio-economic and sustainable livelihoods.

> Financial inclusion is a particularly powerful part of the answer. Options to safely store money, to build-up (small) savings or send and receive money transfers, and to carry out everyday life transactions are vital for FDPs.

Access to a broad set of safe and affordable financial services – payments, savings, credit, and insurance – can enable forcibly displaced populations to master difficult situations and to manage (economic) shocks associated with displacement, to effectively deploy their skills and competencies and to rebuild their livelihoods, all of which can help to mitigate stress and trauma of forced displacement. As a result, financial access allows FDPs to contribute to the economic development of the host community or country. Robust and appropriate financial access can also boost stability and resilience, not just of FDP populations, but also of the markets and local communities in which they live, as well as other populations such as regular migrants. Hence, there are strong links between financial inclusion and economic, development and empowerment outcomes.

At the same time, the financial inclusion of FDPs provides a unique opportunity of linking relief, rehabilitation and development (LRRD) efforts. By enabling and encouraging financial access that is inclusive of FDPs, development actors can foster synergies between measures to achieve humanitarian (crisis relief and recovery) and development objectives (sustainable social and economic empowerment and growth) and facilitate the transition from crisis to post-crisis situations. The financial inclusion of FDPs implicates both humanitarian response and development priorities. Improving response while providing lasting financial inclusion can make aid more effective and enhance individual and market resilience.

Long Term Approach [GPFI]

By embedding this approach in a longer-term vision and developing conducive (legal) framework conditions, national governments play a crucial role and can broker relevant partnerships. The time is ripe for such catalytic support. Financial inclusion is already a strategic priority of the UN Sustainable Development Goalsand other global stakeholders, though FDPs have yet to be formally designated as a vulnerable population segment to be served and included. By acknowledging the financial inclusion of FDPs as a priority development issue, we can help promote enabling policy and regulatory environments that provide fair, safe and sustainable access to the financial services FDPs and their host communities urgently require.

The humanitarian sector is also beginning to understand the role financial inclusion can play in more efficiently and effectively supporting the growing FDP segment under its mandate, and to link current cash-based approaches to longer-term financial inclusion and socio-economic development goals.

Advancements in digital payments technologies, therefore, might have great potential for serving FDPs and promoting their financial inclusion more rapidly, on a larger scale, and at a lower cost, e.g. in providing cash-based assistance via digital payments infrastructure for relief and recovery efforts via the humanitarian community. New digital technologies can render financial services safer and more secure, transparent, and cost-effective for the FDPs – as well as for NGOs and governments in their service provision.

Digital Technologies [GPFI]

Digital technologies might also support more trustworthy and efficient identification and authentication mechanisms for FDPs to enter into the financial system. As such, digital technology potentially offers a strong tool to transition from providing immediate relief to creating enduring financial identities, tools, and capacities that build resilience over time. Doing so can simultaneously bridge the humanitarian-development divide in unprecedented ways.

Recognition & Right to Work [GPFI]

For refugees, the right to work is vital for reducing vulnerability, enhancing resilience, and securing dignity. Harnessing refugees' skills can also benefit local economic activity and national development. But there are many obstacles.

Overall, there is a remarkable diversity in legal provisions and constraints on refugees' right to work. A restrictive approach to the right to work prevails, and most states are reluctant to ease these restrictions. The majority of refugees work in the informal sector, but under much less satisfactory and more exploitative conditions compared with nationals. Informal labor markets are also constrained in countries with fragile economies which often host large numbers of refugees. More national and international coordination is required, multiple actors should share in the responsibility to deliver decent work, labor market policies, as well as training and education, should be harnessed to support sustainable livelihoods, and refugee social capital should be more effectively engaged.

Policy & Regulatory Aspects [GPFI]

Policy and regulatory frameworks may generally challenge the achievement of the financial inclusion of FDPs, because most do not recognize the special circumstances and legal status of FDPs and do not stipulate specific measures to address them. The lack of consideration of specific FDP circumstances and related policy consequences applies at the level of both overarching policy frameworks and of specific technical regulations.

With respect to broader policy frameworks, FDPs are rarely considered as an explicit target group in national policies promoting socioeconomic development and resilience. Particularly refugees are generally absent from financial inclusion policies or strategies, where these exist.

