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Current Issues in Banking

ASIAN BANKERS ASSOCIATION

ABA BANKING & FINANCE JOURNAL

AIMS & SCOPE OF THE JOURNAL

The Journal attempts to link conceptualists and practitioners in banking and finance and related aspects of the industry. It is aimed at providing articles that may serve as guidelines in banking and finance operations.

The ABA Secretariat welcomes opinions and comments and will be glad to consider for possible publication articles relevant to the aims and purposes of the Asian Bankers Association (ABA) and of this Journal.

This journal is issued twice a year.

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IN THIS ISSUE (Vol. XXXIII, No. 1, 2022)

This issue features articles that appeared in IMF Blog, The World Bank, The Busines Times, East & Partners, Morgan Stanley, ADB and BRINK, the news service of Marsh & McLennan Insights, a research institute dedicated to analyzing increasingly complex risks that are reshaping industries, governments, and societies. The editors and staff of the ABA Journal of Banking and Finance would like to take this opportunity to thank the authors for sharing their materials with the ABA and its members.

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The Impact of Mega Trends and Harnessing the Power of Growth through Challenging Times

The opening remarks delivered by Mr. Eugene Acevedo at the "13th Mobile Money & Financial Inclusion Virtual Summit 2022" organized by Magenta Global on February 23-24, 2022.

Today, I will speak about the rising trends in the banking industry. I will do my best to describe in detail what is happening, and my expectations for the near future.

Before diving into my material, there are two things I would like to share:

First – I have realized that, in extrapolating trends, it is useful to study the banks in the more advanced countries. Before the pandemic, I immersed myself in several leading banks in the region with my management team. The future is literally happening in the Asian neighborhood.

Second – I have always paid attention to banking surveys. For a long time, the main reason for opening an account was, as they say in the real estate business: location, location, location. That has changed. Mobile apps, after all, do not need location.

The financial services industry has gone digital in a substantial way. And when customers taste digital, they will not go back to traditional. The battleground is no longer location. The new battleground is user experience.

Our new recruits do not look or behave like the stiff bankers of the old days. If I graduated now as a physics or statistics major, I would be welcome into the bank.

But let's talk about things that get us worried. Our margins are narrowing. We need to manage down opex, partly with an axe called re-engineering, but mostly through digital tools.

Finally, a reminder that, before we fall in love with all things digital, we remember that we have a commitment to leave a clean and more inclusive planet for future generations.

When I was a young trader in the 90's, it was big news when Swiss franc interest rates became negative. Now, most interest rates are close to zero, if not negative.

Take for example Danish banks. Last year, they offered a zero percent mortgage rate for 20 years. Imagine that!

In the Philippines, the net interest margin is around 4%. And this is before you deduct operating expense. In this Danish example, the margin is less than 1%. How will we manage in Asia when asset yields drop further?

It is looking clear that the only sustainable solution is a digital transformation exercise which will radically cut the cost of product delivery.

We need to recognize the undeniable fact that the sun has set on traditional banking.

Financial technology companies or Fintechs have become first movers, armed with customer-centric solutions, winning customers away from banks. To measure up against our fintech competitors, we have to work with them and borrow from their playbook.

The best known fintechs in the region have millions of digital users, and offer compelling financial products with great customer interface. They collaborate with other fintechs and traditional companies across platforms and ecosystems. They have an entrepreneurial culture.

Can a Bank be a fintech? Can we integrate technology into financial services, and adopt an entrepreneurial start-up vibe. We need to change our models, looking beyond traditional banking and compare ourselves with transformative companies like Amazon, Netflix, or Airbnb.

In order to do this, we need to create a digital-savvy and customer-obsessed organization.

We have started to train our bankers in design thinking and agile project management. Cross functional teams will become the norm, as we invent and reinvent our services.

The vast majority will need to be educated on Coding and the latest emerging technologies: Blockchain, Crypto, Data Science, Robotics and AI.

We will need to integrate a deep awareness of Customer Experience or CX principles in our culture.

People transformation is key.

Beyond transforming the way we do business, as Bankers we also need to adopt important societal advocacies. In our case, we chose problems that we could help solve using our own unique internal capabilities.

First, climate change. In December 2020, RCBC became the first bank in the Philippines to declare that we will no longer fund coal-powered plants.

We have also taken the lead roles in financing some of the region's biggest renewable energy projects. Investors have supported our advocacy by subscribing to our Sustainability Bond issuances.

Second is financial inclusion.

This remains a major societal challenge in the Philippines, where many have no means nor incentives to participate in the formal financial system.

To help solve this problem, we developed a financial inclusion app, Diskartech, to create millions of new basic digital accounts in an interface that uses multiple local languages.

To close, I have to admit there is still a much to be done. Transformation will be ongoing for a very long time. But we really have no choice. We, banks, need to stay relevant.

Thank you for your time and enjoy the rest of the conference.

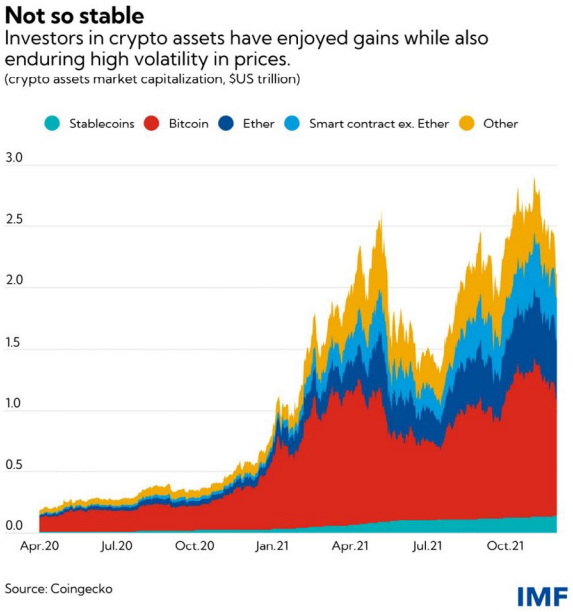
Global Crypto Regulation Should be Comprehensive, Consistent, and Coordinated

Tobias Adrian, Dong He, and Aditya Narain

The IMF's mandate is to safeguard the stability of the international monetary and financial system, and crypto assets are changing the system profoundly.

Crypto assets and associated products and services have grown rapidly in recent years. Furthermore, interlinkages with the regulated financial system are rising. Policymakers struggle to monitor risks from this evolving sector, in which many activities are unregulated. In fact, we think these financial stability risks could soon become systemic in some countries.

While the nearly $2.5 trillion market capitalization indicates significant economic value of the underlying technological innovations such as the blockchain, it might also reflect froth in an environment of stretched valuations. Indeed, early reactions to the Omicron variant included a significant crypto selloff.



Financial system risks from crypto assets

Determining valuation is not the only challenge in the crypto ecosystem: identification, monitoring, and management of risks defy regulators and firms. These include, for example, operational and financial integrity risks from crypto asset exchanges and wallets, investor protection, and inadequate reserves and inaccurate

disclosure for some stablecoins. Moreover, in emerging markets and developing economies, the advent of crypto can accelerate what we have called "cryptoization"—when these assets replace domestic currency, and circumvent exchange restrictions and capital account management measures.

Such risks underscore why we now need comprehensive international standards that more fully address risks to the financial system from crypto assets, their associated ecosystem, and their related transactions, while allowing for an enabling environment for useful crypto asset products and applications.

The Financial Stability Board, in its coordinating role, should develop a global framework comprising standards for regulation of crypto assets. The objective should be to provide a comprehensive and coordinated approach to managing risks to financial stability and market conduct that can be consistently applied across jurisdictions, while minimizing the potential for regulatory arbitrage, or moving activity to jurisdictions with easier requirements.

Crypto's cross-sector and cross-border remit limits the effectiveness of national approaches. Countries are taking very different strategies, and existing laws and regulations may not allow for national approaches that comprehensively cover all elements of these assets. Importantly, many crypto service providers operate across borders, making the task for supervision and enforcement more difficult. Uncoordinated regulatory measures may facilitate potentially destabilizing capital flows.

Standard-setting bodies responsible for different products and markets have provided varying levels of guidance. For example, the Financial Action Task Force has issued guidance for a risk-based approach to mitigating financial integrity risks from virtual assets and their service providers. Actions by other standard-setting bodies range from broad principles for some types of crypto assets to rules for mitigating exposure risks of regulated entities and setting up information exchange networks. While useful, these efforts aren't sufficiently coordinated towards a global framework for managing the risks to financial and market integrity, financial stability, and consumer and investor protection.

Making regulation work at the global level

The global regulatory framework should provide a level playing field along the activity and risk spectrum. We believe this should, for example, have the following three elements:

- Crypto-asset service providers that deliver critical functions should be licensed or authorized. These would include storage, transfer, settlement, and custody of reserves and assets, among others, similar to existing rules for financial service providers. Licensing and authorization criteria should be clearly articulated, the responsible authorities clearly designated, and coordination mechanisms among them well defined.
- Requirements should be tailored to the main use cases of crypto assets and stablecoins. For example, services and products for investments should have

requirements similar to those of securities brokers and dealers, overseen by the securities regulator. Services and products for payments should have requirements similar to those of bank deposits, overseen by the central bank or the payments oversight authority. Regardless of the initial authority for approving crypto services and products, all overseers—from central banks to securities and banking regulators—need to coordinate to address the various risks arising from different and changing uses.

- Authorities should provide clear requirements on regulated financial institutions concerning their exposure to and engagement with crypto. For example, the appropriate banking, securities, insurance, and pension regulators should stipulate the capital and liquidity requirements and limits on exposure to different types of these assets, and require investor suitability and risk assessments. If the regulated entities provide custody services, requirements should be clarified to address the risks arising from those functions.

Some emerging markets and developing economies face more immediate and acute risks of currency substitution through crypto assets, the so-called cryptoization. Capital flow management measures will need to be fine-tuned in the face of cryptoization. This is because applying established regulatory tools to manage capital flows may be more challenging when value is transmitted through new instruments, new channels and new service providers that are not regulated entities.

There is an urgent need for cross-border collaboration and cooperation to address the technological, legal, regulatory, and supervisory challenges. Setting up a comprehensive, consistent, and coordinated regulatory approach to crypto is a daunting task. But if we start now, we can achieve the policy goal of maintaining financial stability while benefiting from the benefits that the underlying technological innovations bring.

Crypto assets are potentially changing the international monetary and financial system in profound ways. The IMF has developed a strategy in order to continue to deliver on its mandate in the digital age. The Fund will work closely with the Financial Stability Board and other members of the international regulatory community to develop an effective regulatory approach to crypto assets.

IMF Blog

Making Electronic Money Safer in the Digital Age

José Garrido and Jan Nolte

Imagine you go to pay for your morning coffee and your stored-value card returns an error message, or the wallet in the payments app on your phone isn't opening because the company providing the payment service has gone bankrupt. Worse, what if you live in a rural area and the e-money service provided through your mobile phone was the only access you have to the financial system? Or your government now relies on the e-money system to transfer benefits or collect taxes on a large scale?

Digital forms of money—including central bank digital currencies, privately issued stable coins, and e-money—continue to evolve and find new ways to become more integral in people's day-to-day lives. In essence e-money is a digital representation of fiat currency guaranteed by its issuer. Customers exchange regular money into e-money, which they can use to make payments through an app on their cellphone to individuals and businesses alike with ease and immediate effect. Compared to other recently developed forms of digital money, such as stablecoins, e-money has been around for some time and its customer base continues to rapidly increase. Unlike most privately issued stablecoins, e-money operates in a regulated framework.

For regulators and supervisors charged with protecting consumers and ensuring a level playing field for all financial intermediaries, keeping pace with new developments can be challenging. Regulators and supervisors need to consider how to best protect customers from the failure of (potentially systemic) e-money issuers, including preventing the loss of their funds.

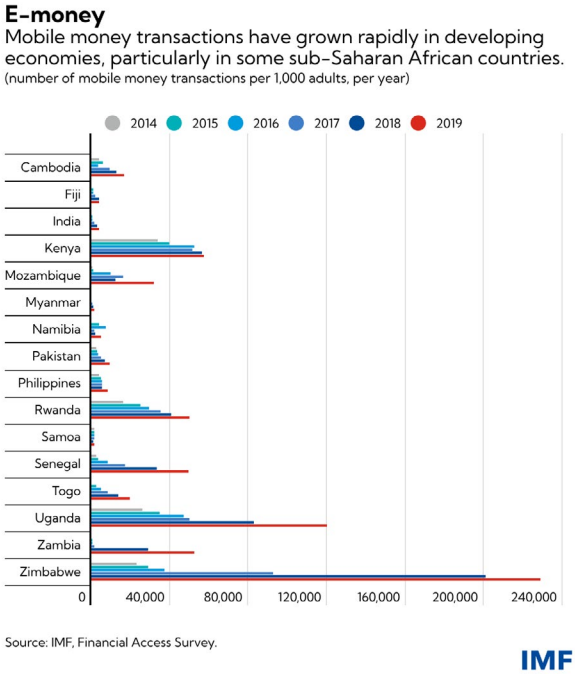
A new IMF staff paper considers these and other scenarios that may put consumers and—potentially—entire e-money systems at risk. We examine how regulatory practices are evolving on a country-by-country basis and put forward a set of policy recommendations on regulating e-money issuers and safeguarding their customers' funds.

