THE FLETCHER SCHOOL

Leadership Program for Financial Inclusion

Policy Memoranda 2013
The Fletcher Leadership Program for Financial Inclusion is a two-week residency for mid-career Central Bankers and financial regulators with an interest in furthering financial services for the poor. The April residency at Tufts University (outside Boston USA) is capped with a meeting at the AFI Global Policy Forum, several months later.

Our curriculum focuses on key issues in financial inclusion, the global context shaping these issues, and policy implementation skills such as policy logic, persuasion, negotiation, writing and speaking. The primary output is a brief policy action memo that advocates implementation of a new idea pertinent to a timely in-county issue.

Crucial to the policy action process is the challenging of assumptions that may or may not hold true, depending on the circumstances, such as:

- **Access to formal financial services equals inclusion.** Evidence from South Africa, Mexico and other countries shows that a rapid increase in the number of bank accounts does not translate to account usage. From a policy action perspective, we might challenge that access automatically leads to adoption.

- **Formal financial services are necessary for financial inclusion.** Again, a body of evidence indicates that informal services (such as savings clubs and mobile money accounts) are often immediately understood by the poor, more available at a grassroots level, and thus more widely adopted than formal services. From a policy action perspective, regulators might examine proportional regulation, as a means to ensuring that valuable informal services are not over-supervised.

- **Financial education/literacy leads to inclusion.** Little evidence suggests that financial education is a cost-effective way to improve consumer behavior or decision-making. In fact, a strong argument can be made that the causality works in reverse. As people use services, formal or informal, they advance in financial literacy. From a policy action perspective, a regulator might research the true causes of hoped-for consumer behavior and establish policies that support those behaviors.

Our curriculum establishes a method for developing a “theory of change” when designing a new policy.

- What problem are you trying to fix?
- Is regulation a solution to the problem—or will it make it worse? (In 2013, a Fellow from Ghana showed how Kenya’s “lite” approach to mobile money was more effective in encouraging adoption than Ghana’s more complex regulatory regime.)
- How do you distinguish good policy from bad?
- How do you measure the impact so you can make mid-course corrections?
- Will stakeholders buy in and actually help implement the policy? How do you convince those stakeholders to support your policy? What is the role of media and civic engagement in successful policy adoption?

In this publication, we present the resulting policy action memos produced by the 2013 Financial Inclusion Fellows. You may find all policy memos from both cohorts online at: http://fletcher.tufts.edu/FinancialInclusion/Publications.

As always, we are grateful to the Bill & Melinda Gates Foundation for their continued support of the Fletcher Leadership Program for Financial Inclusion.

Best,
Kim and Nick
The policy memos in this publication provide a unique sample of insights into the dynamic world of financial inclusion and financial services regulation. The authors—participants in the Fletcher School Leadership Program for Financial Inclusion—come from a wide variety of countries, professional backgrounds and positions within their respective governments. These memos offer tangible examples of innovative policy strategies and solutions to complex challenges.

As participants in the Fletcher School Leadership Program for Financial inclusion, 15 Fellows are chosen each year to engage in a year-long intensive training and educational program. This innovative program is designed for rising leaders in the inclusive financial regulation world and challenges them to think in fresh ways about financial regulation and the provision of financial services for the poor. While this publication presents a small sample of Fellow memos, all memos, along with more information on the Program can be found on our website at: http://fletcher.tufts.edu/financialInclusion/.

As part of the 2013 Program each Fellow proposed a Policy memo delineating Innovative strategic frameworks and policy options for central banks to promote financial inclusion and effectively regulate the inclusive finance space.

**Cash-lite: Mobile Money and Electronic Payments**

Maimouna Gueye  
Senior Financial Analyst, Central Bank of West African States  
“Enhancing Financial Inclusion through Mobile G2P Payments in the West African Economic and Monetary Union (WAEMU)”

Zaira Badillo Luna  
Director for Access to Finance, Public Accountant, Mexican National Banking and Securities Commission  
“The Development of a Demand-side Survey as a Measurement Tool for Financial Inclusion in Mexico”

John Bosco Sebabi  
Former Director General, Operations Directorate, National Bank of Rwanda  
“Mobile Money as a Gateway to Financial Inclusion in Rwanda”

Elly Ohene-Adu  
Head, Banking Services and Payment Systems Oversight, Bank of Ghana  
“Reassessing the Guidelines on Branchless Banking in Ghana to Advance Financial Inclusion”

Barbara Gowaseb  
Director of Payments and Settlement Systems, Bank of Namibia  
“Accelerating Namibia’s Readiness to Embrace a Cash-lite Society to Facilitate Financial Inclusion”

**Proportionate Regulation**

Kennedy Joseph Komba  
Advisor, Payment Systems, Bank of Tanzania  
“Enhancing Financial Inclusion through Proportionate Policy and Regulatory Framework in Tanzania”

Alok Misra  
Chief Executive Officer, Mico-credit Ratings International  
“Let a Thousand Flowers Bloom: Changing the Orbit and Speed of Financial Inclusion in India”
Davlatov Iskandar
Director, National Banking Supervision Sector, National Bank of Tajikistan
“Financial Inclusion in Tajikistan: Challenges Today and Opportunities for Tomorrow”

Maria del Pilar Galindo Vergara
Advisor to Deputy Minister, Ministry of Finance and Public Credit, Colombia
“Access to Transactional Services: The First Step toward Sustainable Financial Inclusion”

Demand-side Considerations: Consumer Protection, Financial Education, Client Preferences

Frezer Ayalew Mohammed
Director, Microfinance Institutions Supervision Directorate, National Bank of Ethiopia
“Enhancing Financial Inclusion through Implementation of a Sustainable Financial Education and Literacy Program”

Simon Tiwok
Manager for Domestic Markets and Financial Inclusion, Reserve Bank of Vanuatu

Armenuhi Mkrtchyan
Head of Consumer Protection and Market Conduct Division, Central Bank of Armenia
“Balancing Demand and Supply Side Factors as Key to Effective Financial Inclusion: The Case of Armenia”

Gabriel Sergio Arrisueño Fajardo
Director General of Quality of Social Services, Ministry of Development and Social Inclusion of Peru
“Branchless Banking in Peru: Opportunities and Challenges for Financial Education at the Bottom of the Pyramid”

National Strategy

Joseph Abdul Alih Attah
Assistant Director and Head, Microfinance Management Office, Central Bank of Nigeria
“Implementing the National Financial Inclusion Strategy: The Nigeria Experience”

Md. Habibur Rahman
Deputy General Manager (Research), Bangladesh Bank
“Financial Services for the Unbanked: Problems and Prospects in Bangladesh”
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Cash-lite: Mobile Money and Electronic Payments
ENHANCING FINANCIAL INCLUSION THROUGH MOBILE G2P\(^1\) PAYMENTS IN THE WEST AFRICAN ECONOMIC AND MONETARY UNION (WAEMU)

Maimouna Gueye

*Senior Financial Analyst, Central Bank of West African States (BCEAO)*

Mamadou Ndiaye, a rural resident in Senegal and a pension plan beneficiary, spends 4 hours in travel and 6 hours standing in line to receive his payment in cash from the social security administration office in Dakar. The popular statement that “time is money” still has value nowadays as the time spent in cashing out a payment, in many cases, is higher than it should be with the advent of new technologies.

Despite the payment system reform and the legal framework advocating the use of electronic payment methods in the West African Economic and Monetary Union (WAEMU),\(^2\) cash is still the main medium to resolve financial transactions, either among businesses, persons, or government bodies. Yet, governments are the first payers of expenses in any country.

CGAP found that 45 percent of G2P programs launched use an electronic payment mechanism that creates a foundation on which a financially inclusive account can be offered.\(^3\)

In fact, “the proposition for converting to electronic payments has often been considered the most compelling for government out of all stakeholder groups, because governments at all levels receive and make so many payments to different types of stakeholders” (Porteous, 2012).

This memo proposes a strategy for the development of mobile government payments as a way to enhance financial inclusion in WAEMU countries. After a brief description of the background of financial services in WAEMU, it states the cost opportunities of the continued use of cash by governments and suggests the main steps to expanding financial inclusion based on mobile G2P payments.

Background of Financial Services in WAEMU

Types of Government Payments in WAEMU

In WAEMU, government payments can be divided in three major types: The first category involves payments from one government unit to another government unit (G2G), also called transfers. These refer to domestic intra governmental payments. The second category refers to government expenditures (G2P/G2B) such as income tax refunds, salaries, pensions and social security payments. Lastly, payments to government by persons or businesses are classified as (P2G) or (B2G). This paper will focus on G2P/G2B as they are believed to have a higher impact on people and small businesses’ access to finance. According to a regional consultation tour undertaken by BCEAO between October 2011 and September 2012 with public administrations in the region, general needs for electronic payments have been reported in three areas: financial, health services and education services.

Financial Landscape in WAEMU\(^4\)

The region has made relatively little progress in recent years in extending financial services to the unbanked, as access to financial services has grown from 8% to 18% between 2004 and 2011. Within the past 10 years, the number of banks have reached 107 and the number of microfinance institutions almost 800. Today, there are approximately 8,000,000 bank accounts, 12,000,000 microfinance accounts and 3.5 million mobile money accounts. In addition, the
number of ATMs and POS per inhabitant is relatively low compared to developed countries, revealing scarce access to financial points of service. The impact of this scarcity is a profound reliance on cash usage and informal money transfer services by the population and the respective government offices.

**High Mobile Penetration and Mobile Money**

If financial services are not largely widespread in the region, member countries are nonetheless subject to an important mobile telephony penetration as 17 mobile operators are licensed in the region providing on average 70% connection rate. Today in WAEMU, mobile money has reached over 7,000,000 subscribers between 2008 and 2012 accountable to 14 providers. Compared to a population of approximately 100 million people, the subscription rate to mobile money comes up to 7%. However, it is believed by the GSMA that the mobile industry in the region is an economic development enabler as it contributes largely to national GDP.

**An Enabling Legal Context for the Uptake of Government Epayments**

In WAEMU, the legal reform has played a leading role in the uptake of financial inclusion. In fact, the Payment System Act is backed by a Directive enacted on September 2002, that specifically targets the use of electronic means of payments by public administrations with their employees, agents, partners and taxpayers.

**Problem Statement**

**Opportunity Cost of Operating in Cash**

According to BCEAO 80% of the population are still excluded from formal financial services. Many governments today in the WAEMU still pay expenses in the form of cash, particularly in remote areas where bank services are lacking. The excess use of cash puts a burden on the cost of handling for the Central Bank, reduces security for the user and puts a veil on transparency for governments. In many cases, it had been reported that scholarship beneficiaries can incur fraud when their monthly allowances are processed in cash.

The dialogue engaged with government offices (National Treasury, social security administrations, national education) has revealed a strong need to safely and securely conduct financial transactions. In fact, in many WAEMU countries, the use of cash by the government is done in remote areas where banking infrastructure is lacking. Buses are deployed in rural areas to conduct salary payments in the form of cash. Such operations can raise important security risks possibly leading to terrorist attacks.

Finally, the excess of cash in lieu of emoney, is reported to be less efficient in terms of time consumption and cost of processing. Pension beneficiaries in Burkina Faso, evaluated at 50,000 spend many hours standing in long queues, awaiting to be paid.

**Challenges to the Development of Mobile Money among Government Entities**

Besides the cost of cash usage, several challenges prevent the uptake of use of mobile money issued by governments. Some important constraints can be cited as follows:

- lack of innovation and implication of the private sector: banks, emoney issuers and telcos;
- lack of confidence in the banking system by potential subscribers and addiction to cash;
- insufficient knowledge of the market and consumer behavior by the regulator and the private sector;
- limited agent network.

Based on the above, the Central Bank of West African States has defined a global policy to promote mobile financial services as a leverage to achieve better financial inclusion.
In this respect, this memo advocates several policy actions that could be undertaken by the Central Bank, the private sector and the respective WAEMU governments in order to eradicate the issues raised in promoting mobile G2P payments.