The rules and regulations pertaining to FDP's socio economic participation in host communities (including the right to work, freedom of movement, legal identity, and ability to participate in the financial system) may also have a bearing on the provision of financial products to and usage by FDPs, this particularly applies to refugees.

> Local policies, regulations and legal frameworks may in some instances impede access to financial services for FDPs. For example, FDPs often may lack the means to establish legal identity in order to satisfy customer due diligence (CDD) requirements for accessing regulated financial services. Local prohibitions on who may access financial services also can hinder the financial inclusion of certain FDPs.

National financial institutions and service providers need to comply with international Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT) standards. This requires **appropriate CDD**, including customer identification and verification, understanding, and as appropriate on a risk basis, obtaining information on the nature and purpose of the customer relationship, conducting due diligence on the business relationship, and monitoring financial transactions to identify and report suspicious ones. Given that FDPs in some cases lack the means to prove their legal identity, the costs associated with compliance in such scenarios can be prohibitive and discouraging.

Humanitarian agencies, such as the World Food Programme (WFP) and the UNHCR, have developed and use specific identification methods in crisis contexts. FDPs are, for instance, often extensively interviewed and can be issued registration cards. Such humanitarian identification methods are, however, largely not accepted for CDD purposes.

Solutions [GPFI]

In reformulating national policies and strategies related to economic development and financial inclusion, some countries have moved to give explicit recognition to FDPs and have developed corresponding measures to address their special circumstances. Some have adopted **tiered CDD requirements** that allow for the (digital) transfer of small values in lower-risk scenarios without requiring financial services providers to conduct full CDD. For displaced communities specifically, it has been shown that risk-based CDD can speed up the delivery of and access to payments and other financial services.

Private sector actors are key innovators and enablers in advancing the financial inclusion agenda. Included in this trend are new approaches that use **biometric information, alternative data** and **distributed ledger technology** (DLT) to facilitate the development of efficient and trustworthy (digital) identification, in close collaboration with relevant government agencies could be important ways forward.

Table 1. Global Good Practices

Examples of country-level action aim to illustrate the emerging approaches outlined above but are not meant as an exhaustive list of all efforts undertaken.

Bank of Tanzania has integrated FDPs into the National Financial Inclusion Strategy to ensure that they are visible. This is in consideration of the broad range of stakeholders involved in the design and implementation of the strategy, which provides unique opportunities to address FDPs financial needs easily. For easy client on-boarding, which includes lowering KYC requirements, Tanzania is issuing special NIDs (biometric identification) to FDPs.

In **Egypt**, similar to **Jordan**, the government decided to accept the UN refugee registration card as sufficient identity documentation to meet CDD requirements for financial service providers (FSPs).

The **German financial supervisory authority**, BaFin, in consultation with the German Ministry of Finance allowed refugees to open a basic account even if they were not able to produce a document satisfying the passport and ID requirements in Germany. The basic account allows them to perform essential operations, with adjustments exercised in determining the documents required for identification and verification, for example, an official “proof of arrival” document, or the temporary residence permit, or the notice of toleration.

Regarding **Mexico’s** regulatory environment, the country has implemented risk-based KYC requirements that enable underserved individuals to access low-value accounts without fulfilling the full array of traditional identification processes, which can sometimes be burdensome for under-resourced groups. Under Mexico’s four-tiered KYC system (introduced in 2011), “level one” (very low-risk) accounts feature monthly deposit limits and a maximum balance limit of about 400 dollars; accounts can be opened at a bank branch, banking agent, over the internet, or by telephone. Higher-tier accounts have more stringent KYC requirements.

FINANCIAL INCLUSION AS A NON-ZERO-SUM GAME

Informal Economy [ILA]

More than 60 percent of the world's employed population earn their livelihoods in the informal economy. **Informality exists in all countries regardless of the level of socio-economic development, although it is more prevalent in developing countries.** The 2 billion women and men who make their living in the informal economy are deprived of decent working conditions. Evidence shows that most people enter the informal economy not by choice, but as a consequence of a lack of opportunities in the formal economy and in the absence of other means of livelihood.

Policy-makers, workers' and employers' organizations and academics increasingly acknowledge that the high incidence of informality in all its aspects is a major challenge for sustainable development. Informality has a harmful effect on workers' rights, including fundamental principles and rights at work, social protection, decent working conditions and the rule of law. It also has a negative impact on the development of sustainable enterprises (especially in terms of low productivity and lack of access to finance), public revenues and governments' scope of action, particularly with regard to economic, social and environmental policies, the robustness of institutions, and fair competition in national and international markets.