E-money offers payment solutions for the unbanked

We can think of e-money as an electronic store of monetary value on a prepaid card or an electronic device, often a mobile phone, that may be widely used for making payments. The stored value also represents an enforceable claim against the e-money issuer, by which its customers can demand at any time to be repaid the funds they used to purchase e-money.

E-money is already a vital part of daily life for billions of people, especially in

many developing countries, where many lack access to the banking system. As shown in the chart below, a high percentage of the population across a number of East African countries now use e-money, making it important from a macro-financial perspective. It is estimated, for instance, that two-thirds of the combined adult population of Kenya (where M-PESA has reached a high degree of market penetration), Rwanda, Tanzania, and Uganda use e-money regularly. Many of these people do not have bank accounts or other access to the formal financial system, so they store significant shares of their disposable funds in e-money wallets and access them using mobile phones or computers.



Protecting financial systems and consumers alike

With the growing importance of e-money issuers, a comprehensive, robust framework for regulation and safeguarding customer funds is critical. Issuers should be subject to proportionate prudential regulatory requirements. For example, they should establish operational risk governance and management systems to identify and limit risks. They should also be prohibited from retail lending. And, in order to protect consumers who may be less sophisticated than bank customers, rules should be put in place governing how issuers disclose fees, protect consumer data, and handle complaints.

One of the most important regulatory measures identified in our paper is that in order to protect customers' money, all e-money issuers need to implement mechanisms

to safekeep and segregate those funds. Issuers need to maintain a secure pool of liquid funds that is equivalent to the amounts of customers' balances, and which is kept separate from the issuer's own funds. This is a fundamental safeguard against misuse of the funds and should allow, in principle, for recovery of those funds in the event of bankruptcy of an issuer.

Keeping the customers' funds segregated, however, does not resolve all the problems if a potentially systemic issuer were to fail. In the absence of specific bankruptcy rules, segregation by itself does not ensure that the customers would get quick access to their funds, and this discontinuity may create severe problems if the issuer plays a potentially systemic role in the payments system and in day-to-day transactions of the country.

Potentially systemic, potentially problematic

Regulators and supervisors may need to significantly strengthen prudential oversight and user-protection arrangements, depending on the business model and size of the e-money system. In countries with a potentially systemic e-money issuer or sector, the protection in place should seek to preserve customers' funds and ensure continuity of critical payment services.

While some countries have sought to extend deposit insurance to e-money, further efforts may be needed to operationalize such protection and ensure that it would work effectively in practice. In particular, customers should not lose access to their funds and, therefore, services should be restorable or replaceable quickly, preferably within hours. But putting e-money deposit insurance into practice remains untested so far—at least in practical terms. The costs and benefits of extending deposit insurance coverage effectively to e-money should be carefully considered.

As with many issues in the fintech sphere, best practices are still taking shape, making policy decisions challenging. However, the pandemic has only increased the importance of prudent e-money frameworks, as the number of online transactions and e-money's growth has accelerated. For regulators and supervisors, the time for action is now.

IMF Blog

Addressing Inflation Pressures Amid an Enduring Pandemic

Tobias Adrian and Gita Gopinath

The resurgence of the pandemic and the latest variant, Omicron, have sharply increased uncertainty around global economic prospects. This comes as several countries grapple with inflation well above their monetary policy targets. It is however evident that the strength of the economic recovery and magnitude of underlying inflationary pressures vary significantly across countries. Accordingly, policy responses to rising prices must be calibrated to the unique circumstances of individual economies.

We see grounds for monetary policy in the United States—with gross domestic product close to pre-pandemic trends, tight labor markets, and now broad-based inflationary pressures—to place greater weight on inflation risks as compared to some other advanced economies including the euro area. It would be appropriate for the Federal Reserve to accelerate the taper of asset purchases and bring forward the path for policy rate increases.

Over time, if inflationary pressures were to become broad-based in other countries, more may need to tighten earlier than currently expected. In this environment it is essential for major central banks to carefully communicate their policy actions so as not to trigger a market panic that would have deleterious effects not just at home but also abroad, especially on highly leveraged emerging and developing economies. Needless to say, given the extremely high uncertainty, including from Omicron, policymakers should remain agile, data-dependent, and ready to adjust course as needed.

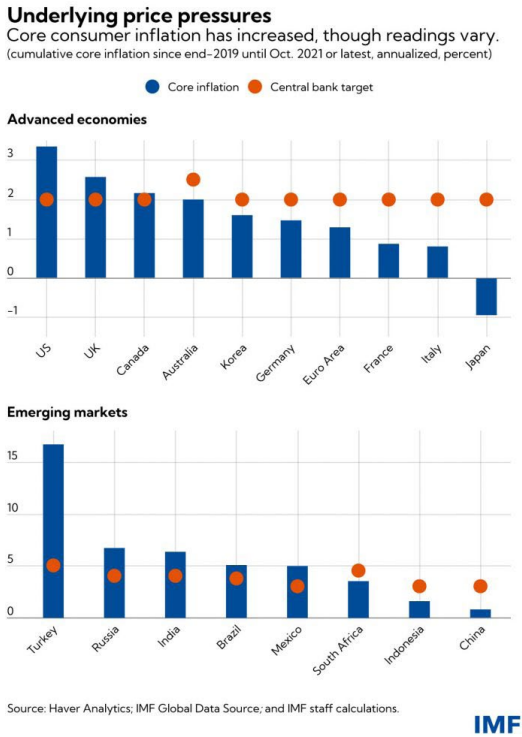
The global inflation landscape

Rising energy and food prices have fueled higher inflation in many countries. These global factors may continue to add to inflation in 2022, especially high commodity food prices. This has particularly negative consequences for households in low-income countries where about 40 percent of consumption spending is on food.

A measure of inflation which strips out volatile fuel and food inflation, so-called core consumer price inflation has also risen but exhibits significant variation across countries. Some of the increase in core inflation in countries reflects reversals of price falls in 2020, such as from the unwinding of VAT tax cuts in Germany. It therefore helps to focus on annualized cumulative inflation since pre-pandemic. By this measure, core inflation among advanced economies has risen most sharply in the United States, followed by the United Kingdom and Canada. In the euro area the increase is much less so. There are also limited signs of core inflationary pressures in Asia, including in China, Japan and Indonesia. Among emerging markets, core is dramatically elevated in Turkey.

Median inflation, a measure that is not affected by exceptionally large or small price changes in a few categories of goods and therefore conveys the breadth and

likely persistence of price pressures, similarly varies across countries. The recent rise in median inflation for the United States to around 3 percent in October is also higher than for other Group of Seven countries.



While inflation is likely to remain elevated well into 2022 in several countries, measures of inflation expectations for the medium and long-term remain close to policy targets in most economies. This reflects, in addition to expectations of waning inflationary forces, that policy actions can bring inflation back to target.

In the United States, long-term inflation expectations have increased but remain close to historic averages and thus appear well-anchored. Euro area expectations have increased but from levels well below target to now close to it, which suggests long-term expectations may have become better anchored to the European Central Bank's 2 percent objective. For Japan, inflation expectations remain well below the target.

For several emerging markets, including India, Indonesia, Russia, and South Africa, expectations show signs of being anchored. Exceptions include Turkey, where the risk of inflation expectations becoming unmoored is apparent as monetary policy is eased despite rising inflation.

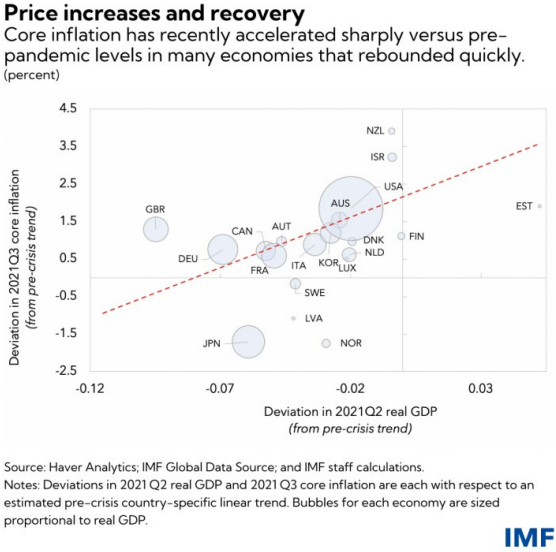
Sources of price pressures

The rise in core inflation reflects multiple factors. Demand has rebounded strongly supported by exceptional fiscal and monetary measures, especially in advanced economies. In addition, supply disruptions caused by the pandemic and climate change, and a shift in spending toward goods over services have increased price pressures. Furthermore, wage pressures are apparent in some segments of labor markets. The United States has experienced a more prolonged reduction in labor-force participation relative to other advanced economies, further adding to wage and inflationary pressures.

We expect the mismatch in supply and demand to attenuate over time reducing some price pressures in countries. Under the baseline, shipping delays, delivery lags, and semiconductor shortages will likely improve in the second half of 2022. Aggregate demand should soften as fiscal measures come off in 2022.

That said, it's important to keep in mind that economic activity has rebounded quickly in several countries, with the United States experiencing the fastest recovery among large, advanced economies. It is in such countries, where economic activity has rebounded more quickly to pre-pandemic trends, that core inflation has risen sharply relative to levels before the crisis. This relationship between recovery strength and core inflation, while far from perfect, suggests stronger underlying inflationary pressures in countries where demand has recovered the fastest.

Varied policy action



At the onset of the pandemic, policymakers around the world were synchronized

in dramatically easing monetary policy and expanding fiscal policy. These actions helped prevent a global financial crisis, despite lockdowns and health shocks causing a historic recession. The confluence of very low inflation and weak demand provided a strong rationale for easy monetary policies.

Earlier this year, when inflation picked up sharply, it was driven by exceptionally high inflation in a few sectors such as energy and autos, much of which was expected to reverse by the end of the year as pandemic related disruptions declined. Central banks, with a long track record of keeping inflation low and stable could appropriately "look through" the runup in inflation and keep interest rates low to support the economic recovery.

However, risks of a further acceleration of inflation previously flagged in our global publications and country-specific reports are materializing, with supply disruptions and elevated demand lasting longer than expected. Inflation is likely to be higher for longer than previously thought, which means that real rates are even lower than before, implying an increasingly expansionary stance of monetary policy.

While we still anticipate that supply-demand imbalances will wane next year, a singular focus of monetary policy on supporting recovery may well fuel substantial and persistent inflationary pressures, with some risk of de-anchoring inflation expectations. Accordingly, in countries where economic recoveries are further along and inflationary pressures more acute it would be appropriate to accelerate the normalization of monetary policy.

Potentially challenging spillovers

The challenge of addressing large and persistent supply shocks is even greater for emerging market central banks. Given the greater risk to de-anchoring of inflation expectations relative to advanced economies, they see the need to get ahead of inflationary pressures and some—such as Brazil and Russia—have raised policy rates sharply. Such tightening comes amid large COVID-related output shortfalls and could further depress output and employment. Emerging markets face potentially challenging spillovers if tightening by advanced economies causes capital outflows and exchange rate pressures that could require them to tighten even more.

Lastly, there remains tremendous uncertainty around the evolution of the pandemic and on its economic consequences. A variant that significantly reduces vaccine efficacy could lead to further supply chain disruptions and contractions in labor supply pushing up inflationary pressures, while lower demand could have opposing effects. The sharp fall in oil prices following the discovery of Omicron and the rapid imposition of travel restrictions by countries is a sign of the volatility ahead.

In sum, policymakers must carefully calibrate their response to incoming data. Varying inflation conditions and strength of recoveries across countries show why the policy response needs to be tailored to country specific circumstances, given sharply higher uncertainty associated with Omicron. Clear central bank communication, too, is key to fostering a durable global recovery.

As we warned in recent reports such as the World Economic Outlook, a more frontloaded Fed response to dampen inflation risks could result in market volatility and create difficulties elsewhere—especially in emerging and developing economies. To avoid that, policy shifts need to be telegraphed well, as has so far been the case. Emerging market and developing economies should also prepare for increases in advanced economy interest rates through debt maturity extensions where feasible, thereby reducing their rollover needs, and regulators should also focus on limiting the buildup of currency mismatches on balance sheets.

IMF Blog

The G20 Common Framework for Debt Treatments Must Be Stepped Up

Kristalina Georgieva and Ceyla Pazarbasioglu

Despite significant relief measures brought on by the COVID-19 crisis, about 60 percent of low-income countries are at high risk or already in debt distress. In 2015 that number was below 30 percent.

For many of these countries, the challenges are mounting. New variants are causing further disruptions to economic activity. COVID-related initiatives such as the G20 Debt Service Suspension Initiative (DSSI) are ending. Many countries face arrears or a reduction in priority expenditures. We may see economic collapse in some countries unless G20 creditors agree to accelerate debt restructurings and suspend debt service while the restructurings are being negotiated. It is also critical that private sector creditors implement debt relief on comparable terms.

Recent experiences of Chad, Ethiopia, and Zambia show that the Common Framework for debt treatments beyond the DSSI must be improved. Quick action is needed to build confidence in the framework and provide a road map for helping other countries facing increasing debt vulnerabilities.