**Recommendations**

Mobile financial services strategies have the potential to catalyze significant improvement in financial inclusion for households and enterprises through a coordinated, prioritized and comprehensive framework of actions that ensures maximum impact within resource constraints. An optimal financial inclusion strategy should bring together initiatives from the public sector, financial and non financial institutions and other stakeholders to expand and improve financial inclusion while maintaining sufficient focus on financial stability, integrity and market conduct.

Many G2P programs conducted in countries like India, Mexico and Columbia, have not encountered sustainable success mainly because of the recipients beliefs that the money should be cashed out at once. In addition, lack of an existing and connecting channel of payment (merchants, POS,) brought recipients to cash out at once. This social behavior prevented the transformation to the cash-lite economy pursued.

In this prospect, the upscale of G2P payments to enhance financial inclusion, in our view, should rely on the followings steps:

- Awareness and sensitization on e-money usage, key learnings from pioneer countries;
- Leverage on existing accepting infrastructure;
- Encourage public and private sector partnership;
- Implement and progress monitoring.

**Awareness and Sensitization on E-money Usage, Key Learnings from Pioneer Countries**

Despite the speed of growth in mobile telephony penetration, the appearance of new technologies in WAEMU is fairly recent. The first licensed e-money institution came into business in the year of 2006, yet the general awareness of e-money is still at an early stage today.

Rolling out successful a G2P program in WAEMU will heavily depend on the moral acceptance of e-money as a payment method. For such to happen, the States and Central Bank should design an awareness campaign involving various promotional materials. BCEAO should publicly announce its validation of mobile financial services as the case was done by the Central Bank of Kenya when “M-Pesa” was launched.

On another hand, building on pioneer countries experiences in G2P, the awareness message should encompass the existence of a payment acceptance network and reassurance that single cash outs are not necessary nor compulsory so as to build confidence in the new system.

**Leverage on Existing Accepting Infrastructure**

The existing payment landscape should be integrated in the roll out plan for G2 Payments. All ATM and POS should be upgraded to accept payments or transfers from a G2P recipients. The GIM-UEMOA network as well as the private payment networks should be mandated by BCEAO to make necessary connectivity changes to their systems.

**Public and Private Sector Partnerships and the Role of the Central Bank**

A 2012 CGAP report on branchless banking in WAEMU showed that banks are not sufficiently involved in the provision of retail payments. There is particular need to capture the demand for government expenditures. For such to happen, the dialogue among stakeholders must take place in order to unveil opportunities underlying in this industry. E-money issuers and banks in WAEMU are licensed to process all electronic payments including mobile payments. In Burkina Faso, for instance, negotiations have been engaged between INOVA, an e-money issuer, and the
Government for the processing of pension payments. However further operations are needed to capture sufficient volume so as evolve toward a cash-lite society.

As to telcos, as mentioned earlier, they hold more than half of mobile money offerings in the region, however very few are involved in government payments. Meanwhile, discussions with the government could raise up solutions to process G2P more efficiently based of mobile technology.

The regulator would have clarified the validity of mobile financial services to the general public, more specifically to the respective government entities so as to reduce reluctance from governments to sign contracts with emoney issuers and telcos as it has been have been reported as an impediment to G2P and G2B impaments. Confidence in the payment instrument is a key concern for governments as they need to be assured payments will be done safely, meaning that the right individual and firm receiving a payment from the government is properly recognized, and that the amount intended to be paid or received is processed in a timely manner.

Implementation and Progress Monitoring

Government payments are important in both developed and developing economies. The relative importance of government payments is naturally correlated to the size and influence of the government in the overall economy, which is usually measured in terms of GDP and or tax collections as share of the GDP.

Based on the importance of G2P payments in WAEMU, the regulator (BCEAO) should consider drafting a global strategy in which the implementation and progress monitoring would be gradually taken in charge by respective governments of each state.

Such strategy should be based data collection as the first step toward promoting mobile G2P and government payments in general. However result measurement should be done using sound indicators, inspired from the international financial inclusion indicators. A pilot program in each country could be built up in order to learn progressively from respective previous experiences.

Overall, the potential to enhance financial inclusion through mobile G2P payments in WAEMU will depend on the regulator’s capacity to leverage on existing strengths and opportunities (high mobile penetration, rapid growth of mobile money, existing needs among states) in order to tackle challenges identified. This capacity lies on the design of a sound strategy to be implemented progressively among member states.

References

Guidelines for the development of government payment programs, The World Bank, July 2012


BCEAO report on mobile banking, 2012

CGAP report on branchless banking in WAEMU, June 2012

Beyond financial inclusion the promise and practice of inclusive cash-lite, Davis Porteous, August 2012

Endnotes

1. G2P: government to person
2. Benin, Côte d’Ivoire, Togo, Senegal, Mali, Niger, Guinee Bissau, Burkina Faso
3. Banking the poor via G2P payment, CGAP 2009
4. Data from BCEAO
6. BCEAO and IFC compiled data
8. Source: INOVA emoney issuer
9. Groupeoment Interbancaire Monétique (GIM-UEMOA), Regional Interbank Card Payment Network
THE DEVELOPMENT OF A DEMAND-SIDE SURVEY AS A MEASUREMENT TOOL FOR FINANCIAL INCLUSION IN MEXICO

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Introduction

Financial inclusion is increasingly recognized as a key point on the development agenda of most countries, considering its positive effect on economic growth and its impact in society. Governments, multilateral agencies, and non-governmental organizations (NGOs) are making ongoing efforts to identify and develop public policies that facilitate the access and usage of financial services among the most excluded population.

Policymakers and regulators need information to identify barriers that limit the development of an inclusive financial system. The existence of a national measurement tool regarding the usage of financial services will result in better official indicators at a national level that will allow the diagnosis and establishment of short- and long-term goals.

This document highlights Mexico’s experience in the development of the National Survey for Financial Inclusion, 2012 [Encuesta Nacional de Inclusión Financiera (ENIF) 2012] as a measurement tool for financial inclusion.

The objective of this memo is to recommend that policymakers and regulators develop a demand-side survey to generate an analysis that allows the design of public policies that promote financial inclusion and adequate products and services for the benefit of consumers, particularly those excluded from the formal financial system.

Background

Most recent studies at an international level gather indicators of access to financial services, although to a lesser extent regarding the usage of such services. For example, the Consultative Group to Assist the Poor (CGAP) gathered supply-side data from approximately 142 countries, including Mexico.\(^2\) Another recent effort is the data collection exercise of the Financial Access Survey (FAS) project aimed at gathering basic geographical and demographic data related to access to financial services worldwide carried out by the International Monetary Fund (IMF).\(^3\) The FAS database currently contains annual data for 187 jurisdictions and its purpose is to allow comparisons among countries and for different dates through these regular surveys.

Most existing demand-side studies try to measure financial inclusion by using data at a macroeconomic level. Although these measurements are useful to carry out comparisons among countries, they rarely provide the deep detail needed to design public policies.

However, there are initiatives for specific efforts. The World Bank (WB) presented the Global Financial Inclusion Index (Global Findex),\(^4\) which is a set of demand-side indicators that measure the usage of financial services in 148 countries. The survey covered at least 1,000 adults in each of 148 economies. This effort will help to make comparisons among countries of the degree of financial inclusion and will motivate the countries to develop projects to collect additional data on specific topics pertaining to their own country’s context in order to design appropriate public policies.
Although recent international efforts provide better quality in the measurement of financial inclusion, countries interested in increasing both the supply and the demand of financial services for their population will need to compile information regarding access and usage of financial services and products by using national surveys.

**Analysis**

Only with complete, statistically precise data that considers the context of the country or region will public policies be designed to obtain greater economic development and growth, with the purpose of reducing poverty.

As long as the available data increases, there will be more opportunities to carry out deep financial inclusion analyses. Surveys on access and usage of financial instruments and services may allow a thorough assessment of the impact of access to finance at a national and regional level.

Mexico generates supply-related data on a regular basis: financial regulators collect data obtained by banks and formal financial institutions through reports, which are analyzed and used internally for monitoring purposes as well as for comparing the penetration of the banking infrastructure within each entity and studying the behavior patterns among different population segments. Although the information obtained from the reports is broad, it offers only a one-sided perspective on access to finance inclusion; it is not so efficient when providing data on usage patterns.

In this context, in 2012, Mexican financial authorities developed a National Survey for Financial Inclusion that aimed to obtain fundamental information from adults users and non-users of financial services in order to have a complete picture of the scope, challenges, and opportunities available to design better public policies regarding the use and access to financial services and products.

The effort was coordinated by the Ministry of Treasury and Public Credit [Secretaría de Hacienda y Crédito Público (SHCP)] through the National Banking and Securities Commission of Mexico [Comisión Nacional Bancaria y de Valores (CNBV)] and technically executed by the National Statistics and Geography Institute [Instituto Nacional de Estadística y Geografía (INEGI)].

For the development and implementation of a national survey, it is necessary to take advantage of the institutional capacity of each country. In Mexico, INEGI is a recognized agency by the population as the official entity in charge of the surveys in the country: population censuses, economic censuses, surveys, statistical indicators, etc.

Mexico (CNBV and INEGI) and the World Bank worked together to design the survey, taking into account similar exercises conducted in other countries in Asia (Indonesia and Malaysia) and Africa (Ghana and South Africa) but adapting it to Mexican culture and information needs.

The main purposes of the ENIF 2012 are the following: (a) identifying the population needs in regards to access to and usage of financial services in rural and urban areas, as well as at different socioeconomic levels (high, medium high, medium low, and low); (b) providing data on savings, credit and insurance products, pension funds, and their channels; (c) becoming familiar with the characteristics of the users and non-users of financial products and services; and (d) exploring some barriers that limit the access to and usage of the formal financial system.

The survey is targeted at individuals instead of households or heads of households. This is due to the heterogeneous structure of Mexican society. It is estimated that there are 28.1 million households in the country: one out of every ten are households with no kinship while the rest are family households; however, 25% of such households have an extended structure.
The questionnaire includes the following topics:

- residents and households in dwelling
- sociodemographic characteristics of the household members
- sociodemographic characteristics of the selected member
- financial capabilities
- usage of financial products and identification of barriers
- usage of remittances
- access to financial channels
- financial education and consumer protection

The ENIF 2012 was conducted from May 3 to May 31, 2012. The survey results provide data that will be the baseline to provide official metrics of the financial inclusion level in Mexico; with this, a foundation is created to develop public policies promoting greater financial inclusion.

The following are the current financial inclusion indicators in Mexico:

**Access Indicators (Coverage)**

- Total access points: the sum of the total of branches, ATMs, and agents.
- Demographic indicator: number of access points per 10,000 adults.
- Municipalities covered: percentage of municipalities with at least one access point.
- Adults covered: percentage of adults living in municipalities that are covered compared to total adults.

Mexico’s financial access landscape has shown marked improvement over the past few years, as revealed by the information obtained from regulatory reports since 2009. As indicated in Table 1, the coverage of municipalities with at least one access point increased from 1,242 out of 2,456 in 2009 to 1,654 in September 2012.7

**Table 1. Access Points Trend, 2009 to 2012**

<table>
<thead>
<tr>
<th>Year</th>
<th>Municipalities with branches</th>
<th>Municipalities with branches and banking agents</th>
<th>Municipalities with branches, banking agents and ATMs</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>1,054</td>
<td>1,054</td>
<td>1,052</td>
</tr>
<tr>
<td>2010</td>
<td>1,052</td>
<td>1,050</td>
<td>1,054</td>
</tr>
<tr>
<td>2011</td>
<td>1,046</td>
<td>1,046</td>
<td>1,049</td>
</tr>
<tr>
<td>2012</td>
<td>1,049</td>
<td>1,095</td>
<td>1,140</td>
</tr>
</tbody>
</table>

Source: CNBV, Mexico
Usage Indicators

- Number of savings accounts per 10,000 adults.
- Number of debit cards per 10,000 adults.
- Number of credit accounts per 10,000 adults.
- Number of retirement savings accounts per 10,000 adults.

