CIPF Podcast Series – Innovation
No. 18 – Financial Innovation from a Global Perspective Part II

Transcript[1]

Intro:

You are listening to the Canadian Investor Protection Fund Podcast Channel. Here we connect with industry leaders and experts in the financial sector.

Ilana:

Hello and welcome to the CIPF Podcast Series on innovation. I'm Ilana Singer, Vice President and Corporate Secretary at the Canadian Investor Protection Fund, or CIPF for short. I'm so pleased to have Mahesh Uttamchandani as our guest today. Mahesh is the Practice Manager for digital development in East Asia and the Pacific at the World Bank Group, where he oversees the World Bank's lending and advisory support to governments in all areas of digital transformation. Mahesh, welcome. We are so delighted to have you here today with us.

Mahesh:

Thanks so much, Ilana. It's great to be back and wonderful to be invited back after our first podcast.

Ilana:

Mahesh, I feel the same way. Our topic for today's podcast is financial innovation from a global perspective. And as you mentioned, Mahesh, back in 2021, and I can't believe it's been two years already, we had the pleasure of hosting you in one of our earlier podcasts. We discussed some of your team's work at the World Bank. And I'd like to say to our listeners, if you haven't listened to that podcast, I would encourage you to do so. It's one of our most popular ones. During today's discussion we'll get some updates since that last recording and discuss the types of innovations that Mahesh is observing at this time, as well as how they're being used. We'll also hear about the research on restructuring firm and household debt coming out of the COVID-19 pandemic and Mahesh's thoughts on the potential implications both in the short and long term that we may see from recent bank failures.

So why don't we begin. Let's start with our first question. So Mahesh, during our last podcast we discussed financial innovation and the significant impact it was having on financial inclusion at that time, particularly for individuals who have historically been unserved or underserved by the financial services industry. What types of innovation are you now observing globally, and do you have any data that you'd like to share with our listeners?

[1] This transcript has been edited for clarity and ease of reading. This podcast is for informational purposes only and is not intended to constitute advice of any kind.

Mahesh:

Sure. Since we last spoke, the World Bank released another iteration of our Global Findex Survey. This is a survey that we conduct once every four years, but it was delayed because of COVID, and so the last version was supposed to be released in 2021, but we ended up having all of our field work and surveys delayed because of the pandemic and weren't able to release the data until 2022. But what we learned from this latest batch of data, most of which was collected during the later stages of the pandemic, is really interesting. So the first thing we look at is basic access to financial services through any instrument that you can use to pay or save, whether that's a bank account, or a mobile money account, or something similar. And just for context, about 95% of Canadians have access largely through one of the large Schedule A banks as they're referred to in Canada.

But globally, we saw this number be as low as 50% across the world about 10 years ago. And it's gone up to 76% by 2022, which is amazing amount of progress and 71% in developing countries. For years, we had a persistent gender gap between men and women where women were far less likely than men to have access by double-digit percentages. And now we've seen that gap come down to 6%, which frankly, is still too high, but really reflects some encouraging progress. So I'm really excited about this new batch of data and what it tells us. It's also really exciting to me that between 2011 and 2017 when we were conducting these surveys, the increase in access was really driven by China and to a lesser extent, India. But in the years since 2017, we've really seen more broad-based access across developing countries in every region of the world. So that tells us a really positive story about how things are changing.

Ilana:

Thank you, Mahesh. This is a really positive trend. And with these significant increases in financial inclusion that you've observed, can you share any interesting observations about how the poor are using financial services, whether in relation to product design or delivery or in other ways?

Mahesh:

Yeah, I think that's a really great question. I mean, intuitively, I think we all understand that COVID was a huge game changer for bringing people online. But now we have the data to prove this and to demonstrate how it was a game changer. So getting a payment into an account, whether it's your salary, or some kind of social assistance payment, or something like that, is a huge catalyst for people to use other financial services like credit, or bill payments, or person-to-person payments. So in other words, if I'm a government official or a policymaker, particularly in a developing country, and I'm sending out a social assistance payment, something like the Paycheck Protection Program payments that were made in Canada during the pandemic, and if I have a choice between sending a check, a physical check, or setting up an account where I can move the money digitally, the choice is a no-brainer.

We now know that if I set up the account and deposit the money in there and give the recipient access to that account, she's much more likely to use that money to deepen her access to financial services, build a credit history, and ultimately make the kinds of financial choices that are going to build long-term security for her and for her family. So during the pandemic, we found that 83% of adults that received a digital payment into an account used that money to make another digital payment. And 40% of these recipients actually borrowed money formally, so they began building a credit history and deepening their integration into the financial sector.