As 2 billion of the world's employed population make their living in the informal economy, there is an urgent need to tackle informality. Although not everyone in the informal economy is poor and there is also poverty in the formal economy, ample empirical research has shown that **workers in the informal economy face a higher risk of poverty than those in the formal economy**, while **informal economic units face lower productivity and income**. For all those reasons, the transition from the informal to the formal economy is of strategic significance for hundreds of millions of workers and economic units around the world that are working and producing in precarious and vulnerable conditions.

Inclusion Matters [Berkeley]

Financial inclusion is widely recognized as one of the most important engines of economic development. Its contributions to GDP, individual and social welfare, and business creation and expansion – particularly small and medium enterprises – have been amply documented. The benefits of financial inclusion for the poor are extremely significant. **Financial inclusion is not just necessary for growth, but also to avoid financial collapses within families**; 28% of adults in developing countries say they would deplete their savings if they were in need of money for an emergency, yet 56% of these adults do not save at a financial institution. Money that literally sits in drawers at houses ends up missing out on high-interest rates offered in developing countries (this is a common policy used to curb inflation), and hence has a lower worth or net present value when used in the future.

There are a number of barriers faced by banks that would conventionally be tasked with the job of increasing financial inclusion around the world. For one, **people in developing countries** (and since the financial crisis, in developed ones too) **do not trust banks**, in digital or agents, leading to a lack of uptake in possible banking services. A large proportion of people lack financial literacy, and are not interested in the benefits they may receive from banking services (such people only believe in financial services on a need-be basis).

> At the same time, regulatory issues around pricing, capacity and KYC (know your customer) requirements have limited the ability of banks to scale.

Add to this the fact that there exists a severe lack of connectivity in several rural areas around the world, or a lack of collaboration with governments; all these factors compound and limit the ability of banks to drive increases in inclusion.

Fintech presents a possible best-response to the lack of financial inclusion – a few years ago, big data was not as important a factor in mainstream conversations about financial inclusion; smartphone penetration in Asia and Africa was nascent, and not much research had been conducted on how smartphones can be used to substitute for conventional banking services in a masterstroke that could easily increase financial inclusion around the world. With smartphone penetration increasing exponentially in developing countries, fintech's today have a tool to **allow individuals and the youth to access working capital**, **small loans** and a number of **basic financial services** that help increase inclusion.

Existing Solutions Worldwide

Cash assistance [EU]

Cash transfers **promote empowerment and responsibility, as well as demonstrate a powerful form of trust in participants.** When a recipient receives a cash transfer, he or she also receives the responsibility of finding providers, negotiating prices, making purchasing decisions, and tracking their expenses. With reduced transaction costs, **cash and vouchers result in more aid directly reaching beneficiaries**, which ultimately ensures the maximum impact for those in need and better value-for-money for donors and taxpayers. Cash transfers also provide people in need with wider and more dignified assistance, giving them the **flexibility to choose** what to purchase based on their preferences. Finally, cash assistance **supports local markets**, lays the foundations for communities' recovery and resilience, and can **complement existing social safety protection systems**. On a daily basis and in practical ways, this becomes a powerful means to increase empowerment and self-esteem as well as an important teaching tool for micro-entrepreneurs.

[WFP, WFP] Cash transfers empower people with choice to address their essential needs in local markets, while also helping to boost these markets.

Cash transfers include assistance distributed as physical bank notes, e-money, mobile money, through debit cards or value vouchers which are redeemable at locally-contracted shops. Findings show that the element of choice is critical: vulnerable households which are empowered to decide about their lives make choices that improve their food security and wellbeing. Cash transfers have multiplier effects on the local economy. By enabling people to purchase food and other items locally, cash can help strengthen local markets, encourage smallholders to be more productive and build national capacities.

Multi-purpose cash-based assistance [EU]

Multi-purpose cash-based assistance can be defined as a **transfer** (either delivered in several tranches regularly or as an ad-hoc payment) **corresponding to the amount of money that a household needs to cover**, fully or partially, their basic needs that the local market and available services are able to meet appropriately and effectively. Beneficiaries will be faced with the need to prioritise how best to use the assistance received so as to ensure that their basic needs are covered.