2022: a more challenging debt outlook

Since the start of the pandemic, low-income countries have benefited from some attenuating measures. Domestic policies, together with low interest rates in advanced economies mitigated the financial impact of the crisis on their economies. The G20 put in place the DSSI to temporarily pause official debt payments to the poorest countries, followed by the Common Framework to help these countries restructure their debt and deal with insolvency and protracted liquidity problems. The international community also scaled-up its financial support, including record IMF emergency lending and a $650 billion allocation of special drawing rights, or SDRs—$21 billion of which was allocated directly to low-income countries. The G20 leaders committed to support low-income countries with onlending $100 billion of their SDRs to significantly magnify this impact.

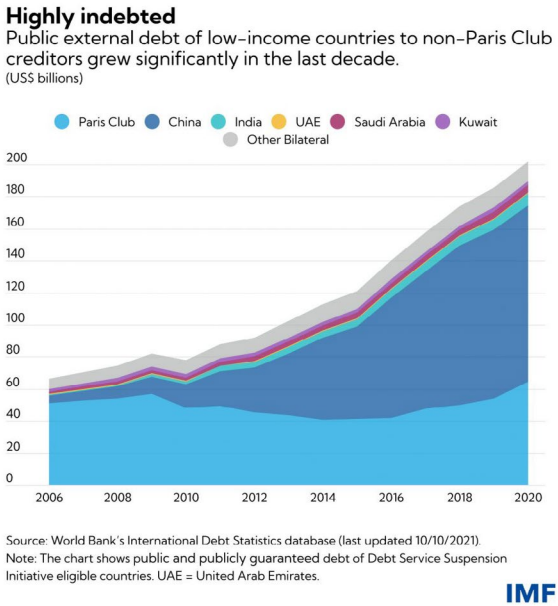
No doubt 2022 will be much more challenging with the tightening of international financial conditions on the horizon. The DSSI will expire at the end of this year forcing participating countries to resume debt service payments. Countries will need to transition to strong programs, and for low-income countries that need comprehensive debt treatment, the Common Framework will be critical to unlock IMF

financing.

But the Common Framework is yet to deliver on its promise. This requires prompt action.

Implementation so far has been slow

The Common Framework is intended to deal with insolvency and protracted liquidity problems, along with the implementation of an IMF-supported reform program. G20 official creditors—both traditional "Paris Club" creditors, such as France and the United States, and new creditors, such as China and India, which, as shown in the chart below, overtook the Paris Club as lenders in the last decade—agreed to coordinate to provide debt relief consistent with the debtor's capacity to pay and maintain essential spending needs. The Common Framework requires private creditors to participate on comparable terms to overcome collective action challenges and ensure fair burden sharing.



But so far, only three countries—Chad, Ethiopia, and Zambia—have made requests for debt relief under the Common Framework. And each case has experienced significant delays.

In part, these delays reflect the problems that motivated the creation of the Common Framework in the first place. These include coordinating Paris Club and other creditors, as well as multiple government institutions and agencies within creditor countries, which can slow down decisions. The Common Framework aims to mitigate

these problems but does not eliminate them. New creditors, including relevant domestic institutions, need to gain comfort with restructuring processes that would allow all creditors to work together in providing relief and enable the IMF to lend to countries facing debt difficulties. This takes time.

But there were also delays for reasons that have nothing to do with the Common Framework. To restore debt sustainability, Chad must restructure a large, collateralized obligation held by a private company, which is partly syndicated to a large number of banks and funds. This complicates the decision-making process. Domestic challenges slowed progress in Ethiopia and Zambia.

No time to waste

With policy space tightening for highly indebted countries, the framework can and must deliver more quickly.

First, greater clarity on the different steps and timelines in the Common Framework process is vital. Alongside earlier engagement of official creditors with the debtor and with private creditors, this would help accelerate decision making.

Second, a comprehensive and sustained debt service payment standstill for the duration of the negotiation would provide relief to the debtor at a time when it is under stress, as well as incentivize faster procedures to get to the actual debt restructuring.

Third, the Common Framework should clarify further how the comparability of treatment will be effectively enforced, including as needed through implementation of the IMF arrears policies, so as to give greater comfort to creditors and debtors.

Last but not least, the Common Framework should be expanded to other highly-indebted countries that can benefit from creditor coordination. Timely and orderly debt resolution is in the interest of both debtors and creditors.

Ensuring a success in the early cases will not only benefit the countries, but foster confidence in the Common Framework. In that regard, finalizing Chad's restructuring quickly can serve as an essential precedent for other countries. In Ethiopia, the creditor committee should continue the technical work that will allow early provision of debt relief assurances once the situation stabilizes. In Zambia, G20 creditors should expeditiously form a committee of official creditors and begin engaging with the authorities and private creditors on debt relief, while also providing a temporary debt-service suspension for the duration of the debt-restructuring discussions. Otherwise, the country would be confronted with the impossible choice of cutting priority expenditures or piling up arrears.

Debt challenges are pressing and the need for action is urgent. The recent Omicron variant is a stark reminder that the pandemic will be with us for a while. Determined multilateral action is needed now to address vaccine inequality globally and also to support timely and orderly debt resolution. For its part, the IMF is ready to work with the World Bank and all our partners to help ensure the framework delivers for the people it was put in place to help.

IMF Blog

Amid Record Sovereign Debt, Massive Gaps in Debt-Tracking Systems

At a time when sovereign debt in the poorest countries has surged to dangerously high levels, global and country-by-country systems for tracking it are proving to be inadequate. These gaps make it harder to assess debt sustainability and for overindebted countries to restructure debt promptly and generate a durable economic recovery, according to a new World Bank report.

The report, Debt Transparency in Developing Economies, marks the first comprehensive assessment of the global and national systems for monitoring sovereign debt. It finds that debt surveillance today depends on a patchwork of databases with different standards and definitions and different degrees of reliability, cobbled together by various organizations. Such inconsistencies lead to large variations in publicly available tallies of debt in low-income economies—the equivalent of as much as 30 percent of a country's GDP, in some instances.

"The poorest countries will emerge from the COVID-19 pandemic with the largest debt burdens in the last few decades, but limited debt transparency will delay critical debt reconciliation and restructuring," said World Bank Group President David Malpass. "Improving debt transparency requires a sound public debt-management legal framework, integrated debt recording and management systems, and improvements in the global debt monitoring. International financial institutions, debtors, creditors, and other stakeholders, such as credit-rating agencies and civil society, all have a key role to play in fostering debt transparency."

The study finds that 40 percent of low-income countries have not published any data about their sovereign debt for more than two years—and that many of those that do publish it tend to limit the information to central government debt. Many developing countries are relying increasingly on resource-backed loans—in which governments secure financing by putting up future revenue streams as collateral. Resource-backed loans accounted for nearly 10 percent of new borrowing in Sub-Saharan Africa between 2004 and 2018. More than 15 countries have such debt, but none provide details on the collateral arrangements.

Central banks are also using monetary-policy tools, such as repos and swaps, to facilitate government borrowing from foreign creditors. But such borrowing is neither clearly identified in the central banks' balance sheets nor captured in the databases of international financial institutions. Domestic debt markets in the poorest economies are also opaque: the report finds that just 41 percent of these economies use market-based auctions as the main channel to issue domestic debt. And those that use auctions divulge only spotty information to investors.

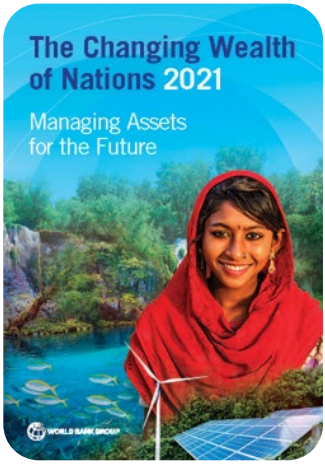
The World Bank Group has long considered debt transparency a crucial step in countries' development process, because transparency facilitates new investments, improves accountability, and helps reduce corruption. The Bank's global Debtor

Reporting System remains the single most important source of verifiable information on the external debt of low- and middle-income countries. All countries that borrow from the World Bank—more than 100—are required to report details of external debt owed by any public agency. Also, the World Bank's Sustainable Development Finance Policy (SDFP) incentivizes IDA-eligible countries to implement concrete performance and policy actions (PPAs) to enhance debt transparency, fiscal sustainability, and debt management.

Achieving effective debt surveillance will not be easy—but it can be done. The report lays out a detailed list of recommendations, ranked in order of urgency. Prominent among them: publishing public and publicly guaranteed debt statistics annually; encouraging coordinated data collection and reporting; and instituting integrated debt recording and management systems that align with international standards.

The World Bank

Global Wealth Has Grown, But at the Expense of Future Prosperity: World Bank



World Bank report provides data for a more comprehensive view of economic growth and sustainability; finds share of total global wealth in renewable natural capital is decreasing and threatened by climate change

Global wealth has grown overall—but at the expense of future prosperity and by exacerbating inequalities, according to the World Bank's new Changing Wealth of Nations report released today.

Countries that are depleting their resources in favor of short-term gains are putting their economies on an unsustainable development path. While indicators such as Gross Domestic Product (GDP) are traditionally used to measure economic growth, the report argues for the importance of considering natural, human, and produced capital to understand whether growth is sustainable.

The Changing Wealth of Nations 2021 tracks the wealth of 146 countries between 1995 and 2018, by measuring the economic value of renewable natural capital (such as forests, cropland, and ocean resources), nonrenewable natural capital (such as minerals and fossil fuels), human capital (earnings over a person's lifetime), produced capital (such as buildings and infrastructure), and net foreign assets. The report accounts for blue natural capital—in the form of mangroves and ocean fisheries—for the first time.

"A deeper and more nuanced understanding of the sustainability of wealth is crucial to a green, resilient, and inclusive future," said World Bank Managing Director for Development Policy and Partnerships, Mari Pangestu. "It is essential that renewable natural capital and human capital are given the same importance as more traditional sources of economic growth, so that policymakers take steps to enable long-term prosperity."

According to the report, global wealth grew significantly between 1995 and 2018, and middle-income countries are catching up to high-income countries. However, growing prosperity has been accompanied by unsustainable management of some natural assets. Low- and middle-income countries saw their forest wealth per capita decline 8% from 1995 to 2018, reflecting significant deforestation. Meanwhile, the value of global marine fish stocks collapsed by 83% due to poor management and overfishing over the same period. The projected impacts of climate change may exacerbate these trends.

In addition, mispricing of assets like carbon-emitting fossil fuels can lead to overvaluation and over-consumption. Development can be put on a more sustainable

path by taking a comprehensive view of wealth and putting in place policy measures including carbon pricing to better value and nurture assets such as forests, mangroves, and human capital.

Global wealth inequality is growing, the report indicates. Low-income countries' share of global wealth has changed little from 1995 to 2018, remaining below 1% of the world's wealth, despite having around 8% of the world's population. Over one-third of low-income countries saw declining wealth per capita. Countries with declining wealth tend also to be degrading their base of renewable natural assets. For low-income countries, appropriately managing renewable natural capital, which accounts for 23% of their wealth, remains crucial.

Globally, the share of total wealth in renewable natural capital (forests, cropland, and ocean resources) is decreasing and being further threatened by climate change. At the same time, renewable natural capital is becoming more valuable as it provides crucial ecosystem services. For example, the value of mangroves for coastal flood protection has grown more than 2.5 times since 1995 to over $547 billion in 2018. The value of protected areas per square kilometer has also rapidly increased.

"The Changing Wealth of Nations provides the data and analysis to help governments get prices and policies right for sustainable development," said World Bank Global Director for Environment, Natural Resources, and the Blue Economy, Karin Kemper. "By ignoring polluting and climate warming impacts, fossil fuel assets have historically been overvalued, while assets that contribute to climate mitigation, like forests, are undervalued."

The report shows that human capital, measured as the population's expected lifetime earnings, is the largest source of worldwide wealth, comprising 64% of total global wealth in 2018. Middle-income countries increased their investment in human capital and in turn saw significant increases in their share of global human capital wealth.

Although the long-lasting effects of the COVID-19 pandemic are still unknown, low-income countries are likely to experience the most severe impacts, with a projected loss of 14% of total human capital. Human capital is additionally constrained by gender gaps across all regions and income groups, with little improvement since 1995. Air quality also has serious consequences for both human capital and climate change, and accounts for over 6 million premature deaths annually.

Nonrenewable natural capital wealth (minerals, fossil fuels) has declined since 2014, mainly due to falling commodity prices. The report looks at the projected impacts of a low-carbon transition and border carbon adjustment taxes on fossil fuel wealth and provides recommendations for managing the economic risks posed for resource-dependent countries. Countries that are heavily dependent on fossil fuel wealth were found to have lower shares of wealth from human capital, despite their high income levels, with human capital only comprising 34% of their wealth.

The report outlines several priorities for policymakers to diversify and rebalance their national portfolios to be more resilient and sustainable. It recommends actively investing in public goods like education, health, and nature, to prevent unsustainable

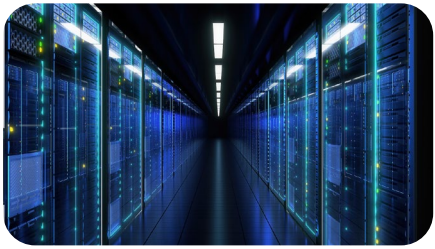
depletion, and manage future risks. Recommendations also include policy and pricing measures that help reflect the social value of assets and to steer private investment toward better outcomes for all. This may include, for example, actions like repurposing fisheries subsidies, and taking action to price carbon and promote renewable energy assets.

