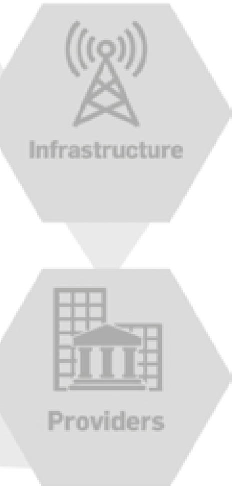


Digital Financial Services

By Hamzeh Ghosheh

In many instances, digital financial services (DFS) have had a positive impact on areas such as financial inclusion, the economy as a whole, and the various stakeholders in the ecosystem. However, DFS's ability to reach this potential relies on many components that together shape the development of digital financial inclusion. These components include policies and regulations as well as an efficient delivery infrastructure.

A prerequisite in the development of digital finance is an enabling regulatory framework. The role of policymakers and regulators is to account for the changing markets with new participants and risk allocation. For instance, policymakers need to encourage and nurture innovation to reap the advantages for the unbanked or underbanked population. On the other hand, the regulator is also required to recognize and limit the associated risks, such as customer protection, making the balance between innovation and risk very important.

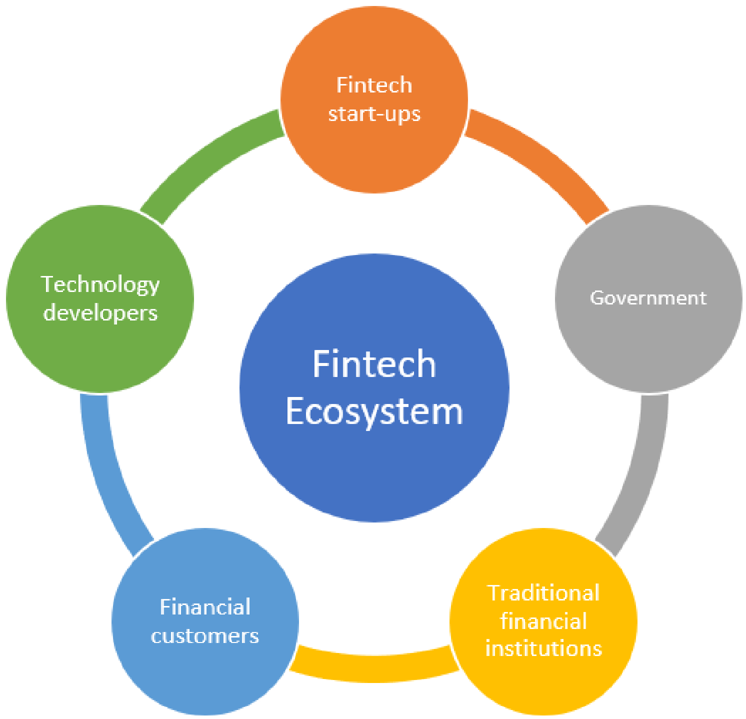
An efficient delivery infrastructure, which all providers can use, is required for the rapid and sustained expansion of the digital finance market. Crucial components for the DFS markets include secure and widespread mobile and internet connectivity, robust digital payment networks, and widely accepted IDs (to aid in identification and verification processes).

DFS delivery channels are the entry points to formal financial services. Access points can be traditional channels, such as bank branches, or, due to technological advancements, alternative delivery channels (ADCs). ADCs include ATMs, internet banking, call centers, agency banking, extension services (such as the POS devices that are found on supermarket countertops), mobile banking, and mobile wallets. These channels facilitate access to the main providers of digital finance, enabling them to offer their services in a more efficient manner.

The term "banks" refers to all financial institutions that have offered financial services even before the digital transition and are usually

In general, providers of DFS can be categorized as banks, mobile network operators (MNOs), and third-party operators; they operate through three main components: a digital transaction platform, a network of retail agents, and a special device.

Alternative delivery channels Source: IFC, Software Group: Alternative Delivery Channels and Technology (2015)



licensed by the central bank (or local monetary authorities or regulation body). This includes microfinance institutions, post banks, and cooperatives.

Mobile network operators (MNOs) are another major DFS provider, especially in emerging countries, due to low bank and high mobile penetration. In many countries, they have led a digitization process via mobile money products.

Third-party providers, or fintechs, refer to digital finance providers that combine financial services with modern and innovative technologies. Fintechs often operate with no or limited banking licenses, focusing their entire business model on digital technologies and redesigning the distribution of financial services. Customer-centricity is also a main focus.

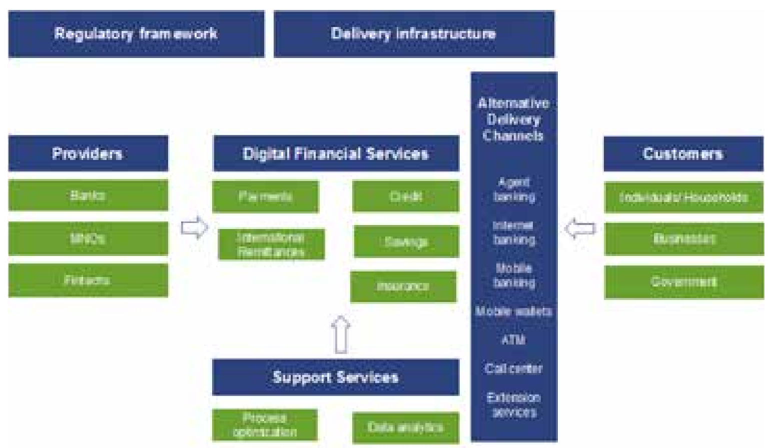
A digital transactional platform allows customers to send and receive payments and store the value electronically. A network of retail agents enables customers to convert cash to e-money and vice versa. And a special device, such as a mobile phone or a payment card, allows customers to access financial services. With these three components, payments and transfers, as well as credit, savings, and insurance can be offered digitally to underserved customers and communities. Distinguishing these channels is important, as they lay the foundation for the business model most suitable for each market, based on that market's reliance on each channel.

