Fundamentals of an Inclusive Financial System

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In their opening article, Sanchez-Moyano and Shrimali lay the groundwork for a more inclusive financial system by outlining the roots, and present-day consequences, of America's history of financial exclusion. We turn now to describing what must come next: a truly inclusive financial system. Below we outline what such a system entails, what it does, and the benefits—both widespread and reparative—it will bring.

What Is an Inclusive Financial System?

First, what do we mean by an inclusive financial system? We define it as follows: **An inclusive financial system provides everyone—all people and small businesses—with the ability to access, utilize, and reap the benefits of a full suite of financial services that facilitate stability, resilience, and long-term financial security.**[1]

Although an inclusive financial system provides for all of society, it recognizes—as the articles in this issue describe from many different perspectives—that certain populations face higher barriers to participate and benefit from the financial system. An inclusive financial system therefore targets market gaps, previous policy choices, and the other barriers that prevent historically underserved groups from being full system participants and beneficiaries. To do so, it is designed to have a reparative effect—for example, by redirecting flows of capital to institutions who serve historically excluded communities, people, and small businesses, as described in the article by Wicks and Standaert.

A truly inclusive financial system aligns motives and rewards of financial institutions' leadership with rewards and benefits for the customer and is specifically designed for and with the input of the historically excluded, underserved, or others who have been targets of predation. As a result, financial products and services in an inclusive financial system provide value for traditionally underserved consumers. They are designed for trust, respect, and dignity from the onset, enabling customers to gain confidence and agency through usage of products and participation in the financial system. In

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1 Aspen Institute, "Why Now Is the Time for a National Strategy to Build an Inclusive Financial System" (Washington, DC: Aspen Institute, October 18, 2019), https://www.aspeninstitute.org/publications/why-now-is-the-time-for-a-national-strategy-to-build-an-inclusive-financial-system/.

their article, Lajewski and Sabharwal describe the need for, and approaches to, designing financial products with and for traditionally underserved consumers.

An inclusive financial system also has strong consumer protections, targeting bad actors and activities that can cause harm to people, small businesses, and the financial system overall. This includes behavior that is abusive, deceptive, or criminal. Given the digital evolution of financial services, this also includes an expanded consumer protection framework that accounts for responsible data use and data protection. These strong protections are balanced with the need to allow for responsible innovation and support market competition. Such a regulatory approach allows beneficial products and services to enter the market and improve financial outcomes for consumers. In their article, Evans and Pence describe the current state of consumer protection regulation in the United States and highlight areas that warrant further attention from regulators and policymakers.

And finally, although equitable and universal access serves as its foundation, an inclusive financial system looks beyond financial access and focuses predominantly on financial outcomes, including end-user stability, resilience, wealth creation, and economic mobility as its dominant measures of success. Asrow and Creehan provide a path to operationalizing a focus on outcomes in their framing article on regulating for financial wellness.

What Are the Elements of an Inclusive Financial System?

An inclusive financial system is composed of four sets of financial infrastructure, key enabling infrastructure, and a combination of stakeholders in the public, private, and social sectors. A truly inclusive financial system also accounts for the financialized parts of nonfinancial systems in our society.

The collective and individual benefits of an inclusive financial system require four sets of financial infrastructure that together facilitate stability, resilience, and long-term financial security for households and small businesses: (1) payments, (2) credit and financing, (3) short- and long-term savings, and (4) insurance.

Authors in this issue explore various aspects of financial infrastructure in more depth. Kumar and Ehrbeck address payment infrastructure, which forms the backbone of the financial system. Cochran focuses on inclusion in credit systems, including the data and analytics methods used to make credit decisions. A robust savings infrastructure provides opportunities to build near-term resilience through emergency savings products, as well as longer-term wealth through affordable retirement savings and investing products. Phillips explores the potential for technology—and mission-minded financial technology companies—to make savings infrastructure more inclusive. Finally, an inclusive insurance system is needed to enable people and small business to pool collective risks together to protect against adverse shocks and advance longer-term financial security.