Download the Changing Wealth of Nations 2021 here.

The World Bank

Why the Cybersecurity of the .1% Is Relevant to You

Paul Mee, Cyber Risk Platform Lead Oliver Wyman and Co-Head, Cyber Risk Initiative, Oliver Wyman Forum;
Kevin Kelly, Chief Executive Officer at Halo Privacy; Alec Harris, Managing Director at Halo Privacy



Cyberattackers sometimes target companies which they know have cyber insurance, and then demand a ransom for the exact amount that is covered by insurance.

The 0.1% are particularly rich targets for cybercriminals and hackers, but their strategies for deterring hackers hold lessons for all of us.

Tech moguls, private equity barons, corporate CEOs, celebrities, sports stars and other elites enjoy notable wealth and prominence. Yet in today's digital world, they can't rely solely on the defenses of gated manors, private islands or security details. The wealthy and their staff need to sharpen their cybersecurity capabilities to protect themselves, their families and their entourages from data breaches, ransomware, scams, extortion and other digital harms.

"Prominent individuals are targets because it is assumed that they have access to funds and their brands are valuable," says Alec Harris, managing director of security specialist firm Halo Privacy. "Wealthy people get hit by everything from low-level phishing attacks to coordinated campaigns involving spear-phishing, social engineering, and other persistent cyberattacks." Their children also may be vulnerable, especially if they post actively on social media about their activities, adds Kevin Kelly, the firm's chief executive.

Inequality being a political issue, the cyber travails and tribulations of the 0.1% may not attract significant sympathy. However, cyberattacks against them can affect a much wider population if such events undermine corporate operations or profitability. Importantly, the public at large can learn lessons from the cybersecurity strategies of the rich and famous.

Kelly and Harris talked recently with Paul Mee, lead partner of Oliver Wyman's Cyber Risk Platform and co-head of the Oliver Wyman Forum's Cyber Risk initiative.

How Attackers Can Compromise the Wealthy

Paul Mee: How much of a threat is cyber to wealthy families and their assets?

Alec Harris: It's significant and underappreciated. People talk about cybersecurity and physical security as if they're 50-50 equals. The reality is more like

90-10. Cyber events occur all the time while physical security events are, thankfully, rare.

MEE: What are the typical outcomes or objectives in these cases?

HARRIS: One notable and worrying outcome can be the appropriation of an individual's brand, identity, email address or phone numbers — basically anything that would allow an adversary to act as if they are, or are acting on behalf of, the victim. If you're prominent on Twitter and your account gets taken over, it can be used for a period of time to elicit scams, misrepresent you, or provide a digital treasure trove of contact information and conversations.

Within the compromise spectrum, there can be exploitation and coercion that results in the loss of funds, control or data. An affluent party could be convinced that someone is acting on behalf of the family or firm and be persuaded, often in an urgent manner, to share or provide access to otherwise sensitive, personal or confidential information.

The third type of attack involves a brand or reputation event. We saw this recently when someone infiltrated a large U.S. video game producer and obtained information about when a new game would be released, on what platforms and on what terms. The revelations undermined the company's marketing strategy because consumers became aware that they could wait and get the game for free with their existing subscriptions.

A Digital Footprint Can Have Real World Consequences

MEE: Can cyberattacks serve as a path to something more physical?

Kevin Kelly: There is certainly that potential. It is critical to create situational awareness with certain people because they're still going out and acting in their daily lives like they're not targets. It can be worse with the younger generation because they want to post on social media platforms about what they're doing, where they are, who they are with and where they're going

MEE: How does someone's digital footprint affect the likelihood of a physical incident?

HARRIS: The key intersection is what we call "pattern of life" — where you go, how you pay for things, what devices come along with you. It creates a very accurate profile, like an individual fingerprint. If you go to the same gym class each Wednesday at 8 a.m., it's very likely you'll be there next Wednesday. … We live in a world of granular, specific, ubiquitous personal information, a lot of which can be acquired commercially. This modern digital phenomena significantly increases physical risk, and security details need to be aware and posture accordingly.

MEE: How do you enhance awareness and preparedness?

KELLY: We talk about the three Ts — training, tradecraft, and technology. Training is the most critical. Having an ability to sit down and take time with family offices is essential. Given a greater appreciation of the threats, we find they're more willing to do that than they have been historically. We're talking about two or three hours, engaging them on how to be aware of certain situations, what to do and what not to do when traveling, how to engage with social media and digital technology, and how to do basic things like the privacy settings on their smartphone.

MEE: Can you quantify who is most at risk?

HARRIS: We've seen cases where a cyberattacker will seek to find out through access to a corporate network if a company has cyber insurance or kidnap and ransom insurance and how much that insurance covers. Consequently, when an attack occurs the ransom request is, not coincidentally, for the exact same amount — to the dollar. The bad actors know that someone is prepared to pay, and it may seem like everyone walks away unscathed. Except these insurance policies are becoming increasingly expensive with more stringent terms. Also, successful attackers frequently leave behind a back door so they can come back for seconds.

The Importance of Good Cyber Hygiene

MEE: What are the top practical recommendations you have for keeping prominent people cyber safe?

HARRIS: First, you've got to deal with your cell phone number and your SIM card. A cell phone number has become more valuable to an attacker than a social security number. Someone can try to SIM swap it, which involves switching a phone number from one device's subscriber identity module to another, and use the number to impersonate you or access your accounts — especially where you use the phone for second-factor authentication. You need to treat your cell phone number as privileged information and then lock down the access and management of your SIM card.

Second is cyber hygiene writ large: how you authenticate your accounts, how you save your passwords, what kind of alias you use for email, how you lock down your logins. If we can get someone to use a password manager, that is an 80% solution.

Then you need to deal with the sprawl of your publicly available information: Public records, data brokers, social media — all the places that attribute your pattern of life. … A capable adversary will readily compile this, but even a lesser adversary can usually buy that information. You have to deal with what is already out there and adopt a more judicious approach and discipline regarding future use of digital tools, apps and services that call upon personal data.

MEE: How do you do that second part — containing what's already out there?

HARRIS: We typically do it through brute force. We will go to data brokers and use various approaches. With some data brokers you need to use the right form. Some you call, some you persuade or threaten, some you beg. We undertake the basic process of going through over one hundred data brokers and aggregators, petitioning for client data to be removed. Over time, it significantly reduces the attack surface. You also can do suppression campaigns to reduce the prevalence of certain information in search results.

Why Cyber Protection Matters

MEE: Why should people in general care about the risks facing the 0.1%? Will attack strategies targeting the ultra-high net worth be commoditized to go after the public more broadly?

HARRIS: People might not care in isolation. However, the more affluent typically run businesses. We have never worked with any high-net worth individual where an attack didn't also have an impact on the associated organization. It's going to affect rank and file employees. It's going to affect capital allocation goals by diverting resources into remediation and risk mitigation, and that's not good for the organization.

Ransomware is already a commodity and that makes it easier to attack anyone. The people who perpetrate it aren't the ones who come up with the malicious code. They rent it and then share the proceeds or pay off the coders. There's a whole industry, and it's not a cottage industry. As Fyodor Yarochkin articulated in a recent article, Ransomware as a Service (RaaS) is highly organized and very lucrative. It's a quasi-licit economy in some parts of the world. In certain countries, you can have a day job at a cybersecurity firm and then by night code ransomware.

The techniques used to exploit the wealthy, once proven, are being rapidly deployed across populations more broadly and as part of a growing cyberattack armory for advanced persistent threat campaigns. Given this, we owe it to ourselves and our families to be security conscious, to be disciplined in how we care for our personal data, and to be vigilant in our digital lives.

Brink News

About the Authors

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Cyber Risk Platform Lead at Oliver Wyman and Co-Head, Cyber Risk Initiative, Oliver Wyman Forum

Paul Mee leads the Oliver Wyman Forum's cybersecurity initiative. He is a partner at the consulting firm Oliver Wyman and is the head of the firm's Cybersecurity Practice. He has over 20

years of professional experience in helping organizations tackle strategically significant issues regarding strategy, governance, and information security. He leads the firm's Cyber Risk Management value proposition.

Kevin Kelly
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Kevin Kelly is the CEO of Halo Privacy, which helps organizations, family offices and government lock down and secure their communications pre- and post-breach. Kelly is a board member of several companies and organizations, including RecruitiFi, Halo Privacy, BTS and Duke University's Fuqua School of Business. And he is the author of three books on leadership: CEO – The Low Down on the Top Job, Top Jobs – How They Are Different and What You Need to Succeed and Leading in Turbulent Times.

Alec Harris
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Alec Harris is the managing director at Halo Privacy. His focus areas include secure communications,managed attribution, Bitcoin & Monero, reputation management, identity management, enhanced privacy, and private clouds.

Why Inflation Is the Biggest Test Yet for Central Bank Independence

Anton Muscatelli, Principal and Vice Chancellor at University of Glasgow

Central bankers' public statements all hint at the difficult decisions ahead. Photo: Public Domain/BRINK

Central banks are being tested by the recent resurgence in inflation, with the U.S. recently reporting an annual rate of inflation of 6.8%, the highest in nearly 40 years. The question they are all asking is whether this inflation is temporary ("transitory") or persistent.

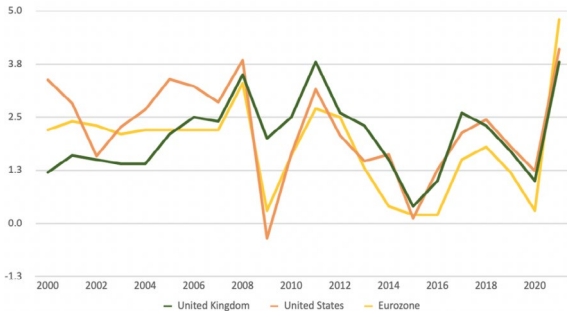
If it is only transitory, it would be counterproductive to deal with it aggressively. If central banks tighten monetary policy unnecessarily by sharply raising short-term interest rates or quickly unwinding those government asset purchases (known as quantitative easing or QE) which supported many economies during the COVID-19 economic shock, it will needlessly push back the recovery.

Central bankers' public statements all hint at the difficult decisions ahead. The chair of the U.S. Federal Reserve, Jay Powell, signalled recently that the strong U.S. economy combined with rising inflation meant the Fed would "taper" its QE asset purchases more quickly (they are currently due to end by June 2022).

The Bank of England is due to end its asset purchases this month, and Huw Pill, the chief economist, has indicated that "the conditions now existed for him to vote for higher interest rates". The European Central Bank's chief, Christine Lagarde, has struck a more dovish note, saying it is unlikely the ECB will increase interest rates in 2022, despite inflation well above its 2% target, as it considers it transitory. It is unclear whether the ECB will extend its QE programme beyond March 2022.

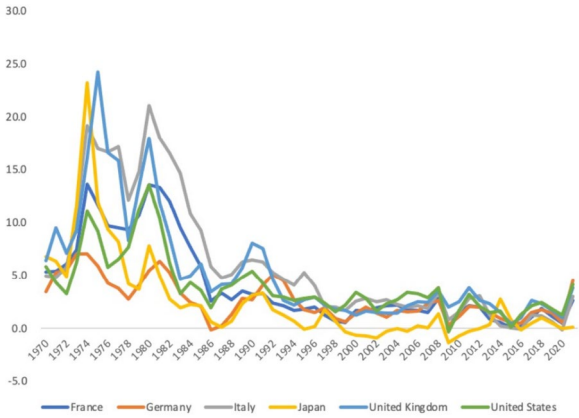
So how significant is the current inflationary shock, and what are its causes?

Inflation Causes



As you can see below, the recent surge in prices is not large compared with those of the 1970s and early 1980s, which were caused by large increases in oil prices.

However, if one compares the current inflation increase to the 2000s, it is one of the biggest shocks since the Bank of England became independent and the ECB was set up.



Today's inflation is due primarily to the disruption the pandemic has caused to key global supply chains. In sectors like electronic goods and vehicle production, bottlenecks and shortages of key inputs such as semiconductors emerged as consumer demand recovered more rapidly after the first pandemic wave than suppliers could keep up with. Similarly, shortages of shipping containers and freight capacity have increased costs.

The rapid economic recovery in 2021 has also put pressure on energy prices, especially spot gas prices in Europe. Meanwhile, there have been labour shortages to contend with: the U.K. and U.S. are among those nations that seem to be seeing labour-force participation falling due to people retiring. The U.K. and certain northern European economies have also not been seeing enough of the short-term migrants that they need for sectors like hospitality and goods transportation. When there are fewer workers available, employers have to pay higher wages to fill posts.

Inflation Expectations

How should monetary policy respond? For central banks, the key question relates to inflation expectations. If consumers and businesses believe that inflation will continue at similarly high levels, as they did in the 1970s, they will try to incorporate it into wage claims and in setting future prices. Inflation will then become more persistent.

What is the evidence for these "second-round effects" on wages and price-setting? There is some evidence from consumer surveys and bond prices that inflation expectations in the U.S., eurozone and U.K. have increased marginally in the latter half of 2021, but they still seem contained.

One difference with the 1970s and 1980s is that labour markets are more flexible, in the sense that trade unions have less wage-bargaining power in the private sector, and there is greater international competition as a result of globalisation. Rather than setting off a wage-price spiral, rising prices might therefore be absorbed by wages falling in real terms (meaning they would increase below the rate of inflation).