Table 2. Access Points, September 2012

<table>
<thead>
<tr>
<th>Total adult population</th>
<th>79.8 M (100%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total municipalities</td>
<td>2,456 (100%)</td>
</tr>
</tbody>
</table>

| Adults with possibility of access points (%) | 90.9% | 95.4% | 96.7% | 97.6% |
| Adults with possibility of access points (Mill.) | 72.6 M | 76.1 M | 77.2 M | 77.9 M |
| Municipalities with access points (%) | 46.4% | 62.1% | 67.4% | 72.6% |
| Municipalities with access points (#) | 1,140 | 1,525 | 1,654 | 1,784 |

Source: CNBV, Mexico

Some relevant results of the ENIF 2012 are the following:

- At a national level, 56% (39 million) adults are users of a financial product (savings, credit, insurance, or retirement savings).
- 35% (24 million) adults have formal saving products.
- 27% (19 million) adults have a formal credit with a financial institution.
- 22% (15 million) adults are users of some kind of insurance.
- 27% (19 million) adults have retirement savings account.

This measurement exercise is the first step toward generating sound and reliable data on the current situation of financial inclusion in Mexico. In this regard, financial authorities are working together to develop new measurements and public policies to promote a sound and inclusive financial system to benefit the population of the country, especially those segments that are excluded from the formal financial system.

Having detailed data will be the baseline to provide sound indicators of the financial inclusion level in Mexico that allows financial authorities to establish short- and long-term goals in regards to access and usage of financial services. In this regard, identifying the barriers to access and usage of formal financial services and products will aid in the development of public policies that promote an inclusive financial system, to benefit Mexican society and encourage economic growth.
Recommendations

The need for increased financial inclusion data requires the design of specific surveys to measure financial inclusion in a reliable and consistent way, and thus offer data aimed at increasing financial inclusion in a sustainable manner. The lessons learned from experiences in other countries are very useful; however, the experience in the country itself provides better lessons.

Policymakers and regulators should consider developing a demand-side survey to measure financial inclusion. The results will generate data on specific topics pertaining to the own country's context that are useful for the design of appropriate public policies aimed at increasing financial inclusion for the benefit of consumers, particularly those excluded from the formal financial system.

Endnotes

MOBILE MONEY AS A GATEWAY TO FINANCIAL INCLUSION IN RWANDA

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Introduction

Mobile phone usage is fast sweeping through the developing world. This mobile revolution is not only influencing communication but making a huge impact on the channels of delivery of financial services all over the developing world. It is easily becoming the most popular way to send money from family members living in urban centers to the rural dwellers. It has taken off in a dramatic way in countries where rural-urban migration is common because of the ease of remitting funds back home. The reliability, portability, and convenience of the mobile phone makes it a more user friendly instrument and easily adoptable for any service including payment and banking services. In many jurisdictions, there are more mobile phone users than there are bank account holders and payment card holders.

Financial inclusion loosely means that most or all the population can access financial services such as credit, savings, and payment services. This implies that they must have some form of monetary balances in a financial institution. The FinScope Rwanda 2012 survey defines financial inclusion as access to both formal and informal financial services. However, the study adds that financial inclusion initiatives are mostly geared toward banking transactions taking place at formal financial services.

According to the African Development Bank, “Mobile money is fast becoming the consumer’s payment service of choice due to the establishment of multiple access points, minimal cost, and service availability.” The above conclusion stems from the massive usage of mobile phones in general, as it is believed that 60% of the world’s mobile phone usage is in developing countries.

This paper sets out to advocate the adoption, promotion, and linkage of mobile money (MM) to formal financial services as the most appropriate gateway to achieving financial inclusion and comparing its usage to traditional banking services. The methodology used in this paper is that of collecting evidence through statistics of traditional banking versus mobile money using the existing figures and making a comparison as far as growth of either channel.

The paper takes the case of Rwanda and uses data on mobile money account subscribers, the number of bank accounts, the total number of mobile phone subscribers, and the total national network coverage. Reference is made to the East African region because it is believed that the most success stories in mobile money emanated from East Africa, in particular M-PESA in Kenya. Therefore, a snapshot of the following country demographics as far as mobile money is concerned is displayed in some tables. The targeted audience includes telecommunication companies (telecom), telecommunication regulators, banks, the Central Bank, and other policymakers (ministry of Finance and Economic Planning and Ministry of Information, Communication, and Technology) whose policies largely influence the development of the financial sector and ultimately financial inclusion.

Background

There is a significant gap in the traditional financial infrastructure [automated teller machines (ATMs), point of sale (POS) systems, and bank branches] in Africa and Rwanda in particular. The lack of ATMs, POS, and other traditional/conventional banking facilities in Rwanda has made
mobile money a better option to send and receive money. This is also spreading to obtaining other services like buying electricity, airtime, and paying for goods in shops. The table below depicts the situation in the East African countries.

Table 1.

<table>
<thead>
<tr>
<th>Country</th>
<th>Population</th>
<th>Access to formal banking services</th>
<th>Number of branches</th>
<th>Number of cell phones (estimated)</th>
<th>MM subscribers (estimated)</th>
<th>MM as % of the population</th>
<th>Number of “agents” (estimated)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rwanda</td>
<td>approx. 10 million</td>
<td>42.7%</td>
<td>14</td>
<td>580</td>
<td>5.1 million</td>
<td>1.6 million</td>
<td>16</td>
</tr>
<tr>
<td>Burundi*</td>
<td>8 million</td>
<td>2.5%</td>
<td>11</td>
<td>114</td>
<td>1.6 million</td>
<td>300,000</td>
<td>3*</td>
</tr>
<tr>
<td>Kenya*</td>
<td>38.6 million</td>
<td>41%</td>
<td>43</td>
<td>1200</td>
<td>20 million</td>
<td>17 million</td>
<td>44*</td>
</tr>
<tr>
<td>Uganda*</td>
<td>32 million</td>
<td>31%</td>
<td>22</td>
<td>377</td>
<td>14 million</td>
<td>2.1 million</td>
<td>6.5*</td>
</tr>
<tr>
<td>Tanzania*</td>
<td>40.7 million</td>
<td>22%</td>
<td>42</td>
<td>349</td>
<td>19 million</td>
<td>3.2 million</td>
<td>8*</td>
</tr>
</tbody>
</table>

*The Statistics for Burundi, Kenya, Uganda, and Tanzania are for 2010.

Whereas banks have been in existence for several decades in the East African region, mobile money started in late 2007 in Kenya and in 2010 in Rwanda. Taking Rwanda as an example, total bank accounts are in the region of 2,584,287 for all traditional commercial banks as compared to approximately 1,200,000 mobile money subscribers in barely three years. The figure above (1.2 million MM users) is as at end 2012; the figure has risen to 1.6 MM users at the end of March 2013. This depicts an increase of more than 120,000 subscribers per month.

**Statement of the Problem**

Independent of the fast growth in mobile money, financial inclusion through access to formal financial services is only 42%.

The same study puts total access to financial services including informal means at 71.2%. The formal channels include all licensed banks, micro finance institutions (MFIs), and savings and credit cooperatives (SACCOs). There is currently a noted gap between mobile money and licensed financial institutions services. Only 5% have used mobile money to send and receive money; however, 38% trust mobile money. The infrastructure required for banks to cover the total surface area of Rwanda can be expensive. Consequently, since mobile network coverage is very high, the answer to financial inclusion may lie in promoting, adopting, and linking between mobile money and licensed financial institutions.

**Detailed Analysis**

In analyzing the trend of mobile money, we need to consider the aspects of cost, convenience, reliability, and the use of agents.

**Cost**

The cost of doing traditional/conventional banking is generally far higher than the cost of transacting through mobile money. The table below show a snapshot of the tariffs of the basic services from different mobile network operators (MNOs) that offer mobile money services in Rwanda, denoted in Rwandan Francs. These are costs that are borne by the client and emanate from the demand side.
In the next series of tables, we show costs from traditional banking and other money transfers. The banks usually charge account management fees whereas the MM service providers do not charge any fees on maintaining a mobile money account.

Table 2. MTN

<table>
<thead>
<tr>
<th>Service</th>
<th>MIN</th>
<th>MAX</th>
<th>COST</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deposit cash</td>
<td>500</td>
<td>500 000</td>
<td>0</td>
</tr>
<tr>
<td>Send money to registered MM user</td>
<td>500</td>
<td>500 000</td>
<td>250</td>
</tr>
<tr>
<td>Send money to non MM user including buying services</td>
<td>500</td>
<td>1 500</td>
<td>350</td>
</tr>
</tbody>
</table>

Table 3. TIGO

<table>
<thead>
<tr>
<th>Service</th>
<th>MIN</th>
<th>MAX</th>
<th>COST</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deposit cash</td>
<td>500</td>
<td>300 000</td>
<td>0</td>
</tr>
<tr>
<td>Send money to registered MM user</td>
<td>500</td>
<td>300 000</td>
<td>0.07%</td>
</tr>
<tr>
<td>Send money to non MM user including buying services</td>
<td>500</td>
<td>300 000</td>
<td>11%</td>
</tr>
</tbody>
</table>

Table 4. Account Management Fees from Selected Banks in Rwanda

<table>
<thead>
<tr>
<th>Institution</th>
<th>Fees Per Month (Rwandan Francs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank of Kingali</td>
<td>1000</td>
</tr>
<tr>
<td>Kenya Commercial Bank</td>
<td>1000</td>
</tr>
<tr>
<td>Banque Commerciale du Rwanda</td>
<td>1500</td>
</tr>
<tr>
<td>Banques Populaire du Rwanda</td>
<td>475</td>
</tr>
<tr>
<td>Equity Bank</td>
<td>Free of charge</td>
</tr>
<tr>
<td>COGE Banque</td>
<td>600</td>
</tr>
<tr>
<td>Fina Bank</td>
<td>1500</td>
</tr>
<tr>
<td>Ecobank</td>
<td>1000</td>
</tr>
<tr>
<td>Access Bank</td>
<td>1000</td>
</tr>
</tbody>
</table>
It is clear that the cost of transacting through mobile money is much less than the cost of conventional banking from the demand side. On the supply side, the comparison can be easier assessed from the banks rather than the telecom (MNOs). In order for a bank to extend banking services, there is a need to invest in “brick and mortar” branches, with all the inherent costs (rent, services such as electricity and water, installation of ATMs, and the general laying of the required network). All the above increase the operating costs of the banks and this falls on to the consumer, who often finds the cost of banking high and opts for the alternative of being financially excluded.

Moreover, mobile money has impacted the cost of transport. Often people do not have to drive long distances to deliver money but rather can transfer funds using their mobile phones. This has a significant impact on the general cost of transactions.

Table 5. Charges on Money Transfers by “Stand Alone” Remittance Service Providers

<table>
<thead>
<tr>
<th>Institution</th>
<th>Pricing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Western Union</td>
<td>Min 15 USD 23USD: 200USD 54USD: 1000USD</td>
</tr>
<tr>
<td></td>
<td>Max 212 USD for 5000USD (max)</td>
</tr>
<tr>
<td>MoneyGram</td>
<td>Min 6500Rwfs 8,000Rwfs: 100,000 Rwfs 27,500 Rwfs: 500,000Rwfs</td>
</tr>
<tr>
<td></td>
<td>Max 136,000Rwfs for 3millions rwfs (max)</td>
</tr>
<tr>
<td>RIA</td>
<td>1.8% of transferred amount</td>
</tr>
<tr>
<td>MoneyTrans (Amasezerano and Virunga)</td>
<td>5 Euro for any transferred amount</td>
</tr>
<tr>
<td>Dahabshiil Rwanda Ltd</td>
<td>USD 1–50: USD3</td>
</tr>
<tr>
<td></td>
<td>USD51–100: USD5</td>
</tr>
<tr>
<td></td>
<td>USD1011–1510: 2.7%</td>
</tr>
<tr>
<td></td>
<td>USD 4511–5000: 1.2%</td>
</tr>
<tr>
<td>UAEXCHANGE Rwanda Ltd</td>
<td>Up to US 1,000: USD 15</td>
</tr>
<tr>
<td></td>
<td>USD 2000 Above: USD 20+0.3%</td>
</tr>
<tr>
<td>Express Union Rwanda Ltd</td>
<td>USD 1 to 100: USD 5</td>
</tr>
<tr>
<td></td>
<td>USD 201 to 300: 5%</td>
</tr>
<tr>
<td></td>
<td>USD 4,001 to 5,000: 1.7 %</td>
</tr>
<tr>
<td>Rwanda Cash Ltd</td>
<td>Euros 1,000: Euros 45</td>
</tr>
<tr>
<td>BAKAAL Rwanda Ltd</td>
<td>USD 1–50: USD 3</td>
</tr>
<tr>
<td></td>
<td>USD 51– 300: 5%</td>
</tr>
<tr>
<td></td>
<td>USD 4001–5000: 1.15%</td>
</tr>
</tbody>
</table>
Convenience

Mobile money transactions can take place anywhere and at any time—in the comfort of one’s bedroom or office, a transaction is completed. This convenience is what has made mobile money such a success. In many jurisdictions, there are less “Know Your Customer” (KYC) requirements for mobile money users than traditional banking.