Another thing that we learned coming back to your question about product design and delivery is that mobile money has become an important tool for financial inclusion, particularly for women, and has been a huge driver of bringing women, again, particularly very poor and world-dwelling women who have traditionally been ignored by banks, into the financial system. So a person in Africa today is more than three times as likely to have a mobile money account than someone anywhere else in the world. And I think what this is telling us and what it should tell the entire financial services industry is that mobile money is a product that really speaks to the very poor and to poor women in particular. Now, just for the benefit of your audience, when I say mobile money, what I mean is an account that resides on your phone and that you can top up with cash the same way you top up your phone time.

Because in most countries outside of North America, people actually have pay-as- you-go phone time. They don't have these long-term subscription accounts with Rogers or with other phone providers like you might have in Canada, but you can use the money that you put on your phone for transactions, big or small. And there are virtually no hidden fees or costs other than very tiny transaction charges when you make or receive that payment. And so the financial services provider really just relies on a very high volume of transactions and the ubiquity of these accounts to generate profits for themselves. So this has been an incredibly powerful way to meet women where they are in terms of their financial needs, whether it’s shopping in the marketplace or paying school fees and using these accounts to transact very simply, very cheaply and very efficiently.

And let me just take a slight detour here if I can, to say that one of the great enablers of financial inclusion is digital identification. So when we think about what the role of government is to enable the kinds of services that the poor need, digital ID is a big part of this. And there are about a billion people in the world without any kind of formal identification. And again, those people are overwhelmingly more likely to be women or the very poor. In Canada most people are fortunate enough to have an ID if they need one, whether it's a driver's license, social insurance number, or a passport. But imagine if you didn't have one, how difficult would it be to open a bank account or even access basic services like health and education?

But now what countries are doing when they're looking to introduce some kind of ID system is that they're doing it digitally and, in a way, if I can say this, leapfrogging over what we have here in Canada. So a great example is what India has done over the last few years by issuing a national Digital ID Program, where over the space of just a few years, they onboarded 1.2 billion people into a biometric ID system. So now if you're an Indian and you want to open a bank account sitting in the comfort of your home, without ever even walking into a bank, you need a basic, cheap fingerprint reader that you can attach to your computer or even to your phone, and your bank can authenticate your ID remotely and digitally. That's a massive transformation for people with low literacy, refugees, and other forcibly-displaced people and vulnerable groups.

Ilana:

Thanks, Mahesh. It's just great to get these updates from you on financial innovation and inclusion, especially two years after our original podcast. In particular, the importance and prevalence of mobile money and digital identification that you've described have been, I think, eye-opening from my perspective and hopefully as well for our listeners. On a slightly different note, we understand that you and your team conducted research about restructuring firm and household debt coming out of the COVID-19 pandemic. The results were included in a World Development Report issued in 2022. Can you elaborate on this important piece of work?

Mahesh:

Sure. And I have to say, I'm really proud of this work. Look, the pandemic triggered the largest global economic crisis we've seen in more than a century, with especially severe impacts for emerging economies. And we saw that governments around the world responded with really large economic programs that were successful in the short run. However, they exacerbated a number of preexisting fragilities that we argued in the report would need to be actively managed to promote an equitable recovery. So one of the things we identified was that because there was this massive outflow of economic support to individuals and businesses, really everywhere, including in the US and Canada plus moratoria on debt service, relaxed reporting rules about non-performing loans, and generally a looser attitude towards loan forbearance.

There's a real risk as we come out of the pandemic of these hidden vulnerabilities in the financial system where businesses that might not be fundamentally viable were given lifeline after lifeline, but ultimately, that was just kicking the can down the road to an inevitable future. So we advised countries to really shore up their bankruptcy systems, both in terms of legislative reform for formal insolvencies, but also for out-of-court workouts, financial institution insolvency, and tailoring rules for small businesses so that you don't have this one-size-fits-all bankruptcy system that really doesn't speak to the needs of the financial sector or of small businesses. What I think we worried about is that all of these latent risks in the market could materialize and trigger a cascade of defaults that would also lead to tightening credit conditions and a follow-on effect of constrained growth.

Now, to be fair, what I think we didn't anticipate when we published this last year, and what I think very few people anticipated, was the multiple negative shocks of not just the pandemic, but the invasion of Ukraine, high inflation, and the consequent tightening of monetary policy to contain that inflation. So just two days ago, we released our Global Economic Prospects Report in which we project global growth to slow significantly in the second half of this year, with credit conditions remaining quite restrictive. Borrowing costs are going up everywhere, and many governments from a fiscal perspective are just tapped out because of all the necessary spending that went on during the pandemic. So last year, the global economy grew 3.1% and we're projecting that to slow to 2.1% this year.