Humanitarian assistance strives to provide the most appropriate, effective and efficient responses to the needs of people affected by a crisis. It is provided in many ways depending on needs and context. The choice of appropriate transfers (in-kind, cash or vouchers), or their combination, must be based on a thorough assessment and context-specific analysis, including cost effectiveness and efficiency, secondary market impacts, the flexibility of the transfer, local availability of goods and services, prioritisation and targeting, gender and protection considerations, and risks of insecurity and corruption. In the past assistance was delivered as food parcels, blankets and packages of soap and medicine, whereas now, increasingly, it is provided in the form of cash. In kind deliveries will continue to have a place, often in combination with cash or vouchers, but in order to understand this fundamental change in the way assistance is delivered, the humanitarian community needs to look at why this change is taking place, where it is likely to lead and what in fact is meant by multi-purpose assistance.

Essentially this change is taking place because our understanding of poverty and vulnerability has evolved to recognise that **access to goods and services is a greater problem than availability and one which cash based assistance is well placed to address**. Also this change is taking place because it can. In the past, delivery of cash was hampered by the absence of technological solutions, which are increasingly in place either through mobile phone coverage or the more widespread use of cash cards and which allow cash to be delivered at scale. The ability to register beneficiaries in a way that associates them with an electronic cash card, a bank account or a social security register, improved information sharing and technology and the realisation that markets can rebound to meet needs efficiently in crisis situations, even when those needs grow exponentially, have all helped to encourage greater use of cash.

> As beneficiaries see that cash-based assistance results in greater purchasing power, dignity and choice, it is difficult to see this leading anywhere else but to a greater demand for humanitarian assistance delivered in the form of cash.

Cash transfers can be defined as the provision of money to individuals, households or communities, either as emergency relief intended to meet their basic needs for food and non-food items, or services, or to buy assets essential for the recovery of their livelihoods. Money can be distributed directly using an electronic card, which need not necessarily be associated with a bank account and which beneficiaries can then access as with any cash card. Cash can also be distributed through mobile phone transfers, remittance companies, post 6 offices or even physically. Beneficiaries decide how to use the cash received. As such, **a cash transfer is an unrestricted multi-purpose cash transfer**, enabling beneficiaries to meet their basic needs, be they food, non-food or services.

As previously mentioned, there are many ways to deliver multi-purpose assistance. However, electronic cards (bank cards, debit cards, prepaid cards) as well as other electronic devices (i.e. mobile phones, virtual wallets) are increasingly the system of choice for both cash transfers and vouchers with the difference being the degree to which use is restricted. For example, cards may be mixed with part of the card in voucher form and part in the form of unconditional cash. Absence of identification documents should not be used as a pretext to prevent access to the means to deliver cash.

The Benefits of Digitalization

Innovation

Provision of humanitarian assistance in the form of cash, which by nature is multi-purpose, is innovative. The modality itself has demonstrated its worth – it has been tested at small, medium and large scale and advances in technology offer a variety of ways to deliver the assistance securely and at scale. The crises that spark humanitarian assistance require humanitarian actors to operate with agility and to be open to solutions that have the potential to offer a better service to beneficiaries. Working with new or innovative ways of delivering humanitarian assistance demands that particular attention is devoted to the development of best practices. Experiences need to be documented and are shared so that lessons can be learnt as to what works best, with future actions adapted accordingly. **The innovation represented by multi-purpose cash-based assistance is not technological**. While technology advances facilitate a shift to cash-based solutions, **the innovation is more about an approach**, which looks at the basic needs of beneficiaries and seeks to identify how best to meet these.

Inefficiencies

Delivery mechanisms can be used to facilitate and foster coordination and can side-step the issues prescribed by mandates of humanitarian actors and specialised agencies. Where assistance is delivered using a cash or bank card, funds can be loaded on an individual card by multiple agencies to correspond to the assessed needs. In effect, different organisations contribute to a card and meet "their portion" of an agreed MEB. Beneficiaries need not be aware of how the card has been loaded – in a given month they may need to spend more on food and less on health, but overall, if needs have been properly assessed, it can be expected that the "sectoral" allocations will correspond to 17 beneficiaries' actual expenditure. In this situation, agencies can therefore be reassured that money is being used in line with their mandates and costs to donors should fall.