That depends on the COVID-19 supply disruptions being temporary, as ultimately, with tightening labour markets across most countries, employers would eventually have to pay wages that keep pace with inflation. Unfortunately, the omicron variant is a sign that as COVID-19 becomes endemic, economic recovery might be punctuated by occasional disruptions and further supply shocks, potentially increasing the pressure on employers to pay higher wages.

Central Banks and Independence

The key to gauging whether inflation remains transitory will be future labour market and expectations data. Suppose that by early to mid-2022, inflation appears to be dissipating, central banks might only need to increase rates gradually to anchor expectations.

But if the data points to inflation remaining stubbornly higher than central banks' inflation targets (say 4%-5%) for a longer time-horizon, it would be evidence that a wage-price spiral has set in. Central banks would then have no alternative but to substantially increase short-term interest rates and reduce QE — potentially reducing economic activity until wage and price increases moderated. As we know from the 1970s and early 1980s, this can cause painful recessions, leading to unemployment.

At any rate, QE needs to be ended carefully. It has created extra demand for government bonds and increased the supply of money available to invest in other assets such as stocks, so tapering has the potential to cause volatility in these markets. This is likely to be compounded by investors selling stocks in the belief that tighter monetary conditions will mean less economic growth.

The QE purchases have also greatly enlarged central banks' balance sheets. For example, the Fed balance sheet has increased from around US$4 trillion (£3 trillion) to US$8.7 trillion since the start of the pandemic. Besides tapering, this is going to have to be unwound. It can either be done very slowly as QE-debt matures, or — if central banks feel they need to tighten monetary policy more aggressively – by selling these bonds on to the market. This might mean selling at a loss, in which case governments would have to rebuild central banks' balance sheets. By making central banks dependent on governments in this way, it might compromise their independence.

There is also a more immediate challenge to central-bank independence, which was granted several decades ago to stop monetary policy being subject to political interference and to reassure the markets that inflation would be kept under control. Yet just because a central bank sets rates independently of government, it may not be immune from external pressures during a major economic crisis. Central bankers could succumb to political and media pressure either to move too fast on tackling inflation, or

too slowly to preserve the economic recovery.

Some central banks like the Bank of England look set to hold fire on interest rates until early 2022 — despite the comments from Huw Pill — given the uncertainties surrounding the omicron variant. The ECB is similarly holding steady. So all eyes will be on the Fed on Wednesday 15 to see if it is going to taper QE faster than previously announced. For the time being, I would argue that it would be better to wait. The next few weeks will give us more data on both inflation expectations, but also on how COVID-19 might continue to affect our economies.

A version of this piece was originally published by The Conversation.

Brink News

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Professor Sir Anton Muscatelli is a principal and vice chancellor at the Univeristy of Glasgow. Muscatelli has been a consultant to the World Bank and the European Commission and was a member of the Panel of Economic Advisers of the Secretary of State for Scotland from 1998 to 2000. Since 2007, he has been an adviser to the House of Commons Treasury Select Committee on monetary policy, and in 2008 he was appointed to chair an independent expert group for the Calman Commission on Devolution, set up by the Scottish Parliament and led by the Chancellor of the University of Glasgow, Sir Kenneth Calman.

Buy Now, Pay Later Programs Help Consumers and Merchants Alike

Russell Jones
Partner in Oliver Wyman's Banking Practice

With inflation having risen significantly across the globe, affecting the cost of food, fuel and other goods for consumers, payment programs allowing shoppers to "buy now and pay later" might help to ease the financial strain of the holidays — and benefit merchants as well.

For consumers, BNPL programs, unlike ordinary credit cards, offer a defined period of payments leading to a zero balance. Photo: Unsplash

Even in the best of times, online shoppers sometimes load up their online shopping carts, only to winnow them down at checkout or abandon the purchase altogether at the moment of truth. A BNPL program offered at this critical juncture can help ease a shopper's worries.

Buy now, pay later programs began appearing in the early 2010s and are starting to catch on in the U.S. after early successes in Australia and Sweden. In a BNPL transaction, a shopper making an online purchase is able to set up installments, such as six equal monthly payments, at the time of checkout. A BNPL provider screens the shopper, approves the payment plan and arranges for a bank or other financial provider to originate the loan and assume the risk. It's like the layaway programs of the past, except the customer gets the product upfront. The whole process takes a couple of minutes.

While the service took root in e-commerce, providers are beginning to branch out to in-store retail as well, though the customer experience of applying at the register can be more complicated.

Another Innovation Accelerated by COVID-19

Buy-now, pay-later programs were already gaining popularity before the COVID-19 pandemic began. Oliver Wyman estimates that leading providers accounted for roughly $20 billion in transaction volume in 2019, with some providers more than doubling volumes year-over-year. Last year's recession, however, may have pushed more retailers to consider BNPL programs.

For consumers, BNPL programs, unlike ordinary credit cards, offer a defined period of payments leading to a zero balance. With a credit card, by contrast, a $1,000 charge could take years to pay off if only the minimum payment were made each month. What's more, many BNPL services allow customers to choose their repayment term —

from three to 12 months or longer. Other providers have a fixed structure — typically four payments over six weeks.

Merchants often opt to pick up the interest payments as an incentive to buy, reducing or eliminating the cost for consumers. Some merchants view this subsidy as a marketing expense, similar to a discount code.

Facilitating Payment for Larger Purchases

The programs tend to appeal especially to shoppers who don't like to carry balances on credit cards. Millennials have been the biggest users so far, both because they are typically more tech-savvy than older shoppers and because, as a group that came of age during the Great Recession, they tend to be wary of credit card debt.

A recent study showed that once consumers try one BNPL program, they often end up using multiple BNPL providers. This so-called category comfort suggests the universe of users will grow over time as more people try it and expand to more purchases with additional providers.

BNPL programs can also help facilitate bigger purchases. Say a customer wants a new television and has $300 to spend today. If offered a BNPL option, the shopper might be persuaded to move up to a $600 model. One study from 2020 showed that almost 40% of those surveyed said they would hold off on major purchases such as appliances until the coronavirus pandemic eases in their nation, while 20% said they will hold off until the pandemic ends globally. Having more BNPL options might have persuaded some of those shoppers to take the plunge.

BNPL Transaction Risks

To be sure, there is risk in a BNPL transaction — and it is the financing providers that shoulder it. During a time of economic uncertainty, a lender might well want to pull back on providing this kind of credit. After all, they would be the ones to absorb the loss in the event of a default.

But there are incentives for financing providers as well. Like credit cards, BNPL solutions appeal to consumers across the credit spectrum — both those with excellent credit and those with less-than-stellar credit. Yet BNPL transactions don't have the same risk profile as ordinary credit card purchases. The BNPL provider can, on its own or with financing providers, make rapid adjustments to risk models, which are quickly reflected in the portfolio given short terms of weeks or months. In addition, lenders could ask for more interest to compensate for the added risk they are taking on.

What's more, in many BNPL transactions, the first installment is made the same day as the purchase, and future payments are established through autopay. That offers some protection for the lender; after all, avoiding an upcoming auto-payment is much more difficult than simply ignoring a bill arriving in the mail.

Buy now, pay later purchases aren't a retail panacea, and their success in this era hinges on making responsible approval decisions. But if merchant and consumer awareness continue to increase, BNPL programs could be the difference between a shopper emptying their virtual cart or completing their purchase.

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Russell Jones is a partner in Oliver Wyman's Retail and Business Banking practice, based in New York. In his time at Oliver Wyman, Russell has supported leading financial institutions, industry associations and private equity firms on topics spanning strategy, operations and risk.

Getting Asia's Banks on the Path Towards Sustainability

Martin Smith

There have been fervent efforts to enact real change in how global finance aligns with ESG best practices - including a collective of banks, insurers and investors pledging to combat climate change via their operations. But this move has been met with scepticism, especially on how such measures can be scaled. ILLUSTRATION: PIXABAY

With 2021 being noted as the 'make or break' year for managing the climate emergency, COP26 spotlighted both governments and the private sector to take a more collaborative and active role to alleviate the crisis. More concerted efforts are needed from a wide range of stakeholders but - especially due to the impact it has on economies - the financial services sector will play a critical role in helping determine the sustainable path towards a zero-carbon future.

There have indeed been fervent efforts to enact real change in how global finance aligns with environmental, social, and governance (ESG) best practices. This includes a collective of banks, insurers and investors valued at US$130 trillion pledging to combat climate change via their operations. Still, this move has been met with scepticism, especially on how such measures can be scaled.

This scalability, particularly at the global level, is relevant for regions facing the brunt of climate change such as Asia. This must exert pressure on the region's financial services ecosystem players to do their part for the environment via green financing and broader ESG alignment.

The state of green financing

ESG-led finance initiatives have exploded worldwide since the European Investment Bank issued the first ESG bond in 2007. Today, banks are not only investing heavily into establishing best-of-breed ESG teams and marketing their capability, but also turning away from business opportunities unaligned with their green vision.

With little surprise, some Europe-headquartered banks (or those with strong European linkages) have emerged as among the standout providers of green financing, namely BNP Paribas, Standard Chartered and HSBC. Although the ESG movement among banks is gaining ground, the actual pace of implementation has lagged - even in more developed regions - and banks have to do more to catch up to other private sector industries, especially in markets which are by and large still developing such as Asia.

Asian banks have been falling behind

Though there is room to improve, more banks are aligning with ESG principles.

This is evidenced by more banks dropping clients deemed to carry potential ESG risks, such as businesses that depend on unsustainable practices in their operations. However, it has often been the long-established, traditional 'global' banks leading this green banking drive. In Asia, the momentum has been slower.

Based on direct interviews East & Partners has conducted with corporate treasurers and chief financial officers, banks in Asia - including several of the most established lenders in the region - are seen to have the least green credentials or have been slowest to act on ESG and sustainability initiatives. The one primordial challenge (which, admittedly, is faced by the global banking sector as a whole) is the inconsistency of ESG definitions, which is impacted by poor data quality on ESG.

However, the driving force behind corporate ESG financing decisions is defined financial returns. This is a more powerful underpinning for understanding and mitigating risk than outright altruism, with greater appetite in both debt and equity markets for project finance that is sustainable in its application. Disclosing and improving governance around flagged risks will increase existing asset values over time. Concerns over profit losses arising with the need for Asian corporates to invest upfront in ESG with, traditionally, only poor-quality data to guide them, have affected their banking partners' decision to implement ESG principles themselves.

Just like many other businesses, banks are following the lead set by governments and corporate clients. They are generally not going green purely out of the goodness of their hearts and in Asia, this is particularly evident.

The promise of a greener banking future in Asia

Although Asian banks must do more to accelerate ESG adoption, there are hopeful signs. In more advanced markets such as Singapore, private banks are adopting more ESG factors in their investment decision-making.

As alluded to earlier, one major reason is more Singapore enterprises themselves adopting ESG principles. This is evidenced in East & Partners latest Global Insights Report on green banking that shows Singapore enterprises record the second-highest proportion of successful ESG-based requests for proposals (RFPs) - meeting the entirety of scope, cost structure and execution of transaction, second only to the United Kingdom.

This suggests that Singapore-based corporates are highly versed in the criteria required to secure use of proceeds and sustainability-linked finance. Still, observers must be wary to not solely link this movement to altruism; corporates in Singapore are facing increasing scrutiny by regulators, such as the Singapore Exchange wanting to introduce sustainability reporting as part of listing requirements, in addition to growing demand driven by investors and consumers.

Whether ESG decision-making is driven solely by banks or outside factors, banks in Singapore are helping to lead the charge of a movement that is starting to be reflected in neighbouring markets. Such shorter-term pushes towards green financing will likely still be state-driven - especially across emerging regions such as South-east

Asia - rather than being driven strongly by the private sector.

The longer-term, private sector-led impact, however, may come from broader scale digital transformation - which has been touted to reduce emissions and inefficient use of resources arising from economic growth. The digitalisation trend has picked up the pace due to the Covid-19 pandemic, as digital products and solutions are becoming more favoured over physical ones, especially in markets where the digital economy has taken strong roots, such as Singapore and China.

Asia needs a concerted private-sector-led shift towards green banking

Leading enterprises in Asia and their banking providers must take up the call in helping the region transition to a low-carbon economy and ESG-led future. This is not just as issuers of ESG debt but to fully embrace as general adopters of the green finance ethos. Effectively, they must "practise what they preach".

In Asia, the sustainable financing ecosystem, at large, remains nascent. However, there is optimism to be had by the green push shown by governments and several corporates. Especially within the private sector - whether they truly espouse the ESG spirit or are driven solely by returns derived from it - the drive for banking providers to tailor their products and/or services along more sustainable lines will be the crucial bellwether to Asia's future for green banking.

The writer is global head of markets analysis at East & Partners

The Business Times

The Financial Sector Is Decarbonizing — And It's a Huge Challenge

Kate Levick

Big promises are being made in the financial sector around getting the sector to net zero.

After COP26, there's a recognition that it's no longer sufficient for investors simply to divest their carbon intensive assets. But who carries the responsibility and cost of ensuring that investments and insurance are free of carbon is very complicated.