Reliability

Whereas traditional banks are concentrated in urban centers and their network is limited therein, the mobile network operators cover almost over ninety percent of the Rwandan territory. This implies that any customer who is registered to any of the three mobile money platforms can transact in more places than if he or she was to use a traditional bank.

Use of Agents

The use of agents further ensures that mobile money goes closer to the people than conventional banking. The agents are usually the folks who are known around the villages and hence people feel comfortable using their services. The traditional brick and mortar branches often appear alien to people and create resentment. The use of agents has therefore further increased the usage of mobile money.

Conclusion and Recommended Policy Options

Deducing from the above discussion, there is no doubt that mobile money is more convenient, cheaper, and appealing to people in developing countries. The bulk of the people in developing countries with low incomes are excluded from the formal banking system because they largely live from hand to mouth. They view the banks and other financial institutions as places where people with large incomes put money to save and obtain credit. The poor do not see themselves as bank clients, and the banks have not done much to woo them. The incomes of the rural poor are for consumption only and that’s the reason mobile money has picked up. Their urban counterparts can spare little to send back home to their rural relatives.

Consequently, the following are the proposed policy options:

1. The linkage of mobile money to traditional banking. This will ensure that people with low incomes who want to pay for goods and services keep their funds in financial institutions with confidence that they will be able to conveniently pay for those goods and services. Today, we have cards that can read the holder’s account in real time. For mobile money to make an impact on the poor, the same linkage needs to be established between mobile money and financial institutions. This implies that individuals should use their mobile to pay directly from their accounts at banks and/or micro finance institution. To achieve this, the banks, telecom, and the regulators need to come out and advocate this policy in the same manner cards are encouraged the world over. The regulators need to determine the use and purpose of mobile money as any other payment instrument and set strategies for mobile money promotion as opposed to treating mobile money as a transfer only remittance. Banks are financial intermediaries; they collect funds/savings from savers and lend them out. For this to happen efficiently, for a couple of reasons, the banks need to collect funds from small savers who are usually excluded. Firstly, the cost of such funds is not usually high as compared to the rates offered to big savers. Here the banks need to consider volumes rather than large values that are costly and often auction their funds. Secondly, the large companies that put funds into the banks at high interest rates need to be incentivized to put these resources into secu-
rities either at the primary dealership or at the secondary market on the stock exchange. This approach needs to be a collective action by the Central Bank, banks, and the capital markets authority.

2. **Encourage the use of agents even for the banks.** Traditional bank branches tend to scare away the locals. MNOs and banks should deploy more agents, which will reduce their cost of operations and attract low-income clients as well. The use of agents should be encouraged by the Central Bank through the issuing of light regulations and massive education of the agents on financial stability. The key actors and beneficiaries in this space are the MNOs, banks, agents, and all spearheaded by the Central Bank.

3. **Development of microfinance institutions and savings and credit cooperatives.** This will link the poor to mobile money services which will further the cause of financial inclusion—in the Rwandan case, regulatory agencies of the MFIs and telecoms (MNOs). The Central Bank and the Rwanda Utilities Regulatory Agency need to bring all the MFIs and MNOs to the drawing board and drive the cause. However, this may need some rather massive investments, as they drive mobile money usage through MFIs and MNOs. The regulatory agencies need to determine who should shoulder some of the investments as an incentive.

Given the policy options above, if taken in tandem and considering the advantages of mobile money, we stand to see the already high growth of mobile money continue to increase. Lastly, we can conclude that linking the widely used mobile money to the licensed financial institutions, allowing customers to pay for goods and services directly from their accounts, will ensure financial inclusion due to its convenience and adaptability.

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**Endnotes**


2. African Development Bank

RE-ASSESSING THE GUIDELINES ON BRANCHLESS BANKING IN GHANA TO ADVANCE FINANCIAL INCLUSION

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Head, Banking Services and Payment Systems Oversight, Bank of Ghana

Introduction

Mobile Financial Services (MFS) have been rolled out successfully in some emerging economies, notably, Kenya, Pakistan and the Philippines, with significant benefit to the lives of the poor and unbanked societies of those countries. In Ghana, however, the story is different. While widely used in Ghana, mobile phones, have failed to make inroads in MFS and the needed impact on financial inclusion. A number of Mobile Network Operators (MNOs) in Ghana branched into mobile money (m-money) transfer services during the mid-2000s. The central bank sees this as an opportunity to harness funds from the informal sector into the formal banking system and bring banking services to the unbanked poor of Ghana. However, it also presents a challenge on how the sector can be monitored and regulated effectively to allow innovation and development without sacrificing safety and efficiency.

Problem Statement

The financial authorities in Ghana, in 2008, issued the Guidelines for Branchless Banking (BB). The guiding principles underlying the drafting of the regulation were safety, soundness and interoperability. In spite of the existence of the Branchless Banking Guidelines, however, MFS have not seen any significant growth as is seen elsewhere (See Appendix). What then, are the barriers to the achievement of success and scalability in MFS in Ghana?

This memo seeks to create awareness for Government and regulatory authorities of the need to employ more flexible regulation to serve as a catalyst for the growth of financial inclusion in Ghana. The paper describes problems inherent in the existing regulations and brings attention to the tensions they create which have a negative impact on financial inclusion and, therefore, on economic empowerment and growth. It draws primarily on empirical evidence from Ghana and various countries where MFS are both developed and underdeveloped, as well as research analysis/results of financial inclusion experts and writers. The paper concludes by offering some recommendations to address the problems described.

Background

The Finscope Ghana survey of 2010 surmised that 56% of adult (18 years and above) Ghanaians have access to financial services (41% in the formal sector and 15% in the informal sector) while a good 44% do not have access. The survey further shows that only 34% of Ghanaians have a bank account.

In contrast, it is estimated that about 80% of the population have access to a mobile phone. This in itself constitutes a vast potential to widen access to financial services to much of the 44% of adult Ghanaians who are not financially served. There are currently 3 MNOs partnering with a total of 12 banks to provide mobile financial services. Mobile Telephone Networks Ltd. (MTN), the leading telecommunications company (telco) in the MFS space, is in partnership with 9 banks while Airtel and Tigo have 6 and 3 banks respectively. The main product offerings are
funds transfers, from mobile wallet to other wallets within each network and to other networks, top-up of airtime, and bill payments. Since 2011, MTN has been offering transfers from/to mobile money wallets to/from actual bank accounts. They also offer microfinance facilities to customers and, at least two of the MNOs are looking to start inward international remittance services.

Since the rollout of MFS, however, mobile money subscribers in Ghana number only about 3 million, with less than 200,000 active users, and an agent population of just over 10,000. In comparison, M-PESA has grown rapidly from 2007 when it was launched in Kenya, to a subscriber level of 14 million by the middle of 2011. Available information shows that the unbanked population who use M-PESA increased from 21% in 2008 to 75% in 2011. Similarly, the agent network ballooned to about 28,000 in the same period.

The Branchless Banking Guidelines
The Guidelines were essentially, a notice to banks and savings and loans companies to provide guidance and to regulate branchless banking business. The Guidelines therefore advocate a bank-led, bank-based model (where the “Customer account relationship must reside with a financial institution (FI) and transactions must hit the actual customer account.”). In this regard, the Guidelines designate MNOs as agents of banks or partners, at the most.

The regulation goes on further to restrict participants to a many-to-many model where exclusivity is prohibited. (The terminology is explained in further detail in the ensuing sections). In 2009, the central bank further directed that in the many-to-many model, at least three banks must partner each MNO without specifically saying how many MNOs should partner each bank. This model was envisaged to “ensure maximum connectivity and outreach as well as interoperability” (Guidelines for Branchless Banking, 2008).

Under the Guidelines, agents are to be selected, owned and managed under agent due diligence (ADD) procedures, and monitored under anti-money laundering/countering the financing of terrorism (AML/CFT) processes by banks and non-bank FIs.

Evidence and Analysis
Consultations with the market players have brought up startling revelations indicating primarily that players find the many-to-many bank-led model advocated by the regulatory authorities constraining and constitutes a disincentive to commitment. This turn of events has led to a situation where regulation and market dynamics are mismatched. Market practice is therefore contrary to the provisions of the regulations. One may need to take a critical look at the terminology and its implication for MFS in the Ghanaian context.

The Model: Many-to-Many versus Exclusivity
In many ways, the Ghanaian model is similar to Pakistan’s proposition which stipulates a branch-banking model that is bank-led and can be offered only by banks or regulated FIs. The difference, however, is that Pakistan allows various partnerships primary among which are the one-to-one (1–1) which is an exclusive partnership between a bank and an MNO, the one-to-many (1–∞), collaboration between one bank and many MNOs, and many-to-many (∞–∞), that is, a partnership between many banks and many MNOs. They are quick to add that the one-to-one model “does not necessarily require exclusivity so that a bank can join up with several MNOs each on a one-to-one basis and vice versa.” While the Ghana Guidelines acknowledge benefits that can accrue to a one-to-one model as leading to “greater customization, good service standards, possibility of co-branding and co-marketing, it specifically forbids One-to-One models on the premise that “it lacks outreach as it is limited to the customers of one Telco and one FI only.”

It is interesting to note that while the Ghana model specifically prohibits exclusivity (MNOs are expected to partner with at least three banks), most of the successful countries do not. Further-
more, no country in the world currently operates a Many-to-Many model. There is therefore no system to learn from to establish its success. Ghana may have to begin to take another look at this policy and relax it to reflect what is actually happening in the market.

Bank-based versus Non-bank-based
A bank-based model is one in which the customer has a contractual relationship with the bank or regulated financial Institution (FI) licensed, or otherwise permitted by the regulator, to provide the financial service(s). This terminology is often misconstrued to mean that the funds in MFS should reside in a bank.

In reality, customer acquisition and assignment in Ghana is at the discretion of the MNO; the customer does not even know which bank they are linked to. Furthermore, while the regulation prescribes that transactions hit actual accounts within financial institutions, customer accounts are actually electronic money (e-money) accounts backed by a ring-fenced float or pooled account in a bank. This is also the case in Kenya where the float is held in trust accounts with commercial banks. It may be noted that Philippines accommodates both the bank-based Smart Money, as well as the non-bank based G-Cash.

Bank-led versus Non-bank-led
The bank-led is a business model in which the bank is primarily, the entity which drives the innovation and implementation of the product or service. It also takes the lead in the branding, marketing, and management of customer relationships.

Unfortunately, banks in Ghana have so far failed to participate in the space of branchless banking as envisaged by the Guidelines. This is because MFS, like other branchless channels, is a volume business and requires a significant level of nurturing to achieve the necessary scope and traction. It should be noted that the core business of banks is to mobilize and intermediate funds. The process of leading must therefore provide enough incentives for banks to divert into branchless banking channels. Evidence in Ghana shows that most banks are more interested in high net-worth customers to achieve healthy bottom-lines. Furthermore, banks typically lack the know-how, resources and infrastructure to promote technological innovations. As one official of an MNO put it, “technological innovation is in our (MNOs) DNA.”