Beneficiary identification, selection and registration needs to be streamlined – this may take the form of identifying one agency to take care of the logistics of registering beneficiaries, receiving allocations from individual specialised agencies and putting this on single monthly allocation on the card. Or it may be more suitable to agree on a joint methodology and process. In some situations, it may be possible to make an allocation directly through existing government safety net systems. However, efforts to streamline data collection and management must not compromise beneficiary protection.

More generally, governance is an issue - working with multiple independent mandate specific agencies and actors will not always be a smooth process and an overall governance/decision making entity needs to be foreseen if agreements are to be reached, enforced and implemented. Working with cash-based assistance does not require the establishment of any new structures or coordination mechanisms. However it does require that **existing mechanisms are used effectively and with goodwill for the ultimate benefit of beneficiaries**, which often asks partners to go a step beyond formal coordination. As this method of working becomes more commonplace, it may be the case that an individual agency will be able to deliver a full multi-purpose response. While this would help to streamline administration and reduce costs even further, care needs to be taken to ensure that the appropriate expertise can be brought to bear on a given situation and that the comparative advantages of individual agencies are harnessed.

> The role of the private sector in delivery of cash transfer programmes is crucial. For the most part, the private sector manages to ensure the infrastructure needed to deliver financial services.

Accountability

Provision of assistance in the form of cash should not raise more accountability issues than in-kind. However, the reality is that it does; it also raises issues related to accountability that do not arise with in-kind assistance, with the perception that cash is more easily diverted to terrorism and purchase of weapons or that cash allocations contribute to inflation. This should be seen as an opportunity to raise the bar on accountability across the board: for in-kind transfers as well as cash.

Work done on the risks of diversion of cash has not concluded that cash is more high-risk than in-kind and yet this perception persists. Multi-purpose assistance programmes need therefore to be accountable towards donors and affected populations alike. Programmes need to be designed so that targeting is properly done, checks and balances are in place and impact and outcome indicators are carefully thought out, using, where available, those which are accepted internationally. In this way opportunities for diversion are minimised.

Programmes need to be designed to include robust impact and outcome indicators to assess the success or otherwise of the interventions. Targeting of beneficiaries, no matter how good, will not avoid all inclusion and exclusion errors, but efforts should be made to minimise errors, while also being quick, cheap and reliable. The use of a cash delivery system makes it easier to rectify errors as this can be done remotely by changing the allocation to a group of beneficiaries or individually.

THE COMPLEXITY OF FINANCIAL INCLUSION [GSMA]

(*Account ownership in a glance:* https://datawrapper.dwcdn.net/AmFVU/2/)

Harmonising KYC requirements for low tier money accounts can foster financial inclusion by reducing redundant regulations and penetration to proceed in greater alignment - and it can do so at relatively low cost. The key hurdle is interagency coordination. Getting financial regulators to coordinate in most cases requires a top-down effort from the highest levels of government making this a priority.

Policymakers and regulators need to clarify under what circumstances remote onboarding is allowed, as well as what technologies or intermediaries may be used. They may specify that risk controls be boosted in other areas, such as in transactions monitoring.

Regulators should aim to have clear, predictable and effective regulatory frameworks that are flexible enough to adapt to market developments. Constant dialogue between operators and regulators should be encouraged to resolve any regulatory areas that require clarification with immediate action. Innovation should not be viewed as solely market-led, but also as a regulator-led initiative. These efforts should be in line with the Financial Action Task Force (FATF) recommendations which state that regulatory frameworks ought to strike the balance between financial integrity and financial inclusion.

Like all financial institutions, providers have a responsibility to identify their customers and understand the risks these customers may pose before providing services. When prospective customers lack formal identification, or when their identification is difficult to authenticate, providers cannot easily verify their identities or perform customer due diligence (CDD). This imposes two main constraints on digital financial inclusion: on the supply side, expensive customer identification and due diligence procedures can render low-income customers unprofitable, thereby constraining the size of the viable market; on the demand side, lengthy or inconvenient onboarding procedures can deter potential customers from signing up for services.

Simplifying onboarding for restricted accounts; and using digital IDs to enable electronic KYC (e-KYC). While both practices are still relatively new, they have already proven to be beneficial.

Anti Money Laundering Regulations (AML)

In nearly all countries, financial institutions are required to comply with strict laws and regulations designed to counter money laundering and terrorist financing (ML/TF), as well as other forms of illicit finance, such as tax avoidance and proliferation financing.