Wind turbines sit just off of a traditional power plant in the Netherlands. One way to decarbonize your portfolio is to get rid of your high-emitting stocks or assets. Photo: Unsplash

Kate Levick is the associate director for Sustainable Finance at the climate change think tank E3G, responsible for overseeing E3G's work on public and private finance including systemic financial reform.

LEVICK: Over the course of 2020, and in particular, 2021, we saw a real step change in how mainstream an issue decarbonization has become. This is now a central concern for the financial sector.

Increasingly, firms are seeing themselves being subject to more regulation, which is one of the drivers for this behavior. But another driver is realizing that this change really does look like it's underway and wanting to get ahead of it in investment terms and make money as these new industries and sectors of the future grow — and not just be left holding the industries and sectors that are no longer going to be viable.

The Glasgow Financial Alliance for Net Zero (known as GFANZ) is a bit of a wrapper, which has a number of different sectoral initiatives underneath it. But the one thing they all have in common is this pledge to get to net zero by 2050. There's been absolute proliferation of subsector initiatives. So there's one for banks, there's one for insurers, asset owners, asset managers, financial service providers, the list goes on, really.

How Will This Work in Practice?

BRINK: How do you see this working in practice? How will an asset manager try to get their portfolio to net zero?

LEVICK: The first thing they need to understand is what carbon is in the portfolio. Financial firms have a lot more information about that these days.

After that, it's looking at different ways to take action. Of course, one way to

decarbonize your portfolio is to get rid of your high-emitting stocks or assets. But on a 2050 time scale, there is the scope for more sophisticated approaches.

Do You Have a Transition Plan?

One area that's receiving a lot of attention right now is to look at what transition plans the underlying firms have got. There's now increasing expectation for firms to be making transition plans to net zero by 2050.

That's now an expectation within the TCFD disclosure rules following a consultation last year. And the U.K. government came out at COP26 and said that in the U.K., listed companies and financial firms would have to disclose their climate transition plans by 2023. So these regulatory expectations are coming down the line, and firms that take voluntary action now are just really getting in ahead.

Transition plans are being increasingly discussed at annual general meetings by shareholders. And last year, we saw quite a number of these votes and resolutions where transition plans were coming up for scrutiny by the shareholders.

BRINK: Presumably it's not as easy as it might sound to map exactly where the carbon is. It could be within the company itself or the supply chain of that company.

LEVICK: Some sectors obviously are big primary emitters. Others may not be, but may have more what you'd call Scope 3 impacts that are outside their direct control. Investors are always going to look at Scope 1 and Scope 2 emissions first. But for some sectors, Scope 3 will be of much more interest.

And actually, one of the sectors where Scope 3 is of the greatest interest is the financial sector itself. Many of these firms, of course, are listed companies themselves, with their own investors. The emissions profile of particularly the large banks is very, very substantial in terms of climate change emissions.

BRINK: Could you explain what is the difference between Scope 1, 2, and 3?

LEVICK: This is a nomenclature that was invented under the Greenhouse Gas Reporting Protocol, which is the most widely accepted methodology for reporting greenhouse gas emissions, very widely used.

Scope 1 are emissions that you pretty much create yourself through direct combustion. That might be the gas in your boilers, for example. Scope 2 is energy that you buy, such as electricity and heat. And then Scope 3 is a very broad range of additional impacts, where the actions that you take are having emissions impacts. And that might be, for example, things like flying, or leased vehicles, it might include investments that you're making, which is where the Scope 3 of the financial sector starts to be so big. So it's a broader set of impacts. You're not directly causing the emissions by turning the lights on, but if you didn't take certain actions, those emissions wouldn't happen.

Trading Is Contributing to Emissions

Trading is a really interesting question. Fundamentally, trading doesn't in itself cause emissions to rise or fall. It's not quite the same thing as making an investment. But it's fair that companies who are engaged in trading activity look at the future for those commodities that they're trading in, whether it's Bitcoin, whether it's coal, or whether it's something else.

There's a lot of attention being put at the moment on commodities that are created that have a lot of deforestation impacts, such as palm oil or wood. And increasingly regulation is tightening around those.

BRINK: What about investment in climate reduction and mitigation? Are there goals for that as well as just decarbonizing?

LEVICK: That is a really great question, because, of course, it's very easy to focus on losing the emissions that we have, because we can see those big emitting companies and activities in front of us and they're the status quo.

What's harder to imagine is what doesn't exist yet, which is really scaling up investment in clean air industries and sectors, including new technologies. And of course, to decarbonize your portfolio, you either need to get all those companies that you already invest in to get to net zero.

Or you need to be investing in something that's brand new, that possibly might not even exist yet, but will by 2050. And of course, in reality, it's going to be a little bit of both. So scaling up the green investment is a very, very important part of this.

Creating a Taxonomy of Green Activities

What a lot of governments around the world have been doing is creating lists of what they consider sustainable, green, future fit, economic activities. They're called taxonomies. And so the EU went by creating a green taxonomy and trying to categorize different economic activities and define what sort of threshold of performance they'd have to be in to constitute a green investment.

So as those become more mature and more normal, it'll be easier for investors to look at that in terms of their portfolios. And say, "Well, how much of our portfolios are invested in these activities that are considered green?" And there's a standard they can hold themselves up against. At the moment, it does feel a little bit like futurology at times.

BRINK: What should we look out for this year in this sector?

LEVICK: In the U.K. particularly, look out for the development of the Transition Plan Task Force that was announced at COP26. E3G, my organization, is going to be co-leading the secretariat of that with the Centre for Greening Finance and Investment.

It will be producing guidance on what a good firm-level climate transition plan

looks like, both for the real economy and for the financial sector. And since the U.K. firms are going to have to be disclosing these plans from 2023, that work is going to have to proceed pretty quickly.

I think what we will see in the context of the COP this year in Egypt, is an even greater focus on how to make this a global transition. How to really address the needs of the developing emerging economies as well. I know that Egypt will make sure that the world continues to have that focus.

Brink News

About the Author

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Kate Levick is associate director for Sustainable Finance at climate change think tank E3G. She is responsible for overseeing E3G's work on public and private finance including systemic financial reform.

Decentralized Finance: The Next Big Threat for the Finance Sector

Kevin Werbach,
Chair of the Department of Legal Studies and Business Ethics at The Wharton Business School, University of Pennsylvania

People use bank ATMs next to a Bitcoin ATM at a shopping mall in Istanbul, Turkey, on April 16, 2021. There are now more crossovers where decentralized finance architectures are being built within the traditional financial services world. Photo: Chris McGrath/Getty Images

Decentralized finance, or DeFi, is a fast-growing segment of the financial markets. Based on a blockchain platform, DeFi provides software services that can cut out intermediaries in financial transactions, thereby allowing for financial services, such as mortgages and investment, to be delivered at lower costs. The question is: Will it take off, or will the financial sector push back?

Kevin Werbach is the chair of the Department of Legal Studies and Business Ethics at the Wharton Business School, University of Pennsylvania.

WERBACH: At a broad level, DeFi is about reconstructing the entire financial system on decentralized blockchain-based foundations.

At the moment, we have a significant and growing market around cryptocurrency trading, as well as payments in things like Bitcoin. However, most of that activity still goes through centralized actors. If you buy Bitcoin on an exchange like Coinbase, for example, Coinbase is taking custody of your assets, and it's providing a similar kind of intermediation function to a traditional financial services provider.

No One Takes Custody of Your Assets

DeFi is about taking the actual financial service provision and transforming it into software that is operating as what are called "smart contracts" on a blockchain.

Most of this kind of activity today is on the Ethereum blockchain, but there's a number of other blockchains that are growing in their level of DeFi activity.

There are three key attributes of DeFi.

The first is that settlement is done on a trust-minimized blockchain platform. The base layer is that these are digital assets — cryptocurrencies where the ultimate ledger of transactions is a blockchain — as opposed to some centralized database in a financial entity.

The second piece is that the services are non-custodial — no one takes ownership or full control custody over investors' assets. The investor still has control of their assets — even though they are transacted — whether it's a trade or a lending

relationship through the financial services platform.

The third piece of DeFi is that services are open, programmable and composable. What that means is that all of these are just software components that are running on a blockchain network. So it's easy to add in additional functionality or to combine functions from different services because everything is running on a standardized software environment.

Which of the Intermediaries Will Be Most Threatened?

BRINK: Which intermediaries are likely to be most disrupted by this?

WERBACH: We first need to question whether DeFi actually disrupts traditional finance, operates alongside traditional finance or integrates with traditional finance.

It probably will be some of all three, but the growing success of DeFi does not necessarily require undermining traditional financial institutions. The question that DeFi poses to traditional finance is whether intermediation is valuable.

If the things that a bank or an asset manager does turn out to be things that can be provided more cheaply and efficiently in an automated way through software, then that will ultimately lead to capital flowing away from those traditional intermediaries.

In terms of the infrastructure, staffing, processes and relationships that are wrapped around that basic intermediation function in traditional finance, what will happen to all of those if we move to a world where at the core is software and decentralized blockchains as opposed to existing finance structures?

BRINK: Can you describe any new services or new areas of financial activity that might open up as a result of this innovation?

WERBACH: Right now, there is a tremendous amount of experimentation in DeFi because these base functions in finance can be combined in different ways. So one area of experimentation we see are aggregators — where if, for example, you have multiple opportunities to earn yields for providing capital as liquidity, then that can be automated and optimized in very efficient ways.

So there's a new layer of DeFi providers that have already sprung up on top of the first level of DeFi applications to do that automated management. We have things somewhat like that in traditional finance, but generally speaking, they're only accessible to the largest investors, the hedge funds and the very sophisticated players. They also have a lot of manual activity and costs associated with them. So that's one area of experimentation.

Getting Your Mortgage via DeFi

Another area of experimentation is potentially opening up financial products that have not been accessible to retail level investors, or to the billion or so people in the world who don't have bank accounts and access to the traditional financial system.

Now that has to be said with some caution because there's risk involved, and DeFi today is very immature. Making complex financial services accessible to someone who doesn't have the background or the knowledge or the legal protections

that traditional banking customers enjoy is not a desirable outcome.

Right now with DeFi, we're seeing people trying all sorts of creative things because they can — but that doesn't necessarily mean that all those things are going to succeed or that they should.

BRINK: For example, one could potentially see mortgage services provided this way?

WERBACH: Sure, any kind of lending relationship can be done in DeFi. The idea is that the collateral pool can be drawn from multiple holders of these digital assets in very flexible ways. Lending can be done in an automated way that is fully-collateralized or even over-collateralized. This addresses some of the risk concerns with these assets.

That being said, markets, like mortgage markets, are extremely large, sophisticated and regulated based on experience of where things can go wrong. I think we will see DeFi integrating in and providing alternatives to some of those markets. But again, there's a long way to go to the point where people would feel comfortable doing that at scale.

BRINK: What are the major risks that regulators should have an early lead on?

WERBACH: First of all, there are a host of technical risks and concerns about attacks and hacks that have been very significant in DeFi. There have been hundreds of millions of dollars lost because these systems are not sufficiently mature, robust and resilient.

Manipulating the Oracle

For example, DeFi systems depend on what are called oracles. A blockchain doesn't know the price of an asset — it only knows what's on the blockchain. There needs to be some decentralized mechanism to allow the price signal to be recorded in the blockchain. It turns out that those can be manipulated. If you can manipulate the price oracle, you can use that in some cases to drain funds from the DeFi application that depend on that price oracle.

Now there's a lot of sophisticated technical work going on to harden these systems, but we still have a long way to go.

All of these applications are based on smart contracts, and they generally have fail-safes involved and mechanisms to address significant price volatility. But as we've seen time and time again in finance writ large, it's impossible to fully predict how systems will respond to every possible scenario. We don't entirely know what will happen if there are rapid price swings in these assets.

Legal Risks

There are legal risks as well, where regulators appropriately have concerns about things like money laundering and fraud that are going on in the larger blockchain

and cryptocurrency world and as well as in DeFi specifically.

The value of these DeFi services is that they are decentralized, so there's not one actor that is responsible for all of the transactional activity. However, that can't simply open the door to eliminating any protections against various kinds of financial crime and fraud. That's certainly an area that the regulators are looking at because there have been plenty of examples in the cryptocurrency world where this has happened.

BRINK: Ten years out, what percentage of the financial landscape do you think will be running through DeFi systems?

WERBACH: It's a hard question to answer: probably still a relatively small amount because finance is so gargantuan around the world and is tied into so many different kinds of systems. The value of transactional volumes in trade finance, for example, is astronomical.

Finance is a Software Application

I think the basic concept that finance is increasingly becoming a software application is unstoppable, and that's happening independently of DeFi. FinTech broadly is moving in this direction as well.

I think we will see more and more crossovers where DeFi-type architectures are being built within the traditional financial services world once we can get greater confidence about addressing risks and the regulatory questions.

And there'll be more and more gateways where the activity may not flow predominantly through these new DeFi providers, but the line between DeFi and traditional finances is going to blur. So 10 years out, I think, some version of what we're now calling DeFi is going to be fairly well-established as an element of the financial landscape.

Brink News

About the Author

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Kevin Werbach is the chair of the Department of Legal Studies and Business Ethics at the Wharton School, University of Pennsylvania. He examines business and policy implications of emerging technologies, such as artificial intelligence, next-generation wireless, gamification and blockchain. His books include For the Win: How Game Thinking Can Revolutionize Your Business and The Blockchain and the New Architecture of Trust.