It is pertinent to note that while Pakistan follows a bank-led regime (Indeed, Pakistan is currently seeking to introduce non-bank-led models), Kenya and the Philippines pursue MNO-led models to significant advantage for financial inclusion.

Agent Network
In the Ghana model, banks are required to own agents for branchless banking as well as take the lead in the development of agent networks. In reality, this is not happening. MNOs claim that they have taken the lead in making huge investments in agent development and management as well as advertisements and customer education, yet they do not legally “own” the customers and agents.

One of the key success factors in MFS is the number and quality of the agent network. FIs are required to plan and act for long term development and prosperity of their agents. This requires coordination/collaboration with agents and training them to become more efficient. The Consortium on Financial Systems and Poverty (CFSP) reports in their research brief, “The Rise and Impact of M-PESA,” that research work undertaken by Mas and Morawczynski found that the key success factor for M-PESA was the attention they paid to the role of retail agents, and their mobilization of an agent network. In a recent research, Aker and Wilson also assert that the key success factors of m-money “in Kenya has been the breadth and scope of its agent network.” They find that weak support of agents by banks is stifling the adoption of Mobile Money by users in Ghana. It may be worth Ghana’s while to learn from the above and modify the regulation to allow MNOs to build their own network of agents.
Way Forward

While there is consensus that the Guidelines need to be revised, the Ghanaian authorities have been grappling with how and what to change in the regulation.

Policy Issues

The key regulatory questions that came out clearly are:

1. Should mobile operators and other non-banks be allowed to operate their own mobile money schemes? In other words, should they be allowed to issue their own accounts and means of payments, or should they always do so in the name of a partner bank?
2. Should players in the mobile money space be allowed to establish exclusive relationships at the bank level, at the MNO level and also at the agent level (i.e., the agent serving only one scheme)?
3. Do agents always have to be signed up by and be responsible to a bank or FI?
4. Should mobile money schemes be required to interwork? Should this be at the level of systems interconnectivity (so that the customer of any one scheme must be able to send money to the customer of any other scheme without having to do a cash-out), or at the level of agent sharing (so that the customer of any scheme must be able to do cash in/out at the agent of any other scheme).

Perhaps it would be useful to examine the key incentives of the various players as pointers to answering the above questions and to amending the regulations.

Central Bank: The central bank is concerned primarily with safety, soundness of the system to ensure financial sector stability. As evidence from other countries have shown, however, this can be overcome by working closely with stakeholders and taking prompt steps to curtail any adverse occurrences, including stepping up regulation when required.

Monetary authorities are also interested in achieving increased financial inclusion and economic empowerment for the poor, which would ultimately lead to growth of private sector. Authorities in Ghana seem to see interoperability as indispensible to the achievement of a seamless system where customers can use systems of service providers other than their own thereby cutting costs and creating efficiency in systems and convenience to customers. The reality on the ground is that a measure of interoperability is in place where agents of various Telcos are processing cash-in/cash-out transactions for customers of other Telcos. Furthermore, interoperability of systems should be a step-by-step approach to enable relevant structures such as standards and operational guidelines, to be put in place first. Currently, there is no evidence that full interoperability of systems has been achieved anywhere in the world yet there are success stories of mobile financial services.

Banks: For all banks and FIs, return on investment is the ultimate goal. Most banks are however not prepared for the time, commitment and effort it takes to reach this goal. For the interested banks that see MFS as a differentiator, having leverage in decision-making and the ability to roll out new products and gain from it are crucial. These need to be remunerated in the short run, so that they can recover their initial investments. Therefore, being forced into partnerships that give their competitors a free ride on their innovations and investments constitutes a disincentive.

MNOs: Like banks, MNOs are in to make a good return on their investment. As it is currently, all three MNOs engaged in m-money complain that they are not breaking even. This is because they have had to commit funds to functions that should otherwise be undertaken by banks. They complain that they do all the work in contravention of the regulations. Secondly, banks are slow and uninterested in rolling out products. MNOs have therefore made huge outlays in product development and yet they share the margins with the banks. Visibility in branding is also a critical goal for MNOs who, when successful, attract and retain more clientele which, for m-money, engenders deeper financial inclusion.
Conclusion

Ghana is at a critical juncture; commitment of participants in the mobile money space seems to be waning and Ghana is being left out of the global mobile revolution. The importance of financial inclusion to economic development demonstrates that financial inclusion is not an option; it is the choice. Every effort should therefore be made to escalate and sustain access to formal financial services by the poor and unbanked.

It is clear that the Ghanaian model has failed to garner the desired level of participation of banks. Regulation therefore, must be crafted right from the beginning. The literature suggests that the adoption of an exploratory, experimental approach to regulation with regular reviews and revisions may be preferable to a strait-jacket one-fits-all approach. This is especially so in Pakistan where the authorities review the regulations every six months to ensure that it is abreast with new and emerging trends in the branchless banking and payment systems market. In Kenya, as was the case in Philippines, there was little regulation in place at the rollout of mobile money. The two countries crafted regulation gradually in proportion to risks arising and from evidence-based developments. Indeed, policymakers concede that “Regulators can create space for experimentation and, as experience accumulates, build the policy frameworks needed for further growth.”

It is important to see mobile money, first and foremost, as a financial service, a channel for the transfer of funds, and not necessarily a banking function. When that is done, the requirement for rigid and strict regulation becomes redundant and MNOs can actually be allowed to operate as “bus drivers” with their own agent networks. If MNOs decide to introduce products of a banking nature such as loan and credit delivery, savings, insurance etc., regulation could be stepped up to the measure of the banking service being offered and the requirement for partnership with banks could be more stringent. Agents for such banking services could be owned by banks or non-bank deposit-taking FIs which are regulated by Banking Supervision.

Recommendations

From the foregoing discussions, the following recommendations are proposed for consideration:

1. Open up the branchless banking model currently in place to allow an MNO-led approach to operate alongside the bank-led model. Banks can then decide whether they only want to hold the float or issue e-money with the attendant responsibilities. In this regard, MNOs should be allowed to establish non-bank financial institutions licensed to issue e-money as in the case of the Ghana Interbank Payment and Settlement System (GhIPSS). These could be subsidiaries of MNOs solely engaged in that business and subject to capital requirements, regulation and oversight by the financial authorities.

2. Alongside the many-to-many model, allow banks and MNOs exclusive single partnerships for a minimum period of five years subject to review. For MNOs, deposit risks could be managed by designating a threshold beyond which deposits should be spread to other banks.

3. Allow MNOs to legally own their agents and focus on agent development which will enure to the benefit and expansion of financial inclusion.

4. Enact e-money regulations to establish clear guidelines on interest payments on e-money. This would set a level playing-field for both bank and non-bank e-money issuers.

5. Take steps to convert all pooled accounts into Trust accounts managed by competent trustees for the protection of customer’s funds and designate a threshold beyond which the float should be split and transferred to other banks.

6. Put in place strong consumer protection structures which will minimize customer complaints, strengthen confidence and provide overall stability of the payment system.

7. In the longer term, it will be useful to draft standards and regulations that will support interconnectivity of systems and deepen interoperability, and set up a Fair Competition Commission to check unfair practices such as the formation of monopolies and or cartels by MNOs.
These actions, when implemented, should adequately incentivize stakeholders to play their roles to effectively galvanize and drive mobile financial services toward greater financial inclusion. Central bank monitoring and supervision will need to be stepped up to maintain a safe and sound system.
Appendix: Mobile Financial Services—Comparative Analysis (End-2012)

<table>
<thead>
<tr>
<th>INDICATOR</th>
<th>GHANA</th>
<th>KENYA</th>
<th>TANZANIA</th>
<th>UGANDA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adult population</td>
<td>15 million</td>
<td>24 million</td>
<td>22.5 million</td>
<td>18 million</td>
</tr>
<tr>
<td>GNI per capita</td>
<td>1,410</td>
<td>820</td>
<td>570</td>
<td>510</td>
</tr>
<tr>
<td>Households using MM</td>
<td>&lt;5%</td>
<td>86%</td>
<td>36%</td>
<td>20%</td>
</tr>
<tr>
<td># Active MM Users</td>
<td>350,000</td>
<td>21 million</td>
<td>8 million</td>
<td>8.9 million</td>
</tr>
<tr>
<td># Transactions/month</td>
<td>~2.5 million</td>
<td>&gt;45 million</td>
<td>66 million</td>
<td>20.2 million</td>
</tr>
<tr>
<td>$ Transactions/month</td>
<td>~45 million</td>
<td>1.6 billion</td>
<td>1.3 billion</td>
<td>375 million</td>
</tr>
<tr>
<td>Agent Population</td>
<td>10,000</td>
<td>77,000</td>
<td>69,000</td>
<td>NA</td>
</tr>
</tbody>
</table>

Source: CGAP, Central Bank Websites, Web Articles
(NA means Not Available)

References

AFI Guideline Note on Supervision and Oversight of Mobile Financial Services (AFI MFSWG)
AFI Guideline Note – Mobile Financial Services: Basic Terminology (AFI MFSWG)
AFI Policy Note (2010), Mobile Financial Services, Regulatory Approaches to enable access.
Bank of Ghana Notice To Banks and Savings and Loans Companies, Notice No. BG/GOV/SEC/2008/21, Guidelines for Branchless Banking.
The Consortium on Financial Systems and Poverty (CFSP), Research Brief, The Rise and Impact of M-PESA.

Endnotes

1. Guidelines for Branchless Banking, Notice No. BG/GOV/SEC/2008/21
2. This requires cash-out transactions since the funds do not reside on the beneficiary’s m-money wallet
3. CFSP Research Brief, The Rise and Impact of M-PESA
4. Guidelines for Branchless Banking, Notice No. BG/GOV/SEC/2008/21
5. Guideline Note – Mobile Financial Services: Basic Terminology (AFI MFSWG)
7. Speech delivered at Conference on Mobile Financial Inclusion, Washington DC, May 16–17, 2011 (Mr. M. Narh, Deputy Governor)
ACCELERATING NAMIBIA’S READINESS TO EMBRACE A CASH-LITE SOCIETY TO FACILITATE FINANCIAL INCLUSION

Barbara Gowaseb
Fletcher School Leadership Program in Financial Inclusion

Statement of Problem

Namibia is largely a cash-based society. Despite a well-developed payments infrastructure, the move toward electronic payments (and therefore a cash-lite society) has been relatively slow. The term cash-lite, as opposed to cash-heavy, depends on whether the majority of payments are done electronically. This paper does not advocate a cashless society as such an idea might be utopian. In a cash-lite society both cash and electronic means of payments co-exist, with cash playing a marginal role rather than a dominant role.

A cash-heavy society is burdened with the high cost of cash to businesses, such as cash custody and transportation costs, weighing heavily on the central bank, commercial banks and businesses. Cash is an inefficient payment instrument that perpetuates corruption through fraudulent activities such as money laundering, payment of kickbacks and tax evasion. In addition, cash in general does not leave any footprint in the case of crime. Also, the fear of losing cash when carried on person remains high.

Given the reality that cash is an inefficient payment instrument, Namibia’s move to a cash-lite society is hampered by a number of factors, such as:

1. high bank fees for payment services; people are hesitant to bank their money as fees erode their money in the bank;
2. little understanding of electronic means of payments;
3. a large rural population and a lack of innovative branchless banking services;
4. people’s psychological relationship with cash.

A transition to a cash-lite society will have benefits for various stakeholders, notably the Namibian Government, corporations/businesses and consumers. To reap the benefits, the question whether the Namibian regulatory and policy environment is sufficiently geared to embrace a cash-lite society, remains. Although Namibia has made significant strides in creating an enabling environment to embrace a cash-lite society, the pace is rather slow. Both Government and the Central Bank should take a deliberate policy stance toward embracing a cash-lite society and this should be widely publicized to ensure it reaches all Namibians. All government-to-person payments should be done electronically and the Bank of Namibia should further strengthen existing electronic payment services regulations.

