How can Open Banking accelerate Financial Inclusion?

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Having a bank account is a privilege. Over 1.7 billion world citizens are excluded from the benefits and entitlements provided by access to a bank account. Almost two billion people have no access to affordable financial products addressing their specific needs. Almost two billion people have no way to make payments other than cash, convenient savings mechanisms and no access to fair credit or insurance. This egregious societal failure should be, and could be, eradicated.

In my work with the Open Bank Project, assisting banks and regulators around the world in shaping their open banking strategy, I'm often asked, “How can Open Banking address financial inclusion?’

I had the opportunity to dig into this question last year as I traveled across Latin America for client engagements - kudos here to the World Bank and IFC, with whom we have done most of our work in Latin America. My experiences in Mexico, Colombia, Peru and Brazil, countries where financial exclusion is an everyday reality, and my exchanges with local banks, micro-finance institutions, regulators, FinTechs and members of civil society helped to crystallise my thoughts. I'm glad to share with you here some of the discoveries and key learnings from that experience.

Open Banking is defined here as a global movement that encourages financial institutions to allow authorised third parties access to individual and business customer data (such as transaction history) and banking services in a machine-readable format (through APIs) and with customer consent.

Four ways Open Banking can accelerate financial inclusion

Financial inclusion means both access to financial products (e.g. having a bank account) and usage (e.g. using the bank account to make transfers rather than merely withdrawing funds once a month). We have ample evidence that a well-designed and balanced Open Banking programme can increase banking activity. Indeed, by providing access to transaction data and enabling low value payments, Open Banking can help foster innovation by addressing the underbanked and stimulating the competition to reach new markets and more users. Open Banking enables innovative actors to develop new services targeting the underbanked, building credit capacity and offering legitimate alternatives to loan sharks and other malicious financial practices which target the poor.

Let me show you how Open Banking helps achieve financial inclusion.

#1: Building credit capacity

By enabling data sharing and by using a digital payment mechanism, the underbanked population can begin to build a financial profile and a transaction history. This history can then support their transactions with other banks, FinTechs or microfinance institutions. Citizens or businesses who would typically be rejected at a traditional tier 1 bank can, via Open Banking, find a FinTech or a microfinance institution which better understands their risk profile when considering loan applications. Via Open Banking services, these citizens will also have access to an efficient and trustworthy mechanism for loan repayment.

Furthermore, Open Banking can help improve credit scoring algorithms by enabling the aggregation of transaction histories from a variety of banks, and by encouraging innovation in this area. Credit bureaux can provide more accurate and up-to-date information. FinTech companies can combine this data with unconventional sources, such as social media activity, online footprint or historic activities, to securely offer more loans. More data, more loans to more people and businesses.

#2 Supporting micro, small and medium businesses

Via Open Banking, micro, small and medium companies can access a larger pool of relevant tools and services targeting their particular needs, including cash flow management solutions and accounting software. Technical integration becomes simple under an Open Banking regime. Businesses can also take their data and shop around for cheaper and more legitimate funding sources.

#3 Improving financial health of the most vulnerable

FinTechs might offer mobile-based applications that help people better plan and manage their income and that improve financial literacy. Adding a layer of gamification can help boost savings plans and incentivise people to maximise use of their bank accounts. Introducing nudges to save on a regulator basis for instance.

#4 Banking the gig economy

Independent workers working in the so-called 'gig economy' are typically unbanked. Open Banking can help such 'gig workers' (often in food delivery or transport companies) access more personalised and affordable financial products, such as digital accounts/wallets and digital payment instruments. The gig economy platforms and companies can also extend nano-loans or micro-insurance based not only on the workers' activities on the platform but also on their credit and transaction. This is what BBVA Bancomer is experimenting with Uber in Mexico and what Grab has been doing in South-East Asia since some time now.

Where do we take it from here?

As Open Banking continues to mature and to deliver results, it is useful to keep financial inclusion in mind. For instance, regulators can assess the degree to which Open Banking can foster local financial inclusion. Financial institutions can experiment with opening up APIs and undertaking joint ventures with FinTech partnership addressing financial inclusion

I would welcome further academic research on the topic and will keep an eye open for such developments. Please ping me in the comments if you come across interesting discussions or research, or if you just want to discuss this topic further!

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