Are Banks Leaving the Door Ajar for a Non-Bank Fight Back?

As the wave of non-banks giving the Banks a run for their money crests across financial services, incumbents are fighting back to recapture lost ground by enhancing digital capabilities, collaborating with fintechs or investing in their entities themselves.

But the race is not over.

The Appeal of Non-Banks

Examining the Business Foreign Exchange (FX) market in Asia, new East & Partners research reveals that the proliferation of non-bank providers is significantly more advanced in Hong Kong (22 percent) and Singapore (21 percent) with over one in five small and medium-sized enterprises (SMEs) and Lower Commercials engaging with these alternative providers for their FX needs.

Why are these businesses more open to explore alternative financial service providers?

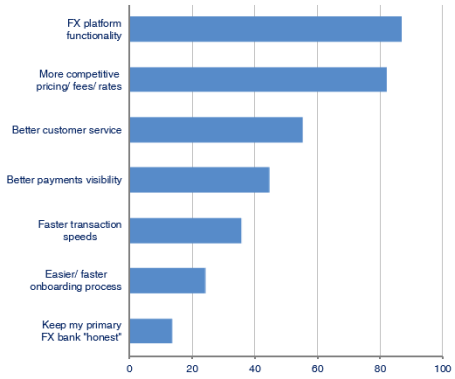
Several catalysts appear to be at play, but the most compelling factors cited by business owners and Chief Financial Officers (CFOs) who have warmed up to using alternative providers include:

1. Better FX platform functionality (87 percent)
2. More competitive pricing (82 percent) and
3. Better customer service (55 percent).

Non-banks appear to understand the core FX requirements of these SMEs and deliver a relevant solution with lower costing.

Additionally, non-banks are successfully removing ingrained pain points associated with cross border payments, providing better payments visibility, faster transaction and easier onboarding customer experience.

Drivers of Non-Bank Engagement in the Asian FX Market: % of Businesses



Source: East & Partners Asian Business Foreign Exchange Markets Report – March 2022

Does this pose a significant threat to the incumbents? Are banks at risk of being disintermediated from providing FX services altogether?

Embedded Finance: A US$7.2 trillion Opportunity

Major banks are embedding a broad array of new functions and services into their core product offerings to create an all-in-one platform – a "super app". Common applications include digital wallets, lending, "buy now, pay later" (BNPL) and insurance.

Helping fuel this growth are the banking-as-a-service (BaaS) and fintech-as-a-service (FaaS) trends where white label infrastructure is provided for companies to build on top of any platforms geared towards better serving their customers and reducing churn.

Singapore based Grab, for instance, has expanded beyond its initial ride hailing vertical to include deliveries, fund transfers, investment and insurance, building around its digital wallet GrabPay to become a true conglomerate. The embedded finance industry in Singapore alone is expected to grow 34 percent year-on-year to reach US$1,047 million by 2022, with a projected compounded annual growth rate (CAGR) of 20 percent thereafter between 2022 and 2029, based on the Q4 2021 Embedded Finance Survey.

Globally, the embedded finance market is projected to be worth US$7.2 trillion by 2030, twice the combined value of the world's Top 30 banks in 2020, according to estimates by an industry expert Simon Torrance. The scale of opportunity is too important to ignore.

The Case for Banks

The majority of importers and exporters across Asia more broadly, however, especially those in Malaysia and Philippines, still rely on their banks for FX services including Spot FX, FX Options and Forward FX.

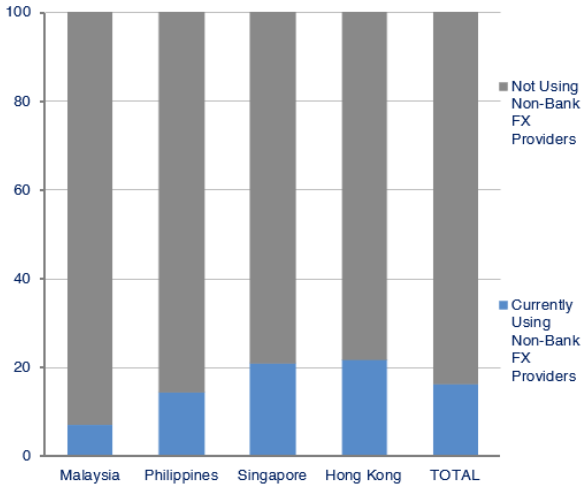
These corporates are anecdotally found to be relatively reluctant to move away from their home currency when conducting international trade, absorbing currency risks. Although value for money is one of the most powerful drivers of customer satisfaction for these firms, there also appears to be a cultural reticence to shop around. This is demonstrated by the fact that FX relationships tend to follow primary credit relationships among these enterprises.

Penetration of Non-Banks in Selected Asian Markets: % of Total

Generally, incumbents in these markets appear to be competing on superior customer support and service (53 percent), as well as offering valuable risk management and advice, and relevant market information (23 percent) for FX, which is consistent with other business banking product offerings. It suggests that relationship managers remain the core asset of the business for these incumbents and are a clear differentiator from alternative providers.

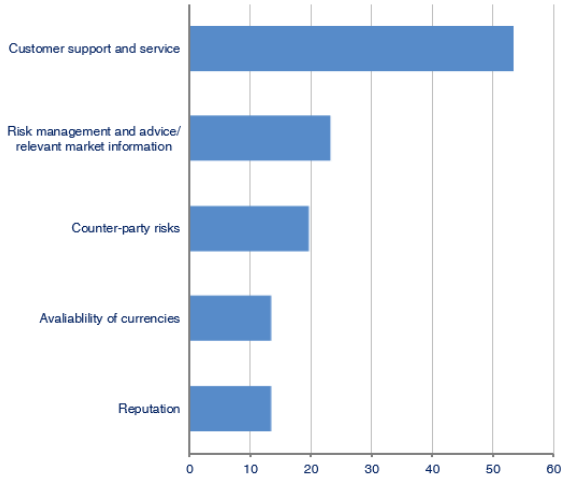
Ultimately businesses still trust banks more with their high value international transactions and currency risk management needs, with one in five (20 percent) citing

counter-party risks as a reason for not using non-bank providers, while a further 13 percent also raised reputational concerns.



Source: East & Partners Asian Business Foreign Exchange Markets Report – March 2022

Top Reasons for Not Using Non-Bank FX Providers: % of Total



Source: East & Partners Asian Business Foreign Exchange Markets Report – March 2022

Should ESG Investors Own Cryptocurrency?

The growing popularity of cryptocurrency has created a new wrinkle for investors—how to balance its potential upside against its inherent environmental and social impacts. A look at both sides of the issue.

Despite the recent exponential growth in the cryptocurrency industry, this emerging asset class leaves many open questions for investors who integrate environmental, social and governance (ESG) issues into their portfolios.

While crypto can offer some societal benefits—such as financial inclusion and the ability to "be your own bank"—there are also potential downsides, including its carbon footprint, prevalence of theft through hacks and lack of centralized governance.

These issues are being hotly debated within the crypto community, as well as by policymakers, corporations and other entities around the world. Investors, for their part, should consider the nuances of individual digital currencies and weigh the pros and the cons in the context of their own sustainability goals.

As a key first step, Morgan Stanley's Cryptocurrency and Sustainability Research teams did a deep dive on the key ESG issues surrounding this asset class. Here's what they found.

Calculating Carbon Intensity

There is almost no escaping the fact that crypto requires a lot of energy-consuming computing power to create and verify new transactions on the blockchain—a process known as "mining." The annual energy consumption of Bitcoin, for example, is equivalent to the total electricity produced in the Netherlands.

"Every $1 of Bitcoin mined is materially more carbon intensive than every $1 of gold mined," says Jessica Alsford, Global Head of Sustainability Research. Put another way, her team estimates that Bitcoin's carbon intensity was 14.2 million times that of a Visa Credit Card transactions

Of course, many variables affect the carbon intensity of maintaining the cryptocurrency network, including how new transactions are validated. For example, the "proof of work" process used in Bitcoin requires significantly more energy than the "proof of stake" that the world's second most prominent cryptocurrency, Ethereum, is hoping to adopt later this year.

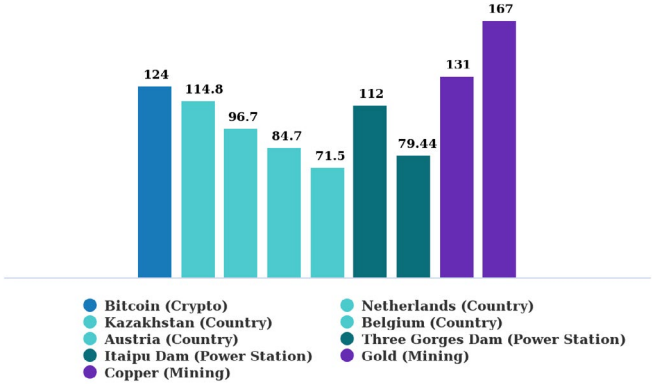
And many crypto mining companies are using renewable sources of power and have committed to carbon offsetting. Still, it's a tall order. "We estimate that powering Bitcoin's yearly energy requirement via green energy would require the equivalent infrastructure of the entire U.S. solar fleet," says Alsford. As long as Bitcoin and other crypto mining is profitable, the energy requirements will continue to increase over time but may use energy from increasingly greener sources.

What may be more critical: Concerns about crypto's environmental impact are more than a matter of social responsibility. "We see continued risk of governments restricting energy use for crypto mining," says Sheena Shah, Morgan Stanley's lead

Cryptocurrency analyst. She notes that many countries, including China, have banned crypto mining, while others have restricted it.

"Mining bans are unlikely in developed markets, but the U.S. government has debated the climate impact and some EU representatives have proposed prohibiting energy-intensive crypto mining," she adds.

Bitcoin's energy use exceeds electricity produced in the Netherlands



Source: Centre for Alternative Finance, IEA, Power-Technology, Water Power Magazine, Morgan Stanley Research.

Weighing Social Pros and Cons

Despite the energy demands of Bitcoin, many of the qualities that make it an attractive currency alternative go hand-in-hand with its real societal benefits, such as greater financial inclusion.

"Cryptocurrencies could be one way to increase access to financial systems for the unbanked," says Alsford. "Anyone with a smartphone or laptop and internet connection can access cryptocurrencies, which arguably is a lower requirement than that of traditional bank accounts."

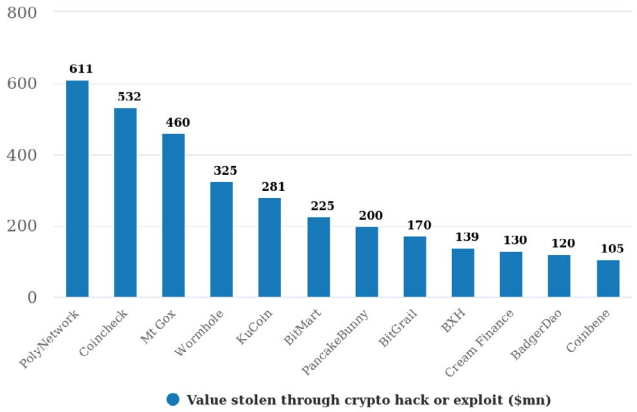
In addition, cryptocurrencies can support faster and more affordable cross-border transactions—specifically, giving people an easier way to send money to relatives in other countries— and may be a better alternative in countries with volatile or depreciating local currencies.

But while crypto could open doors for greater financial inclusion and the ability to transact without intermediaries, it's also a popular payment option for illegal activities.

Academic researchers estimate that between January 2009 and April 2017, 46% of Bitcoin transactions were linked to illegal activity, to the tune of $76 billion, which is equal to the U.S. and EU illegal drug markets. There is a counterpoint: Other estimates of illegal activity across all cryptocurrencies paint a different picture. In 2021,

an estimated $14 billion of cryptocurrency, or just 0.15% of crypto volume traded, was associated with criminal activity.

Crypto hacks could grow in size and prevalence



Source: Elliptic, Coindesk, Twitter, Morgan Stanley Research.

Understanding the Role of Governance

Most cryptocurrencies use blockchain networks that are decentralized databases of transactions where no single entity makes or enforces regulations. Anyone can create a new cryptocurrency, and, in fact, the world still doesn't definitively know who invented Bitcoin.

At first glance, this seems to defy good governance and raise myriad questions, including: Who makes the rules related to how a cryptocurrency operates? Is there a board of directors? Does the cryptocurrency or its applications always comply with the law?

Of course, proponents of cryptocurrency argue that such decentralization is the definition of good governance, precisely because no single entity has control.

For their part, the analysts covering cryptocurrency and sustainability at Morgan Stanley believe that new crypto regulations are likely to change the rules of investing in crypto-related products. Whether that simplifies the complicated nature of the asset class for sustainability-focused investors, however, seems unlikely, at least in the short term.

For more Morgan Stanley Research on ESG consideration for cryptocurrency, ask your Morgan Stanley representative or Financial Advisor for the full report, "Sustainability and Cryptocurrency: ESG Considerations" (February 22, 2022) Plus more Ideas from Morgan Stanley's thought leaders.

Morgan Stanley

Asia's Developing Countries Need Bold Tax Reform to Rebound from the Pandemic

Sam Hill, Yothin Jinjarak, Donghyun Park, Shu Tia

Tax revenue can be raised in a fair and reasonable way to provide much-needed public services and support the poor and disadvantaged still reeling from the pandemic.