Background

Namibia has a fairly modernized payments infrastructure, characterized by an efficient large value and time-critical payment system (NISS—Namibia Interbank Settlement System) and other significant retail payment systems, such as Electronic Funds Transfer (EFT), Code Line Clearing (CLC), NAMSWITCH (supporting domestic debit, hybrid, and credit cards), smartcard and mobile money payment systems. All commercial banks in Namibia are currently working toward ensuring compliance with Payment Card Industry Data Security Standards (PCI DSS) with a 90% EMV (EuroMastercardVisa security standards) compliance on all Point of Sale (POS) devices to strengthen the safety and security of the electronic payment environment.
Although the electronic payment infrastructure has been in place for some time, Namibia remains a cash-heavy society. This can be seen by the increase in cash in circulation over recent years (see Table 1).

Electronic Payments

Although Namibia has experienced a steady increase in the volumes and values transacted through the existing electronic payment systems, albeit at a slow pace, the percentages of electronic transaction values as a percentage of GDP are negligible as can be seen underneath. (see Table 2).

Given the above, Namibia lean more toward a cash heavy society, though the cash in circulation as a percentage of GDP, is low. Despite the absence of reliable statistics on cash transactions in the economy, electronic transactions remain low as a percentage of cash transactions in Namibia. A few initiatives have been undertaken by the major role players, that is, the Namibian Government and the Bank of Namibia, to promote a cash-lite society albeit covertly. But the cost of electronic payments is currently not cheap (albeit cheaper than cash). POS transactions are 0.5 cents for debit cards, 1.71% for credit cards, while ATM withdrawals ranges between N$6.40 to N$25.60 for amounts above N$1500 and can go up to N$46 when using a foreign ATM. EFT per transaction is N$1,575. Cash deposit fees are 2.10% of value. Monthly account fees can be more than N$18.50. With such costs, what benefit is there to the users of cash to move to electronic payments? Despite this, the current cost of electronic payment services is still less than the direct and indirect cost of cash. Several studies have proven this, although none have been conducted in Namibia yet. The Bank of Namibia is developing costing models that will aid in determining the relative costs of cash and electronic payment services.

Legislative Framework

Namibia currently has a number of legislative and policy frameworks in place, which assists greatly in the migration to an electronic-payment environment. These legislative and policy frameworks are encouraging for moving toward a cash-lite society. However, a number of gaps could hamper a robust transition. Notably among these is the absence of policy guidelines and/or regulations that will encourage branchless banking initiatives (with the exception of e-money regulations). The absence of such regulations results in a disabling environment for potential branchless banking service providers. Equally absent or rather limited are initiatives geared toward educating the public on electronic payments, thereby awakening an appetite and instilling trust in the utilization of electronic payment systems. Government’s slow uptake and/or non-visibility in migrating cash payments, (whether social grants or salaries) to electronic platforms, further stifles the migration to a cash-lite society.

Analysis

In theory, Namibia should be receptive to a cash-lite society, based on results of the Finscope study (2011). Namibia has a financial inclusion rate of 65% with only 5 commercial banks serving a vast and densely spread population, thus access to financial institutions remain a challenge. The majority of the financially excluded are rural, where about 60% of the population lives a subsistence lifestyle; 49% of rural communities have to travel more than an hour to a bank, making brick and
mortar solutions cost ineffective. On the other hand, 94% of the population has a mobile device, making alternative distribution channels and payment systems such as branchless banking a key driving force for a cash-lite society and therefore deepening financial inclusion. Such deepening of financial inclusion is achieved through more people having access to financial services such as savings and loan products, rather than merely having a bank account that is often dormant.

Although Namibia has a well-developed payments infrastructure and there is a steady increase in e-usage, the country is in transition. Bankable Frontier Associates provides four stages in the shift to electronic payments (see Table 3). Namibia stands between stage 0 and stage 1, still cash heavy.

Table 3. Transition Stages to a Cash-lite Society

<table>
<thead>
<tr>
<th>Stage 0: Cash Heavy</th>
<th>Stage 1: Bulk Payer Transition</th>
<th>Stage 2: Increasing e-Usage</th>
<th>Stage 3: Cash Lite</th>
</tr>
</thead>
</table>

Source: Bankable Frontier Association, www.betterthancash.org

The transition to a cash-lite society is also hampered by the size of some of the local enterprises; a lack of easy to use standardized and inexpensive interfaces hinders the adoption of electronic payments in Namibia. This leads to many Small and Medium Enterprises preferring to trade with cash rather than electronically. Payment system reliability, both in transactions with customers and with suppliers, due to electricity availability, remains a challenge especially in rural areas.

Government has the power to mandate all its payments to be done electronically. In countries such as Greece and Italy, government imposed limits on the use of cash above defined thresholds. While the Namibian Government stands to benefit greatly from a cash-lite society it might be a conflict for the Bank of Namibia which earns an income from cash in circulation. Salmony (2011) rightfully points out that central banks have a conflicting dual role. A key mandate of the central bank is to promote an efficient payment system, yet a central bank is a market participant and therefore an economic beneficiary of one of the most inefficient payment instruments of all, cash.

The National Government stands to benefit from a more efficient, transparent and safer means of disbursing social grants. Examples of countries that have seen cost benefits by moving to Government to Person (G2P) payments are Brazil and Argentina. In Brazil, the administrative cost of social welfare payments reduced from 14.7% to 2.4% of grant value by moving to an electronic payment program. The Government further stands to gain from increased tax collection, greater financial inclusion and increased economic development. Research conducted by Moody’s Analytics shows that consumption increased significantly and in emerging markets card usage added 0.8% to GDP. At the same time, businesses stand to benefit from faster access to capital and reduced cash-handling costs, and consumers will have increased convenience, more financial service options through access to credit and other financial services and a reduced risk of cash-related crimes.

What Are the Key Requirements for a Cash-lite Society?

For a society to make a shift to a cash-lite society the infrastructure, population readiness and dependent machinery should be in place. Porteous (2012) identified stepping stones for an inclusive cash-lite society, citing the following requirements:

- A near real time electronic transfer that is easy and virtually free
- An appetite to take up more electronic payments
- Educating the public on electronic payments and instilling trust in electronic payments
- Robust legislative guidelines on branchless banking inclusive of electronic payments and agent banking;

The Fletcher School, Tufts University
Better engagement among various key regulatory authorities, notably regulators of financial services and regulators of telecommunications in cases of mobile banking as alternative payment channels and systems.

In this analysis, cash has been presented as an imperfect and risky instrument from a policy perspective. At a practical level, however, cash maximizes the ability of a low-income household to control use and access to make timely choices with their resources. While there are inherent risks to holding and handling cash, the shift required moving a tangible physical asset to an intangible one that is subject to electricity availability and failure, access to payment infrastructure and the potential of taxation is not always clear cut. For this reason providers of electronic payment solutions need to emulate electronic payment environments where transactions happen close to real time. The Bank of Namibia has issued principles to ensure efficiencies in the National Payment system, which among others could contribute to making electronic payments faster. To address the issue of cost of payment services the Bank of Namibia is mandated to set standards for fees and charges, which could ensure that cost of payment services is affordable.

**Policy Recommendations**

**Option 1: Do Nothing**

One option is to keep the current status quo, including initiatives currently in progress. The drawback of the current situation is that Namibia will remain a cash heavy society with increasing revenue leakages for government and the central bank, increasingly spending more money to print currency. Equally, customers will have to deal with the continuous fear of being robbed of their hard earned income if it is continuously paid in cash. If the status quo is maintained it will take long for Namibia to progress to a cash-lite society, and cash will continue to dominate, leading to more inefficiencies and cost to government, businesses and consumers.

**Option 2: Aggressively Promote a Cash-Lite Transition**

This option suggests policy makers take a more robust stance toward moving to a cash-lite society and a stronger voice for the establishment of a cash-lite society. From a policy perspective, the following tangible actions are presented for consideration by the Bank of Namibia and the Ministry of Finance as the custodian ministry of the Financial Industry. Some of the actions were tried and proven to yield positive results in other jurisdictions as discussed above:

- The Ministry of Finance in collaboration with the Bank of Namibia should actively promote a shift to a cash-lite society to facilitate a deeper level of financial inclusion. This lends itself to making a deliberate policy pronouncement by both entities. These pronouncements should be broadcasted in both printed and electronic media to ensure the message reaches all Namibians.
- Review existing payments legislation and develop guidelines on agent banking and outsource arrangements as well as strengthening current electronic money regulations and make it more visible through print and electronic media.
- Encourage small and medium businesses to use electronic payment platforms for sale of goods and services. Government should provide tax incentives and subsidies to electronic payment service providers for setting up and expanding electronic payment infrastructure especially to the rural areas of Namibia and when purchases are done through electronic payment devises such as Point of Sale devises. The Bank of Namibia should actively set standards for interchange fees and other charges to ensure that small and medium businesses do not end up paying more for the use of electronic platforms than they would have if they remained a cash-only business.
- Government should take an active stance to eliminate all forms of cheque and cash payments from government to persons (G2P) by paying all salaries and social grants through electronic
payment means within two years using 2014 as a base year. This essentially requires all pensioners and recipients of social grants to be set up to receive grants electronically and the necessary electronic payment infrastructure be enhanced and developed where non-existent.

**Policy Recommendation**

Given the existing payment environment, Namibia has great potential and stands to benefit immensely from a cash-lite society. With a number of key policy frameworks and regulations already in place, this paper advocates for a stronger central bank and government voice to establish a cash-lite Namibian society. Hence Option 2 is recommended for implementation.

**Conclusion**

The paper has argued that the central bank and the Namibian government should have a clear policy stance on establishing a cash-lite society. This will not only ensure a deeper level of financial inclusion but can result in economic development at a macro level. Additionally better efficiencies in the payments environment should be introduced that will lead to cost effective provision of payment services. Cash as a payment instrument should still be used, albeit in a reduced capacity; with electronic payments given more prominence. This is helpful in leaving footprints when financial crime is committed and will thus ensure that financial crimes are minimized or at least detected and criminals brought to justice. Pensioners and recipients of social grants will travel less distances to a post office or pension pay out point if innovative electronic payment channels and systems are introduced in close proximity where the people live and government make use of them for G2P payments.

As a cash heavy society, the biggest challenge for Namibia is to engage the Namibian populace at a psychological level to use less cash and make use of electronic payments. The sentiments expressed in the Finscope (2011) survey on why Namibians do not make use of banks or the financial system, such as a lack of income and affordability of financial services remains a challenge. Any concerted advocacy for a cash-lite society should be cognizant of this fact. The availability and affordability of Internet and electricity in rural areas remain a challenge especially in making use of electronic payment channels and systems.

**Endnotes**

2. POS transaction are 0.55 cents for debit cards, 1.71% for credit cards and ATM withdrawals ranges between N$6.40 to N$25.60 for amounts above N$1500 and can go up to N$46 when using foreign ATMs. EFT per transaction is N$1,575. Cash deposit fees are 2.10% of value. Monthly account fees can be more than N$18.50.
3. Cheques as a payment instrument is in the process of being reduced due to its vulnerability to fraud and is currently only making up 8% of value settled in the NISS at end fourth quarter of 2011.
4. NPS Vision 2015 stipulates key objectives on NPS Infrastructure and Technology; Guidelines on making debit order system efficient; Implementation of Government EFT to mention a few.
6. The Finscope survey was commissioned by the Government of Namibia, aimed to establish a universally acceptable benchmark of financial inclusion.
8. Branchless banking as defined by CGAP; Lyman et al., 2006 (cited by Dermish et al., p. 83, 2012) refer to new “distribution channels that allow financial institutions and other commercial actors to offer other financial services outside traditional bank premises.”
Proportionate Regulation
ENHANCING FINANCIAL INCLUSION THROUGH PROPORTIONATE POLICY AND REGULATORY FRAMEWORK IN TANZANIA

Kennedy Joseph Komba

Advisor, National Payment Systems, Bank of Tanzania

Problem Statement

The level of financial inclusion in Tanzania is low, with only 12.4% of the adult population formally included (Chart 1). This level is lower than the regional average of 24% formally included. Access to formal financial services, such as savings, credit, insurance, and transactions is also very low (Chart 2). With the exception of mobile payment services that provide access to payment services to 41% of the adult population, the service is limited in scope. It serves urban dwellers who account for only 20% of the adult population. Thus, the vast majority of Tanzanians do not have formal financial services (Chart 2), forcing them to rely on informal services to finance their economic activities.