Under the bank-led model, banks provide DFS either by adding digital channels to existing product lines or by launching new digital products and/or services. This model helps the banks to significantly reduce costs and allows them to move away from expensive physical branch structures. However, a lack of control over the communication channels can be a major challenge, as it might lead to high additional costs.

Under the MNO-led model, the MNO provides most of the activities, including customer acquisition, account management, and management of the agent network. The bank's role is limited to storing funds in a pool or trust account. MNOs can leverage their existing agent and cash distribution networks (used for distributing airtime) and achieve lower costs for setting up agent networks than those of banks. On the other hand, the regulator often prevents MNOs that have no banking license from issuing mobile banking services.

The third-party-led model offers a number of advantages over the MNO and bank-led models that have both particular strengths and a number of weaknesses. These shortcomings include a lack of customized services, slow product development processes, and no interoperability. Under a third-party model, often led by a fintech start-up with little brand recognition and experience in the financial sector, scalability and time-to-market are major differentiators. Fintechs are equipped with agility and specialized expertise in technology that are beyond the core competencies of banks and MNOs.

In Palestine, DFS is expressed mainly in the existence of the five electronic wallet solutions that reflect the role of banks, MNO, and fintechs. Bank of Palestine runs the PalPay-Mahfazati wallet; the telecommunications giant, Jawwal, is present through its own JawwalPay wallet, and the fintech provider Maalchat offers its services.



The Digital Finance Ecosystem Modified from KfW:
The future of the financial sector – Recommendations for Financial Cooperation (2017)

The local market also includes two other Jordan-based e-wallet solutions, namely, MadfooatCom and Middle East Payment Services (MEPS), which were legally licensed in 2018 by the Palestine Monetary Authority (PMA) that is currently also facilitating the introduction of ApplePay's services in Palestine.

The PMA has played (and continues to play) a vital role in the push for a more financially inclusive economy in Palestine, following the principles outlined in the National Financial Inclusion Strategy that was issued in 2019. This is apparent in the PMA's extensive efforts to regulate the monetary market in conjunction with the Palestine Capital Market Authority (PCMA) as they aim to ensure support for the financial technology sector, promote the digital transformation and infrastructure in the banking and nonbanking financial sectors, and provide an enabling environment for these developments.

Because fintech serves more fields than the banking sector, I would like to focus a bit more on insurance technology, InsurTech for short. The above-mentioned advantages and operation modes also apply to this field. InsurTechs work with the insurance markets to offer existing services at lower costs; they help insurance companies better understand their customers and risks in order to extend new and personalized types of insurance policies. Moreover, InsurTech is exploring areas that large insurance firms have less incentive to exploit, such as introducing highly customized policies and using new data streams from internet-enabled devices to price premiums based on behavior. Traditional insurers gather broad demographic information to measure risk and price their products, which is simply unfair. Instead, InsurTechs utilize inputs from all manners of devices, which includes GPS tracking of cars to the activity trackers on our wrists. These companies use behavioral data based on actual usage to price insurance policies. Artificial intelligence (AI), robotic process automation (RPA), and advanced analytics, particularly, are the catalysts that make possible these more real-time and personalized insurance models.

In the Palestinian context, the PCMA reverts to the issuance of Non-Objection Letters to offer room for innovation in areas that current regulations do not cover. The first-ever letter was awarded to the start-up Naviatx for its mobile app, Maslak. Maslak is downloaded onto smartphones to measure driving behavior and reflect it into statistically calculated driving scores that are shared with their clients, including insurance companies. This on-the-road risk profile helps insurance companies identify and reward safe drivers, reducing their compensation costs and increasing profit margins. Such technology is called usage-based insurance and leads to the introduction of innovative, inclusive, and more affordable types of insurance.

In an attempt to harness the power of fintech and pave the road for more inclusion and digital transformation, both the PMA and PCMA now run regulatory sandboxes to provide more supportive and engaging platforms for entrepreneurs and innovators, enabling them to have more impact on the industry. Regulators are also working on other fronts, such as running awareness campaigns and training sessions for influencers and journalists to encourage the coverage of such articles and produce relevant media content.

So the next time you're facing a financial challenge, such as a personal need that is not covered by market offerings or a gap in the financial market that still has no solution, I urge you to consider putting on your innovator hat and helping us solve it by exploring the mentioned sandboxes – as fintech is a nationwide calling that we all should promote and employ.

With an MBA in finance and over nine years of experience, Hamzeh Ghosheh is the founder of Naviatx and the developer of Maslak app. He has worked as a financial consultant and business development specialist with MSMEs/MSEs and enterprises and designed Palestine's first financial clinic with local ecosystem enablers. Hamzeh is the cohost of YallaNFT, Palestine's first fintech-specialized podcast, and has designed and implemented financial literacy training sessions for school students in East Jerusalem.

SCAN TO SHARE