It's been said taxes are the price we pay for a civilized society. Without taxes governments simply don't have the resources to pay for the public goods and services that everyone depends on.

Asian governments need to increase taxes to help pay for their rapidly aging populations. Photo: ADB

Despite Asia's stellar progress in reducing poverty and improving living standards, governments across the region often struggle to generate sufficient revenue.

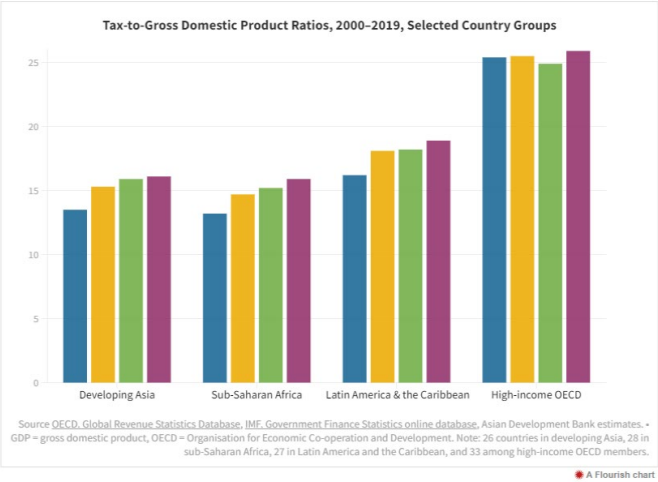
Consequently, many countries in the region spend comparatively little on public education, healthcare, and social protection. Spending shortfalls in these areas were vividly illustrated by the severe impact of the COVID-19 pandemic, evident in strained education infrastructure, overflowing hospitals, and limited financial assistance to the poor.

All of these problems can ultimately be traced back to insufficient taxes and fiscal resources.

Change is needed if the region is to achieve its potential. For example, it is estimated trillions of dollars in additional spending are needed to achieve the Sustainable Development Goals by 2030. Beyond 2030 spending demands will likely increase even further as the region copes with long-term challenges such as climate change and fast-aging populations which require more spending on healthcare and pensions. Much of this spending will inevitably need to be backed by higher government revenues, especially taxes.

Before COVID-19, developing countries in Asia made some progress in increasing tax revenue. But at a modest 16% of GDP, the region lags behind Latin America and trails far behind high-income countries. Some countries in Asia, particularly in South and Southeast Asia, collect significantly less, resulting in financially constrained governments with inadequate fiscal resources.

Most recently, the pandemic set back progress. As economic activity stalled in the region and governments provided fiscal support, tax revenues collapsed, and fiscal deficits and debt jumped. The region therefore emerges from the pandemic with weakened government finances that require urgent action.



So how can Asia's developing countries mobilize taxes to support development?

There is no one size fits all approach to tax mobilization, with solutions depending on individual country circumstances and priorities. Tax policy needs to balance objectives of efficiency, to ensure taxes don't unduly hinder economic growth; equity, to support the poor; and simplicity, to make it easier for taxpayers to pay taxes.

Widespread tax expenditures – special concessions or "tax breaks" – given to businesses and others, yield doubtful and hard-to-measure benefits and can undermine competition. Typically, they lack the same level of scrutiny as regular government spending and are difficult to get rid of once in place. This can cause undue revenue losses and can be mitigated by better reporting and a more judicious use of such incentives.

Value-added taxes are the single most important source of revenue for developing economies in Asia but they can be improved. Indicators suggest revenues could be increased by streamlining tax rates, ensuring coverage of fast-growing digital commerce, and better using technology to improve collection.

Personal income and property taxes can raise more revenue and promote equity, by imposing a higher tax obligation on the affluent. Labor market modernization in the region is making it easier for governments to assess individuals' earnings, which facilitates income tax collection. International cooperation is playing a key role in promoting a fairer and less uncertain system for corporate income taxation.

Environment-related and health taxes can both contribute revenue and directly support development, by discouraging bad behavior and encouraging good behavior. Many governments have well-established pollution and fossil fuel taxes but these are often underutilized. Carbon taxes and pricing schemes are growing in popularity, but their effectiveness can be enhanced via strengthened design and implementation, and quality monitoring, reporting, and verification.

Taxes on alcohol, tobacco, and sugar-sweetened beverages can be better used

to tackle the rising incidence of non-communicable disease and at the same time raise revenues.

Tax reform can be challenging, since it produces winners and losers. However, international experience shows that diverse countries have achieved reforms that substantially increased revenues. Strong political leadership and public buy-in is essential. Timing can also matter. As the region emerges from COVID-19 now is an opportune moment for ambitious reform in many countries. Broader economic reform that reduces the informal sector and thus expands the tax base can help too.

Tax administrations, vital for ensuring fair and efficient tax collection, can be strengthened by making better use of technology to improve taxpayer services, such as electronic filing. As tax administrations in developing economies in Asia are sometimes poorly staffed, there is scope to expand human resources and use them more strategically. Research informed by behavioral insights highlights opportunities for tax administrations to experiment with sticks and carrots to incentivize tax compliance.

Finally, people are sometimes reluctant to pay their taxes, fearing that these will be squandered. It is therefore essential that governments motivate taxpayer compliance by making every effort to improve the quality of public goods and services.

Developing economies in Asia are entering a critical period as they emerge from the pandemic. Efficient and equitable tax collection is an important part of that equation.

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Stagflation Risk Rises Amid Sharp Slowdown in Growth

Compounding the damage from the COVID-19 pandemic, the Russian invasion of Ukraine has magnified the slowdown in the global economy, which is entering what could become a protracted period of feeble growth and elevated inflation, according to the World Bank's latest ***Global Economic Prospects*** report. This raises the risk of stagflation, with potentially harmful consequences for middle- and low-income economies alike.

Global growth is expected to slump from 5.7 percent in 2021 to 2.9 percent in 2022— significantly lower than 4.1 percent that was anticipated in January. It is expected to hover around that pace over 2023-24, as the war in Ukraine disrupts activity, investment, and trade in the near term, pent-up demand fades, and fiscal and monetary policy accommodation is withdrawn. As a result of the damage from the pandemic and the war, the level of per capita income in developing economies this year will be nearly 5 percent below its pre-pandemic trend.

"The war in Ukraine, lockdowns in China, supply-chain disruptions, and the risk of stagflation are hammering growth. For many countries, recession will be hard to avoid," said World Bank President **David Malpass**. "Markets look forward, so it is urgent to encourage production and avoid trade restrictions. Changes in fiscal, monetary, climate and debt policy are needed to counter capital misallocation and inequality."

The June ***Global Economic Prospects*** report offers the first systematic assessment of how current global economic conditions compare with the stagflation of the 1970s—with a particular emphasis on how stagflation could affect emerging market and developing economies. The recovery from the stagflation of the 1970s required steep increases in interest rates in major advanced economies, which played a prominent role in triggering a string of financial crises in emerging market and developing economies.

"*Developing economies will have to balance the need to ensure fiscal sustainability with the need to mitigate the effects of today's overlapping crises on their poorest citizens*," said **Ayhan Kose**, Director of the World Bank's Prospects Group. "Communicating monetary policy decisions clearly, leveraging credible monetary policy frameworks, and protecting central bank independence can effectively anchor inflation expectations and reduce the amount of policy tightening required to achieve the desired effects on inflation and activity."

The current juncture resembles the 1970s in three key aspects: persistent supply-side disturbances fueling inflation, preceded by a protracted period of highly accommodative monetary policy in major advanced economies, prospects for weakening growth, and vulnerabilities that emerging market and developing economies face with respect to the monetary policy tightening that will be needed to rein in inflation.

However, the ongoing episode also differs from the 1970s in multiple dimensions: the dollar is strong, a sharp contrast with its severe weakness in the 1970s;

the percentage increases in commodity prices are smaller; and the balance sheets of major financial institutions are generally strong. More importantly, unlike the 1970s, central banks in advanced economies and many developing economies now have clear mandates for price stability, and, over the past three decades, they have established a credible track record of achieving their inflation targets.

Global inflation is expected to moderate next year but it will likely remain above inflation targets in many economies. The report notes that if inflation remains elevated, a repeat of the resolution of the earlier stagflation episode could translate into a sharp global downturn along with financial crises in some emerging market and developing economies.

The report also offers fresh insights on how the war's effects on energy markets are clouding the global growth outlook. The war in Ukraine has led to a surge in prices across a wide range of energy-related commodities. Higher energy prices will lower real incomes, raise production costs, tighten financial conditions, and constrain macroeconomic policy especially in energy-importing countries.

Growth in advanced economies is projected to sharply decelerate from 5.1 percent in 2021 to 2.6 percent in 2022—1.2 percentage point below projections in January. Growth is expected to further moderate to 2.2 percent in 2023, largely reflecting the further unwinding of the fiscal and monetary policy support provided during the pandemic.

Among emerging market and developing economies, growth is also projected to fall from 6.6 percent in 2021 to 3.4 percent in 2022—well below the annual average of 4.8 percent over 2011-2019. The negative spillovers from the war will more than offset any near-term boost to some commodity exporters from higher energy prices. Forecasts for 2022 growth have been revised down in nearly 70 percent of EMDEs, including most commodity importing countries as well as four-fifths of low-income countries.

The report highlights the need for decisive global and national policy action to avert the worst consequences of the war in Ukraine for the global economy. This will involve global efforts to limit the harm to those affected by the war, to cushion the blow from surging oil and food prices, to speed up debt relief, and to expand vaccinations in low-income countries. It will also involve vigorous supply responses at the national level while keeping global commodity markets functioning well.

Policymakers, moreover, should refrain from distortionary policies such as price controls, subsidies, and export bans, which could worsen the recent increase in commodity prices. Against the challenging backdrop of higher inflation, weaker growth, tighter financial conditions, and limited fiscal policy space, governments will need to reprioritize spending toward targeted relief for vulnerable populations.

The World Bank

9 Takeaways From Davos

BRINK editorial Staff

The annual World Economic Forum took place in Davos last week for the first time in three years. The high-profile gathering of corporate executives and politicians was smaller than usual and was held in May instead of January. Here are some of the highlights.

Klaus Schwab, founder of the World Economic Forum, introduces Ukrainian President Volodymyr Zelenskyy during the 2022 World Economic Forum Annual Meeting. Photo: World Economic Forum/ Sikarin Fon Thanachaiary via CC

The managing director of the International Monetary Fund sought to dispel the gloom at the World Economic Forum, saying a global recession isn't in the cards, but "it doesn't mean it's out of the question." Kristalina Georgieva noted that the IMF expects economic growth of 3.6% for 2022, but acknowledged that it's going to be a "tough year."

A global buyers' club of more than 50 companies, including Microsoft and Ford Motor, say they will buy "green" steel, aluminum and other commodities by 2030. The idea behind the buyers' club, known as the First Movers Coalition, is to stoke demand for green versions of materials that have proved difficult to manufacture without significant carbon dioxide emissions.

The aviation industry, decimated during the pandemic, is rebounding strongly, said Hassan El Houry, CEO of National Aviation Services. He predicted the airline industry would return to pre-pandemic levels at the end of this year or the middle of next, earlier than airline industry group IATA's forecast of 2025. "Almost every airline I speak with is reporting a huge rebound, especially for this summer and particularly in leisure travel."

Ukrainian President Volodymyr Zelenskyy says that his country will not give up land to end Russia's war. Speaking by video link Wednesday, Zelenskyy said through a translator that "Ukraine is not going to concede our territory. We are fighting in our country, on our land." Meanwhile, Henry Kissinger, the 98-year-old former secretary of state urged Ukraine to cede territory to make peace with Russia.

The Chairman of Volkswagen, Herbert Diess, says Volkswagen is seeing a "clear improvement through summer" on the supply of microchips it needs for its vehicles. Audi board member Hildegard Wortmann said the VW-owned brand has its "highest level of orders at the moment," but customers are facing wait times of about a year or more.

An international deal to force the world's biggest multinational companies to pay a fair share of tax has been delayed until 2024, amid fresh wrangling over the painstakingly negotiated agreement. Mathias Cormann, the secretary-general of the

Organisation for Economic Co-operation and Development (OECD) said he remained confident an agreement would eventually be implemented to let countries levy more tax on the world's largest firms based on the sales generated within their borders.

Israeli President Isaac Herzog called on other nations to consider a "renewable Middle East" as a resource for sustainable food, water and energy solutions. He appealed for a new partnership with nations in Europe, Asia and Africa modeled in part on the economic agreements Israel has struck with four Arab nations. He said such new links would expand a "zone of understanding, despite wide gaps and conflicting narratives" about a surge in violence between Israel and the Palestinians.

The World Economic Forum has unveiled an initiative to develop the metaverse. The forum said that it will work with businesses, regulators, civil society and academic experts to help define and build the metaverse. The focus will be on governing the metaverse as well as how to create economic and societal value.

European Central Bank President Christine Lagarde criticized cryptocurrencies, saying that they "are not currencies at all …they are speculative assets, the value of which changes enormously over the course of time … coin issuers should have to back up their coins with as many dollars as they have coins. That needs to be checked, supervised, and regulated." Lagarde's latest comments come after she told a Dutch talk show: "My very humble assessment is that [crypto] is worth nothing, it is based on nothing — there is no underlying asset to act as an anchor of safety."

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