At the international level, regulatory standards for anti-money laundering and countering the financing of terrorism (AML/CFT) regulations are set by the Financial Action Task Force (FATF), an international standard-setting body based in Paris. Over the past two decades, FATF's standards for AML/CFT regulations have been close to universally adopted.

Issues with Know-Your-Customer (KYC)

The lack of a clear regulatory framework for digital financial services to flourish, there needs to be a legal and regulatory framework that is predictable, risk-based, and fair and does not impose excessive, non-risk-based compliance costs.

Inflexibility of KYC requirements: Regulatory clarity should not be confused with taking an overly prescriptive approach, as unduly restrictive or burdensome regulations can hinder the development of innovative markets.

Failure to keep pace with innovation: Regulators must be proactive in responding to fast-moving market and technological developments, as a slow regulatory reform process in a highly innovative world can inhibit the development of mobile money markets.

Lack of automation and digitisation: Automating KYC reporting requirements helps financial service providers to streamline their compliance efforts, thereby lowering the cost of onboarding and service provision.

Lack of a strong (national) ID system: supportive ID structure, since the challenge of conducting KYC is considerably greater in countries that lack a reliable digital ID system. Today, an estimated 1.1 billion people lack an officially-recognised ID and there is a significant overlap between this group and the 1.7 billion people worldwide who lack a financial account.

Alternatives: Tiered KYC (SDD) & e-KYC

At present, there are two main approaches to addressing CDD-related impediments to financial inclusion. The first approach is to relax CDD requirements and compensate for the residual risk by restricting account functionality. **This is referred to as simplified due diligence (SDD) or tiered know-your-customer (KYC)**. The second approach is to allow approved entities to query a national ID system to authenticate or verify customers' identities and, in some cases, to retrieve basic attributes about them. This is referred to as **electronic KYC (e-KYC)**.

The approach a country should emphasise largely depends on the current scope and capabilities of its identification infrastructure, as well as the timeframe in which a solution is sought. SDD is most beneficial to countries or populations with low ID coverage. E-KYC, on the other hand, is best suited to countries with high levels of ID coverage and robust digital ID infrastructure, both of which take time to develop.

> In addition, by lowering the documentation required to open an account, SDD may also make it more convenient to open an account, therefore encouraging more customers to do so. There are, however, situations in which SDD is one of the only viable approaches, as is the case with refugees and other marginalised populations that lack any officially-recognised form of identification.

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The first approach to addressing CDD-related impediments to financial inclusion is to simplify requirements for certain types of accounts. This approach recognises that, while ensuring universal ID coverage is a long-term endeavor, in the short-term a careful loosening of regulatory restrictions can bring more people into the formal financial system without substantially increasing the risk of abuse. Simplified due diligence has steadily gained acceptance over the past decade and has been adopted by many countries around the world.

Comparative Benefits of SDD

The simplified due diligence (SDD) approach relaxes CDD requirements for customers and seeks to offset any residual risk created by restricting account balances or activities. FATF allows countries to offer SDD for customers, products, or market segments that regulators judge to be lower risk. Countries such as Mexico permit a single type of SDD account, while others allow for a tiered approach, in which account functionality and CDD requirements increase progressively in line with one another, which means that as more KYC requirements are met, greater functionality is allowed. This is known as "tiered KYC" or "progressive KYC."

In simplified or tiered accounts, CDD requirements may be relaxed on such variables as the types of identification permitted, as well as the required information, documentation, levels of assurance (degree to which an identity claim is backed up), and records retention.

> Under the SDD approach, financial institutions offset any residual risk caused by gathering less information on their customers by placing restrictions on accounts that seek to limit their usefulness to money launderers and terrorist financiers.

These restrictions can include what types of accounts a customer is eligible to open and the types of transactions they can make. Such accounts typically place limits on transaction value and volume, often on a per transaction basis, as well as on a daily, weekly, or monthly cumulative basis. Accounts may also be limited by the types of transactions customers can make, such as purchases, transfers, deposits, and withdrawals. Restrictions may also be geographic—customers may be limited to only making transfers domestically or, in the case of International Remittances, only to countries with low

AML/CFT risk. Finally, customers may be restricted in terms of what devices or delivery channels they can utilise, including mobile phones.