So again, if you're looking at this from a restructuring perspective, you're still going to need to strengthen your insolvency and debt resolution frameworks, because now businesses are having a tougher time accessing credit. And those that can are paying a lot more for that credit. And we've been so used to what we call lower for longer, where credit was just very cheap for such a long time that I think this increase in the cost of credit has come as a huge shock. So I think the problems we anticipated last year have materialized, albeit via a different method of transmission than we might have thought. But again, from an insolvency and restructuring perspective, the prescription is still the same.

Ilana:

Thanks, Mahesh. As many of our listeners may know, CIPF focuses on returning customer property after an investment dealer or mutual fund dealer becomes insolvent. So all of your points regarding restructuring and insolvency in the area of financial services are directly on point for us. And since your report came out in 2022, we've seen a number of bankruptcies of large firms in the headlines, especially over the past several months. What global impact do you believe this will have in the short and longer term? You touched on this, but could you elaborate?

Mahesh:

Sure. So in a lot of countries we are, as you've said, seeing insolvencies on the rise. I think the Canadian Superintendent of Bankruptcy just reported that in March of this year, consumer and business insolvencies jumped 28% month-over-month, and RBC estimates that consumer insolvencies could rise 28% in the next three years. Now, I know that these are not, strictly speaking, financial institution insolvencies, but as we know, there's a lot of interconnectivity between business, household and financial institution insolvencies for obvious reasons. By the end of the year in 2022, business insolvencies in the UK also were at a 13-year high, basically at their highest level since the global financial crisis. And here in the US where I live, business insolvency filings rose almost 10% from March 2022 to March 2023.

And then obviously, you have the kind of unusual events like Silicon Valley Bank, which may be attributable to the steep rise in inflation and came as, I think, a shock to many people. But generally, I would say, I think it's important to keep these numbers in perspective. In general, we're seeing at this point a reversion to pre-pandemic levels of insolvency rather than extremely high levels. And again, the UK may be slightly different in this regard, but in general, I think we're going back to what was the norm before the pandemic. So at this point, I think it's too early to know whether all that money that was distributed during the pandemic artificially depressed the number of insolvencies, and now we're back to an old normal or whether we're in some sort of new normal that is going to get more dire. And I think that's what everyone is waiting to see.

Certainly it would be reasonable to infer from our low-growth predictions that there will be a sharper rise in insolvencies, but I definitely don't have a crystal ball, and I have to admit I've been wrong before about these kinds of predictions. What remains though to me is a consistent picture of where policymakers need to focus, and that's what my work focuses on. And they need to focus on making sure that debtors and creditors have the tools they need to manage higher levels of distress in a coordinated way. And in the end, that recommendation hasn't changed.

Ilana:

Thank you, Mahesh. I was quite encouraged to hear your comments about the fact that we may be back to pre-pandemic levels and not necessarily extremely high levels of distress in the markets. And I do hope that your predictions turn out to be correct in this regard. And in general, I would like to say, Mahesh, a very sincere thank you. It's been a pleasure having you with us today. It's been inspirational, forward-thinking and very interesting.

Three key takeaways that I've drawn from the session today are first, mobile money is crucial in bringing people who were traditionally unserved or underserved by banks into the financial system and particularly women. Second, you mentioned the role, the important role, that digital identification plays in some countries where there are many people without formal identification, in particular, for example, you mentioned India. I would certainly be interested to see if we move towards some form of digital ID here in Canada as well. And finally, your recommendation, which you noted is really part of the bread and butter of your role at the World Bank Group, your recommendation to policymakers that debtors and creditors be equipped with tools to manage higher levels of distress in a coordinated way. And as you noted, this is not a different recommendation, but it's certainly a recommendation that continues to hold water even today.

Unfortunately, we've now come to the end of our recording. So once again, Mahesh, thank you so much for taking the time out of your busy schedule to provide these insightful comments. I'd also like to thank our listeners for their attention, and I hope that you found this discussion as stimulating as I have. We always welcome your comments. The best way to reach us is through our website at www.cipf.ca. Finally, we invite you to listen to CIPF's other podcasts available on our website and podcast channels, or to read the transcripts, which are available in both English and French on our website. I'm Ilana Singer and goodbye for now.

Outro:

Please subscribe to our podcast and follow us on social media to stay up to date on all CIPF podcasts. More information about the speakers and what we discussed today can be found in the show notes. Please note that this podcast is for informational purposes only and is not intended to constitute advice of any kind. Thank you for listening.