Undergirding and enabling widespread access to an inclusive financial system are two other forms of nonfinancial infrastructure. First, as discussed in depth in the articles by Carnahan and by Kumar and Ehrbeck, inclusive identification infrastructure must exist to provide individuals, government, and institutions with a simple way to verify the identity of individuals as they participate in the financial system. Second, it is critically important in a world of increasingly digital finance for households and small businesses to have consistent, secure access to the Internet and Internet-connected devices, such as computers or smart phones.

A truly inclusive financial system must also consider its role in financializing parts of nonfinancial systems in our society. Over time, nonfinancial systems in our society whose purpose is to deliver nonfinancial goods—like health care, housing, higher education, or criminal justice—have levied costs on users with fees and penalties, using tools of the traditional financial system in ways that exacerbate existing inequality. The administrative fees, interest, financing charges, financial penalties, and intermediary products, like debt consolidation and bail bonds, in systems like health care or the courts are too costly to ignore. This is also increasingly true of actors that use data collected by credit bureaus for nonfinancial uses, such as rental or employment checks, and the debt collection methods of these financialized actors. The addition of more organizations and systems into the financial system does not, by itself, make the financial system more inclusive. Instead, it reveals the need for an inclusive financial system to account for, and be responsive to, the increased financialization of other sectors as we look ahead. As an example, this could take the form of an expanded regulatory framework that includes these new actors and systems involved in facilitating the financialized parts of nonfinancial systems.[2]

What Actors Support an Inclusive Financial System?

In a well-functioning system, a combination of stakeholders in the public, private, and social sectors provide key financial services to an entire society. As the systems we understand to be involved in an inclusive financial system expand, so too are the stakeholders involved. At minimum, key stakeholders in an inclusive financial system include: a wide range of public-sector entities, private financial services providers of all kinds, social-sector organizations (e.g., donors, researchers, advocates, and other community-based organizations), and the technology sector broadly. Over the past decade, the types of organizations involved in an inclusive financial system have grown. As finance has become increasing tech-enabled and digital, the breadth of actors involved in providing financial services has grown to encompass Big Tech companies, their regulators, and other actors in the digital economy.

It is a fundamental responsibility of the government to facilitate a competitive, safe, fair, and inclusive financial system that fosters responsible products and trust, and protects consumers from fraudulent, deceptive, or abusive practices. Regulators must leverage multiple mandates, including their consumer protection, fairness, financial stability, competition, responsible innovation, and other authorities to advance inclusive finance, particularly as gaps emerge between regulatory authority and service provision. Other governmental entities with a significant role in an inclusive financial system include the judicial and court system (e.g., bankruptcies, arbitration, and financial penalties), administrators of economic and social safety programs (e.g., the Departments of Treasury,

2 Aspen Institute, "The State of Financial Security 2020: A Framework for Recovery and Resilience" (Washington, DC: Aspen Institute, November 9, 2020), https://www.aspeninstitute.org/publications/the-state-of-financial-security-2020-framework/.

Labor, Education, and Agriculture), and any government agencies that directly provide or backstop financial services to individuals or small businesses (e.g., student loans, mortgages, health or property insurance, small business credit, social insurance payments, etc.). Given the array of agencies with responsibilities in managing a well-functioning financial system, over 50 countries have implemented explicit national financial inclusion strategies or commissions to help coordinate national action, such as the United Kingdom's Financial Inclusion Commission.[3,4]

In the private financial sector, the breadth and diversity of financial service providers (FSPs) is growing and includes traditional banks and credit unions, community development financial institutions, a wide range of nonbank financial companies, financial technology companies, wealth and asset managers, and credit bureaus and debt collectors. Participants also include the vendors that provide services to FSPs, as well as retailers and agents that provide customer access points to financial services. As profiled in the articles by Wicks and Standaert and by Donaker, mission-driven community development organizations are developing new types of collaborations with other FSPs.

What Are the Benefits of an Inclusive Financial System?