Table 2. International Experiences with SDD

A growing number of countries have enacted SDD reforms in recent years, with at least 60 countries allowing exemptions or simplifications to CDD for certain types of customers or products. **In most countrie**s, simplified or tiered CDD requirements are spelled out explicitly in regulation. In others, like **South Africa**, financial institutions are granted the discretion to determine their own policies. FATF permits both regulatory approaches.

Early evidence appears that such schemes can contribute to financial inclusion. For example, in the two years after **Mexico** introduced its tiered KYC scheme, the number of bank accounts increased by 9.1 million—a 14 per cent increase. Of these newly opened accounts, 77 per cent were accounts with simplified due diligence, with Level 1 accounts accounting for 50 per cent of the new accounts, and Level 2 and Level 3 accounts accounting for 23 per cent and 4 per cent, respectively.

Countries that adopt SDD or tiered KYC must first consider the needs of the targeted population. For example in Brazil, the e-money regulatory framework allows customers to open a simplified account by only providing taxpayer's unique ID number and full name. The maximum account balance limit of BRL 5,000 (US $1,300) is the risk mitigation factor. In Mexico, authorities chose to limit deposits, rather than withdrawals or balances, to accommodate both transaction and savings accounts. The monthly deposit limit was set just above the average monthly household income in each of the lower economic segments of Mexico's population. In **the Philippines**, regulators took the country's high reliance on remittances into account by extending its tiered KYC scheme to cover international as well as domestic transfers. (See "International Remittances and KYC for Mobile Money" for more detail).

International Remittances

International remittances can be a vital source of funds for families in low-income countries. They are also an important source of foreign exchange for many countries, often exceeding inflows of official development assistance and foreign direct investment. In 2018, remittances to low- and middle-income countries are forecast to reach a record $528 billion according to the World Bank.

KYC requirements can impede the flow of cross-border remittances in two ways: First, **some countries maintain stricter KYC requirements for international transactions** than for purely domestic ones, including those sent via mobile devices. For that reason, a customer who has satisfied the KYC requirements to open a low-value mobile money account may not be eligible to send or receive international remittances without additional vetting. For example, some countries require in-person KYC for every international transaction. Second, **KYC requirements often differ between countries**, with some countries permitting simplified due diligence for small international transactions, while others do not. Likewise, some countries have robust national ID systems (and KYC regulations predicated on the assumption that most customers have an officially recognised ID), while others do not.

Regulators can address the issue by extending the risk-based approach to international remittances, including by applying specified transaction limits to international payments as well as domestic ones. The Philippines and Tanzania have both taken this approach. In countries where in-person KYC is required for international transactions, regulators should consider allowing previously-vetted mobile money users to authenticate themselves on their mobile devices with a password or personal identification number.

> SDD / tiered KYC is likely to have the biggest impact on financial inclusion in countries that do not yet have universal ID coverage. In some circumstances, SDD may be one of the only viable approaches, as is the case with refugees and other marginalised populations that lack any officially-recognised form of identification.

However, they can also be useful in countries with universal or near-universal ID coverage in addressing other CDD requirements, such as residential address verification or proof of income, which may still exclude certain populations. **In addition, by reducing the documentation required to open an account, SDD may make it more convenient, and therefore more attractive, to open an account, thereby bringing more people into the formal financial system.**

Refugees and KYC

Conducting KYC for refugees can be difficult because most lack the documentation needed to prove their identities. In addition, **many countries do not accept humanitarian IDs**, such as those issued by the United Nations High Commissioner for Refugees (UNHCR) or by non-governmental organisations. Instead, many countries with large refugee populations, including Kenya and Turkey, require a government ID, which in turn depends on official recognition of refugee status—a process that can take years to complete.

Previously to the digital trust program there were two major avenues to deliver financial access for refugees. The first alternative to address this issue is to explicitly **recognise the validity of humanitarian IDs for KYC purposes.** For example, in Jordan, which has a large Syrian refugee population, KYC regulations for mobile money allow refugees to use their UN-issued ID numbers. This approach can be incorporated into a country's tiered KYC system, if it has one.

Another solution was to establish a closed-loop payment system designed specifically for refugees. Within that closed-loop, refugees could use SIM cards or digital cards with limited functionality to receive food vouchers from the World Food Programme, and then redeem those vouchers at approved vendors in refugee camps. However, due to these closed-loop systems, refugees could not interact with the economies surrounding the camps, limiting their opportunities and capacity of self-reliance.