Low financial inclusion causes several negative outcomes, both at the micro and macro levels. At the macro level, monetary policy cannot be effective if less than a quarter of the population is excluded. At the micro level, households cannot effectively engage in economic activities. They are limited by the unpredictability of informal financial service provisions.

What is the cause of low inclusion? And what solutions can be deployed to reverse the situation? This policy memo proposes solutions to address the problem of low financial inclusion in Tanzania through a proportionate policy and regulatory approach that will stimulate the provision of financial services to the unbanked majority.

Analysis

Narrow Formal Financial Institutions Base
Tanzania’s formal financial institutions include commercial banks (32), community banks (9), and micro finance companies (2). In total, these serve only 12% of the population. They are largely concentrated in urban areas where only 20% of people live. The rest live in areas with limited
access to the population (Table 1). The Central Bank subjects these institutions to prudential regulation.

Table 1. Formal Financial Service Access Point

<table>
<thead>
<tr>
<th>Access Point</th>
<th>Access per Population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank Branches</td>
<td>1:107,000</td>
</tr>
<tr>
<td>ATM</td>
<td>1:18,750</td>
</tr>
<tr>
<td>POS</td>
<td>1:5,769</td>
</tr>
<tr>
<td>Mobile Payment</td>
<td>1:2</td>
</tr>
</tbody>
</table>

Semi-formal financial institutions include financial NGOs, savings and credit co-operatives (SACCOs), financial companies, and financial services associations. These, too, are concentrated in urban areas. They are not subject to prudential regulations and are not regulated by the Central Bank but subject to different laws and different oversight. Moreover, they are only accessed by 4.3% of the population.

Informal financial service providers are not regulated nor registered under any law. They include money lenders, self-help groups, traders, rotating savings and credit associations (ROSCAs), savings and credit associations (SACAs), and family and friends. In total they serve 27% of the population. Most of these informal financial services are in rural areas.

Such a thin institutional landscape means, ultimately, that only 12% of the population has access formal services. Tanzania is lacking a regulatory environment that would enable a more robust financial ecosystem. Right-sized supervision of a range of institutions will allow these institutions to collectively reach the remaining 56% of the adult population.

Regulatory Vacuum

Absence of Microfinance Law

The microfinance sector in Tanzania has the potential to help bridge the financial inclusion gap. Players in this sector have the mission, outreach potential, and proximity to reach both unbanked rural and urban populations. While Bangladesh, India, Rwanda, Kenya, Ghana, and others do have specific microfinance regulatory regimes or legislative controls, Tanzania has no specific law but regulations that only deal with deposit-taking microfinance issued under the Banking and Financial Institutions Act, 1991, and the Banking and Financial Institutions (microfinance companies and microcredit activities) Regulations, 2005. The absence of regulation specifically addressing issues of varied microfinance institutions makes it difficult for semi-formal and informal microfinance to grow. The current regulatory regime in Tanzania makes it impossible for the semi-formal and informal to thrive and serve the underbanked and vulnerable effectively within the scope of regulatory oversight. The regulatory requirements that impede the semi-formal and informal microfinance institutions to be elevated to the formal category include licensing requirements that require heavy capital requirements to be recognized in the current banking laws. Minimum capital requirements for commercial banks is TZS 15 billion (US$ 9.3 million), for community banks it is TZS 2 billion minimum (US$ 1.2 million), and for microfinance banks it is TZS 5 billion (US$ 3.1 million).

These capital requirements are unattainable for most of the financial NGOs and SACCOs and therefore they remain in the semi and informal sector. In addition, other prudential requirements that are applied for the formal financial sector, such as capital adequacy requirements, asset quality, risk concentration, insider lending, reserve and liquidity requirements, ownership
concentration, sanctions, and corrective actions makes it difficult for the semi or informal sector to be elevated to a status that will enable them to effectively serve the unbanked. Proportionate regulatory framework will be useful in applying prudential and non-prudential requirements to the microfinance sector that are commensurate to the risks that such entities introduce to the market. In so doing, existing microfinance institutions that are out of scope of regulations will be elevated to the visibility of the regulatory radar and thus be able to serve the unbanked population and the poor with a broad range of financial service while protecting low income and vulnerable clients.

A number of countries have tried to introduce different forms of proportionate regulation to varied financial institutions to better serve the unbanked. Ghana provides an example where in 2011 it issued a new Operating Rules and Guidelines for Microfinance Institutions. The regulation covers all operations of the microfinance sub-sector in Ghana, bringing into the regulatory scope other intermediaries such as Susu companies and Susu collectors, moneylenders, and other financial service providers, and thus including the semi-formal and informal institutions which were previously unregulated. This Ghanaian approach places the regulated activities in categorization of four tiers and assigns prudential or non-prudential requirements to each of the tiers, encompassing the proportionate regulatory approach advocated in this memo.

To illustrate from Ghana, the first tier composes rural and community banks, finance houses, and savings and loan companies that are already regulated under the Banking Act, 2004 (Act 673) and to which the existing prudential requirements apply. The second tier composes Susu companies and other financial service providers, including financial non-governmental organizations (FNGOs) that are deposit taking and profit making. The third tier composes money lenders and non-deposit-taking FNGOs. The forth tier composes Susu collectors, whether or not previously registered with the Ghana Cooperative Susu Collectors Association (GCSCA) and individual money lenders.

The regulatory requirement for the second to fourth tiers includes the business form, capital adequacy, permissible and non-permissible activities, branch expansion, and prudential oversight. For the third and fourth tier, they are encouraged to form associations or if the FNGOs desire to take deposit they are required to convert from companies limited by guarantee to companies limited by shares.

The Ghanaian approach has been effective in reaching the under banked and financially excluded population with effectively regulated entities based on the principle of proportionate regulation.

Absence of Regulation for Electronic Payments Service Providers

The payment sector in Tanzania, like the microfinance sector, has the potential to bridge the financial inclusion gap. There is no proportionate regulation for electronic payment service providers. The existing framework is based on guidelines on introducing electronic payment schemes of 2007 issued under the Central Bank Act. These guidelines do not account for proportionate market risk. They are too stringent to allow payment service providers to directly engage with unbanked populations; providers must obtain a commercial bank’s sponsorship. This requirement was relevant in the initial stages when the market was nascent. However, currently, there a several market players, beyond Telecos, who are able to offer electronic financial services but are not able to offer them to their fullest extent.

These new market players include technological aggregating companies that leverage on information and communication technology with business innovations to offer payment and switching services. They have a potential to increase competition in the payment system space and enhance financial inclusion due to their business models that target micro-customers. They need to be provided with a proportionate regulatory framework that will provide effective risk management without increasing regulatory costs or stifling their business innovations. For example,
one aggregating company has 4,401 point of sales (POSs) compared to 1,956 POSs owned by all commercial banks. This company has deployed the POSs countrywide in rural and urban areas, and it has been registering average daily customer transactions of 33,765, which is 35% of daily mobile banking transactions and 2% of daily mobile money transactions. The company facilitates payments similar to those offered under mobile money or mobile banking, for payment of utility bills, mobile money transfers, payment of taxes, and pensions. Yet, under current regulatory regimes, such technological aggregating companies are categorized as semi-formal entities.

These companies have the potential of linking the informal and semi-formal microfinance entities with formal financial institutions through their technology. With proportionate regulations, they too can be recognized as a category of service providers in the payment system space that can effectively support microfinance business leveraging on technology to enhance financial inclusion.

**Recommendations**

**Interim Solutions**

Pending fruition of the review process and enactments such as the National Payment Act, passing of mobile regulations, the review of national microfinance, the development of a national financial inclusion policy/strategy, and enactment of a microfinance law, the following is proposed:

1. The Central Bank issue amended guidelines that will provide proportionate regulation to allow more electronic payment systems providers to directly offer linked payment services with banks and microfinance institutions.
2. The Central Bank sensitize banks on adopting agency banking using the existing agency banking guidelines.
3. The Central Bank should establish a monitoring mechanism for financial inclusion initiatives by assigning this responsibility to a specific unit in the bank and the unit should submit progress reports to bank’s management.
4. The Central Bank should hold a national symposium on financial inclusion in Tanzania with a main theme being “breaking barriers to financial inclusion in Tanzania.” The symposium should target all financial inclusion stakeholders with a commitment at the end with a roadmap of implementation of recommendations raised.

**Midterm Solutions**

The Central Bank should engage the Ministry of Finance to review the National Microfinance Policy and enact a microfinance law, which considers proportionate legal provisions that are pro-financial inclusion, as listed in the Appendix to this policy memo.

The Central Bank should expedite the establishment of a national financial inclusion policy/strategy. A monitoring mechanism should be devised to ensure that work is delivered at a predetermined time frame.
The Proposed Model

The objective in this memo was twofold; first, to highlight the causes of low levels of financial inclusion in respect to the regulatory landscape. In this regard, analysis was made on the levels of the institutional base for provision of financial services. It was found out that the base is narrow with limited access excluding the majority of population to obtain formal financial services. The second objective was to find solutions to the low levels of financial inclusion using the regulatory landscape. From the analysis of existing regulations, it was evident that semi-formal and informal microfinance institutions have a difficult time either leveraging existing technology to link with formal institutions or themselves graduating to be categorized under the formal space. Tanzania has a narrow formal financial inclusion rating. To address this, proportionate regulatory approach is proposed that will enable semi-formal and informal microfinance institutions to fall within the scope of regulatory radar, making them effective providers of financial services to the unbanked and the poor. In addition, proportionate regulation is also proposed for the payment system ecosystem. This is to facilitate legal recognition of companies that provide technological solutions with potential to facilitate linkages of financial services between different categories of financial institutions that will create a wide institutional base for financial inclusion. Finally, specific areas of regulatory and policy approach are provided for adoption to create an enabling environment for the private sector to deploy financial services that will address financial inclusion initiatives. A monitoring process is also proposed to ensure that there is an elaborate method of tracking financial inclusion programs.

This memo does not advocate for maintaining the status quo. This is because the status quo attributes to the low levels of financial inclusion.
Appendix

Proportionate Policy and Regulatory Requirements

The proposed reviews of the policies and regulatory framework should include the following:-

1. Allowing different service providers to provide electronic payment services in the country so long as there is linkage with the financial institutions in deepening financial services (that is, savings, credit, insurance, and payments or remittances).
2. Providing proportionate KYC requirements that are commensurate to the risks of the services.
3. Consumer protection in the provision of financial services. These include disclosure, clear terms of agreement in plain and understandable language, equitable service provisions, prohibiting negative advertisements, and confidentiality of personal information and proportionate redress mechanism.
4. Enhancing efficiency in the provision of services by embracing technology such as mobile telephony, the internet, and other electronic payment devices.
5. Encouraging and creating an environment for interoperability of electronic payment services. The interconnections should be across different payment service providers, including non-bank and bank entities.
6. Promoting establishment of microfinance credit bureaus, to ease the cost of lending for the poor.
7. Promoting responsible lending that discourages over-indebtedness and reckless credit.
8. Promote tiered supervisory approaches based on proportionate regulation underscoring the risks the entities impose on the market and financial stability. These include direct and indirect supervision, prudential and non-prudential requirements, and industry self-regulation.
9. Require coordination of different regulators in the financial sector to have a holistic approach on financial stability and financial inclusion.
10. The objective of financial inclusion should be clearly underscored in the policies and adopted in the regulatory framework.

References

AgFiMS (2012). Agricultural finance markets scoping Tanzania Headline Findings. FSDT, Dar es Salaam.


**Endnotes**

1. Source: Bank of Tanzania, MFS data of January 2013 of total registered accounts of being 27,430,276. Factoring a third to remove multiple holders of accounts, you get 9,143,333.90 against an adult population of 22.5 million.