An inclusive financial system represents critical infrastructure for the national economy, facilitating commerce, economic growth, and financial stability and security for all individuals, businesses, and communities. It also facilitates access to other key economic and social safety systems crucial for financial security for all.

An inclusive financial system is an incredible tool for inclusive growth. It supports economic activity and commerce by enabling individuals and businesses to pursue economic gain, invest in themselves and their communities, manage risks, and build wealth. Direct financial benefits for individuals include access to affordable, useful financial products that facilitate financial stability and security, protection from predatory products or abusive acts, and prevention of data bias or credit invisibility.[5] Greater access to high-quality, consumer-friendly credit can give people the tools to successfully buy homes, pursue higher education, and start businesses. These individual benefits also drive growth for the broader economy.[6] Emerging research across countries has begun to tie deeper and more inclusive financial systems with stronger and more inclusive national economic growth.[7] Conversely, when people cannot make efficient payments or access affordable financing for goods and services, financial transactions decrease, thus reducing net economic activity.

3 World Bank Group, "National Financial Inclusion Strategies Resource Center." Policy brief (Washington, DC: World Bank Group, January 29, 2019), https://www.worldbank.org/en/topic/financialinclusion/brief/financial-inclusion-strategies-resource-center/.

4 Financial Inclusion Commission, "Making Financial Inclusion a Top Political Priority in the UK" (London, England: Financial Inclusion Commission), https://financialinclusioncommission.org.uk/.

5 Credit data are used to inform risk-based decisioning. However, the absence of a previous credit file, or a credit file influenced by unfair or discriminatory treatment, leads to credit that is either more expensive or altogether unavailable. Historical discrimination or invisibility in credit beget further cycles of discrimination and invisibility. These issues are described in more detail in Cochran's article in this issue.

6 Ratna Sahay et al., "Rethinking Financial Deepening: Stability and Growth in Emerging Markets" (Washington, DC: International Monetary Fund, May 2015), https://www.imf.org/external/pubs/ft/sdn/2015/sdn1508.pdf.

7 Adolfo Barajas et al., "Financial Inclusion: What Have We Learned So Far? What Do We Have to Learn?" (Washington, DC: International Monetary Fund, August 7, 2020), https://www.imf.org/en/Publications/WP/Issues/2020/08/07/Financial-Inclusion-What-Have-We-Learned-So-Far-What-Do-We-Have-to-Learn-49660.

An inclusive financial system also enables and supports the functioning of other important economic and social systems. As demonstrated by the COVID-19 pandemic and the response by governments globally, there is a strong intersection between the social safety net for households and small businesses and the financial system. Globally, governments' responses have included direct cash transfers to households, wage subsidy programs to keep workers employed and small businesses operating, and investment funds and loan guarantees to stabilize commercial enterprises.[8] In each instance, the financial system was used to deliver these benefits, and the success of those relief programs depended on the inclusivity of the financial systems that underpinned them. On the one hand, the financial system could deliver benefits to households and businesses quickly where the prerequisite infrastructure was in place. On the other hand, inequities in access to financial services hindered the speed and effectiveness of government relief efforts. These global parallels are discussed further by El-Zoghbi. The potential of a technology-enabled social safety net to boost the inclusiveness of the U.S. financial system is further explored in Cuéllar's article in this issue.

An inclusive financial system is not a silver bullet. Financial services are not a substitute for lack of income or good-paying jobs, stable housing, or affordable health care. However, when people and small businesses—especially historically marginalized and excluded people and communities—access, utilize, and benefit from a full suite of financial services, an inclusive financial system represents an incredible engine for shared prosperity. The opportunity now before us, as market and regulatory innovations continue to reshape financial services, is to frame inclusion not as an extension of existing systems, but as a fundamental principle of the future financial services ecosystem. This is a social, moral, and economic imperative. The articles in this issue give us many ways to get started.

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8 International Monetary Fund (IMF), "Policy Responses to COVID-19: Policy Tracker" (Washington, DC: IMF), https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19.

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