Table 3. Remote Onboarding

Another approach that is used to support SDD is remote onboarding. Instead of visiting an agent in person to open an account, customers may instead do so by phone or on a computer. Paraguay now allows customers to register by taking a picture of their ID card and a picture of themselves and sending the two in together. Thailand introduced regulations in 2016 for remote customer onboarding, which have been interpreted to include registering via videoconference. In Mexico, customers can open Level 1 and Level 2 accounts either via mobile phone or online, subject to additional ID verification which must be authorised by their supervisory authority with feedback from the Ministry of Finance. Malaysia's central bank, Bank Negara Malaysia, has laid the regulatory groundwork for e-KYC services for the money services business (MSB) industry, with a particular view toward streamlining the KYC process for users of online and mobile remittance services. The regulations permit the MSB industry to conduct remote onboarding of users through the use of video calls and 'selfie' photos (using facial recognition technology).

Digital ID

The World Bank defines digital ID as "*a collection of electronically captured and stored identity attributes that uniquely describe a person within a given context and is used for electronic transactions. It provides remote assurance that the person is who they purport to be.*" As economic and social activity has migrated online and become increasingly mediated by mobile devices, digital ID platforms have become critically important to being able to access services and an essential element of modern infrastructure.

Digital ID can improve the onboarding process by reducing or eliminating paper-based procedures and record-keeping. This reduces operational costs, which, in turn, should improve servicing low-income and rural customers. Cost savings can also be passed on to consumers through more affordable transaction charges. Digital ID can also link systems together to facilitate the transmittal of information and make identity verification more automatic and secure. Finally, digital ID systems with broad coverage and easy accessibility reduce the need for service providers to accept a wide range of credentials and can replace the need for SDD.

Digital ID solves both the issue of cost as well as responding to security and reliability concerns. Further, efforts to increase flexibility on who can open an account (and where) can be accelerated with a reliable digital ID system.

Considerations regarding Digital ID Implementation

Offline capability: It is important to have offline capabilities in place, which give service providers the option of authenticating users against a smart card using a mobile application or point of sale device when connectivity is limited. Offline capabilities are essential in areas with poor or unreliable internet or electricity. In addition, consideration has to be given as to how biometric devices will be maintained—if, for example, a biometric scanner breaks down in a rural area, it may be difficult to repair or replace.

Design standards and interfaces: Open design standards and open interfaces should be used wherever possible to promote interoperability and to discourage favoritism.

Governance: It is important to have a strong legal backing in place, as well as robust governance and oversight procedures.

The importance of data security: The safety, security, and privacy of digital ID systems is critically important, particularly if those systems are online and accessible to outside parties. Digital ID systems pose a risk to privacy because they typically aggregate sensitive personal information in one place. Databases must have strong cybersecurity measures in place.

Data security by regulation: Countries that lack the technical capacity to manage these systems themselves may need to rely on outside vendors, which can pose risks if the vendors are not well-supervised and if the countries become dependent on them. Moreover, most developing countries still **lack comprehensive legal frameworks for protecting users' privacy,** which may impact the adoption of these digital ID systems.

Data security by design: A digital ID system with strong privacy safeguards will only allow access to the personal information required for the task at hand, require the user to grant permission for the information to be shared, and may, where possible, answer queries with a simple "yes" or "no" without providing access to the underlying information. Where **institutional capacity is low,** it is important to build safeguards directly into the system, applying the principle of privacy by design. This will be geared towards keeping the amount of personal data collected to the minimum necessary, while prescribing data that is extraneous to the purpose of the ID system and that might be dangerous in the wrong hands.

Table 4. Blockchain ID

Using blockchain technology to help individuals manage and share their personal data could confer several benefits including: privacy, since users could control both who they share their personal information with and how much information they share; security, since the absence of a centralised database eliminates single point of failure risk; and convenience, since users could provide verified information with the touch of a button rather than through multiple physical documents.

Despite this potential, at present few, if any, applications of a user-centric ID model have scaled. And while the benefits of such an approach are obvious in theory, shifting from a centralised to a decentralised ID model raises several legal and regulatory challenges. In the first instance, companies interested in using the technology must determine if, and how, they can comply with existing data security and privacy laws. In the second, policymakers must consider whether to change existing laws to facilitate the use of decentralised models. Although blockchain may provide a secure means of storing and sharing ID information, it does not resolve the issue of initial identity proofing at the point of entry into a system.