2. This access point density provides a rough estimate of adult population access; however, the density is much higher because this data does not factor in the account holders of such services except for mobile payments where the data is based on the number of account holders factoring double counting.

3. Non-prudential requirements are those that promote good business practice or conduct such as consumer protection, disclosure, credit referencing bureau, crime and fraud prevention mechanisms, good business practices, and adherence to code of conducts.


5. Currently a Payment System Law is planned for enactment. Regulations for mobile payments are pending to be issued, which upon passing the Payment System Law, it would be prudent to review these mobile payment regulations and have them more general to all electronic payment service providers without limiting them to mobile payment services only.
Alok Misra

Chief Executive Officer, Mico-credit Ratings International

Why Is Financial Inclusion Important for India?

India is tipped to be a global economic powerhouse in the near future with the fast pace of GDP growth in the last decade, swelling middle class, rise in per capita income and increased urbanisation amply pointing toward this reality. While economic growth per se is a welcome feature, the policy makers need to ensure that the issue of equitable development is inbuilt in the growth story. At present, it is not with 68% of population living below $2 a day¹ and as argued by Stiglitz (2012)² inequality can lead to a vicious downward spiral causing instability of the political and economic system.

Access to financial services supported by other enabling measures such as skill development, investments in farm lands, financial literacy and extension services can play a vital role in bridging inequality and ensuring sustainable growth. Global development literature amply supports this link arguing that financial market imperfections, such as information asymmetries and transaction costs of dealing with the formal sector act to constrain the growth opportunities for the talented poor and the micro- and small enterprises that lack collateral, credit histories, and connections, leading to persistent inequality and slower growth (World Bank, 2007)³. Asli Demirgüç-Kunt, lead author of the World Bank report rightly opines that “Better access to finance not only increases economic growth, but also helps fight poverty, and reduces income gaps between rich and poor people.”

The policy memo argues that while the public policy in India has always accorded high priority to inclusion, the progress has been sub-optimal on account of sole reliance on banking channel, imposition of target based approach and preferring conservatism over innovative approaches. The memo shows that enabling changes on two aspects which harness the strengths of players other than banks can change the inclusion paradigm, make it more meaningful as well as lay the foundation for more innovations.

The Access to Financial Services Policy in India: Key Changes in Approach over the Years but Predicated on the Banking Sector

The role of the financial sector has always remained crucial within India’s development strategy, as lack of capital has been seen as the major bottleneck in the fight against poverty. Following the pattern in most developing countries, increasing access to credit for the poor has remained at the core of Indian planning. The assumption behind expanding the outreach of financial services, mainly credit was that the welfare costs of exclusion from the banking sector, especially for the rural poor are very high (Pande, 2007).⁴

The means of expanding access to finance however evolved over five decades and broadly followed the pattern in the macroeconomic policy. Till 2010, three stages can be discerned in the role of financial sector in expanding access to credit, each with its own theoretical underpinnings and mode of credit delivery (Fisher & Sriram, 2004; Rangarajan, 2005⁵). The first phase from the 1950 to the mid-1960s relied on the existing credit structure consisting mainly of cooperative banks in rural areas and private commercial banks in semi-urban and urban areas. The second phase started with the nationalisation of private commercial banks in 1969 and lasted till early 1990s and can be considered as the most important phase inasmuch as it not only resulted in a drastically new paradigm but also created specialised institutions for rural credit.
Government intervention through directed credit, state owned Rural Financial Institutions (RFIs) and subsidised interest rates during this phase increased the tolerance for loan defaults. Loan waivers by the government, lax appraisal and monitoring of loans by banks, reliance on credit through set products and collateral requirement created a two-fold problem. The institutional structure was unviable and even the penetration of credit to the poor was far from desired. This coincided with the general slump in the Indian economy caused by increasing deficit and adverse balance of payments. These twin factors led to reorientation in the economic policy as well as banking sector policy in the early 1990s. The policy response in the form of economic liberalism—the third phase—envisioned a greater role for the market, gradual easing of the social banking norms and introduction of profitability as a benchmark.

This coincided with the growth of microfinance. In India, NABARD took the lead in developing the Self Help Group (SHG)-Bank linkage program, which formed a synergistic relationship between the informal groups of poor and the banking system. Supplementing this, NABARD led model was the private sector initiative termed as "MFI model" which started with many donor funded NGOs taking up group based savings and credit activities. With growth of credit intermediation, the MFI model evolved through the years starting from separation of microfinance as a vertical and ending with transformation as for-profit entity.

Both models witnessed phenomenal growth with the MFI model outreach touching 26.7 million clients by March 2010 and SHG-Bank linkage programme covering nearly 5 million SHGs by March 2010 taking the combined outreach to a whopping 86 million (Srinivasan, 2010). Pande (2007) emphasises the underlying policy stance during post 1991 by saying that while bank outreach fell, the policy stance is to fill the gap through micro credit. However, this limited brush with alternative financial services delivery mechanism too suffered a jolt in the wake of crisis in Andhra Pradesh in 2010. Overnight, the trump card of financial inclusion became a pariah and the paradigm has shifted back to a bank led approach. Though, recently the sector has again received attention by way of framing of draft microfinance bill in 2012 with the objective of regulating the sector, the outreach of MFI model fell to 19 million by March 2012.

The crisis has brought attention back to the banking sector with the broad strategy for financial inclusion in India in recent years comprising of the following elements: (i) encouraging penetration through business correspondents (BCs) model (ii) use of technology to lower costs (iii) encouraging banks to open a basic banking “no frills” account (iv) emphasis on financial literacy and credit counselling and (v) asking banks to provide banking facilities in all villages with a population of >2,000. The intensity of the change is reflected in opening of 96,828 BC outlets and opening of 103 million no frills accounts by March 2012.

**Policy Impact: State of Inclusion in India**

It is vital to examine the impact of above policies on the state of inclusion in India, keeping in mind that albeit for a short period the focus has remained on the formal banking sector and on credit dispensation.

The Global Findex database brought out by the World Bank is one composite source and the picture which emerges tells us that the impact has been far from desired.

The above data is corroborated by Sinha & Agarwal (2011) with an upward bias. As per them 47% have account at a formal institution but this falls to 27% in case of persons earning less than Rs.90,000 per year which is almost the poverty line. On credit side, the report finds that while 46% have taken a loan in the last three years, the share of moneylenders/friends and relatives is as high as 52%. It is clearly seen that vast majority remains excluded from savings and credit services and on account of “credit centric” approach, the situation is far more grim in case of other services such as insurance and remittances.
Factors Impeding Financial Inclusion: The “MMC” Conundrum

The policy memo argues that the mono model, mono product and conservatism [MMC] in policy stance has constrained the pace of financial inclusion in India.

**Mono Model:** As brought out earlier, the policy has mainly remained fixated on the formal banking sector to achieve inclusion despite evidence from the field pointing to limitations of the formal sector on account of its rigid product line lacking flexibility and innovation, complex documentation, high transaction costs associated with low volume transactions, approaching inclusion as obligation and urban mind set (Sisodia, 2005; Sinha et al, 2000). The Sinha & Agarwal report lists high transaction time, documentation and financial literacy as the major challenges associated with the formal sector. However, it needs to be acknowledged that this policy induced formal sector push starting with nationalisation of banks in 1969 has created a vast banking network in India with average population per branch at 13,466.

Despite the obvious limitations of bank led approach, the policy push has only made banks strive to do the minimum necessary to gain approval (or at any rate regulatory forbearance) rather than tapping the vast opportunity. Policy seems to miss that unless policy imperatives/obligations like priority sector lending, having a banking outlet in every village with a population >2,000 are seen as business opportunities, the inclusion efforts will continue to be compliance based rather than being meaningful. For example, a study of no frills accounts in Tamil Nadu by MicroSave showed that 64% of these accounts were inactive for more than a year and 82% were inactive for more than six months.

**Mono Product:** Till recently (as early as 2005) the focus remained on credit ignoring other more required financial services by the poor. Literature on the subject shows that poor people need a wide range of financial services that are convenient, flexible and reasonably priced (ADB, 2000). Author’s PhD dissertation argues that often other financial services such as insurance and remittance are needed by the poor over credit. Mohan (2006) rightly argues that access to other financial services like insurance and remittances are integral to livelihood opportunities of the poor. Even in the phase of promoting alternative delivery channels like microfinance, microfinance institutions were only seen as means of credit intermediation and not savings promotion. Though the policy stance has become more active in promoting savings by way of current focus on no frills accounts but remittances and micro insurance still remain low priority areas. Even the slight broadening of focus is not beneficial as it continues to see it from the prism of “mono model” approach.
Conservatism: Conservatism in policy is exhibited in many forms ranging from mono model approach focussing on rate of interest rather than total cost to customer to keeping costs artificially low, not allowing non-bank financial institutions to mobilise savings and limiting money transfer to be routed through banks. Aligned to this approach is reliance on “supply” with a focus on achieving measurable supply-side targets rather than satisfaction of actual customer needs.

To illustrate the point about costs, the policy still fails to recognise that last mile banking has additional costs and the financial institutions need to be viable. Way back in 1988, ACR C23 reported that the rates charged by formal financial institutions are ~3% below the viable lending rate. Lower rates also do not provide any gain to the client, if transaction time cost and other associated costs are considered. A recent study shows that while the interest rates of MFIs are high at 25% as compared to 12.7% for the formal sector, the actual cost to the client is higher for the formal sector on account of time taken, documentation and bribery (NCAER, 201124). Occasionally, there are welcome pronouncements that adequate and timely credit is more important than cost of credit but the practise remains focussed on keeping costs unviable. Recent capping of interest rates of microfinance institutions is one such example. Such measures paradoxically have the potential to cause exclusion rather than inclusion as micro lenders in order to be within permissible margin will avoid going to difficult geographies with sparse population.

The net result of this approach has been that while the country has a vast and diverse banking infrastructure and a well spread microfinance model, the challenge of making inclusion meaningful and covering financially excluded population remains a major challenge.

Changing the Policy Paradigm: Achieving Higher Inclusion

India is at a tipping point where enablers such as issue of “Unique Identification Number- Aadhar,”25 innovations in mobile technology and high mobile phone penetration, vernacular based micro-ATM and an efficient microfinance sector have opened a policy window.26 A few innovative and bold steps by both market players and policy makers are needed to seize this opportunity and change the paradigm from “obligation” to “opportunity.”

Meaningful financial inclusion will need concerted action across the four pillars—Demand, Supply, Technology and Regulation (See figure). The required action from the market and government are interlinked and overlap across all pillars other than regulation which is an exclusive policy domain.
The policy memo touches upon two required policy actions which have the potential of substantially enhancing financial inclusion.

Allowing Microfinance Institutions (MFIs) to Accept Member Deposits
Government policy needs to decisively move from channel bias to leveraging the strength of each player whether a post office or MFI. The policy needs to recognise that with nearly 20 million clients, that too in an adverse external environment, the contribution of the microfinance sector needs to be leveraged rather than ignored. Retailing small amounts of loan (~$150) at clients’ doorstep, while maintaining costs much below global/regional level (Table 1), the sector has bridged the last mile gap.

Policy Stance toward MFIs Examined
The public policy despite occasional references to the microfinance sector has remained neutral for most part and now borders on hostile. Current policy paradigm has two underlying strands a) MFIs even those which are NBFCs and hence regulated by the Central Bank cannot accept deposits and b) the cost of credit retailed by the MFIs is too high. Both assumptions/prescriptions suffer from ignoring empirical facts and global best practices.

Can Depositor Interest Not Be Protected with MFIs?
On the deposit side, the concern is about depositor interests and systemic risk. The policy concerns in the wake of mushrooming of NBFCs and the crisis in late 1990s have led to tighter regulation and regulation induced reduction in number of deposit taking institutions. In an interconnected financial world, while the regulations have ensured that share of public deposits in NBFCs source of funds dropped to 0.5% during 2010–11, share of other forms of public funds have gone up [bank borrowings –21%, debentures –22%\textsuperscript{27}]. What has changed is the nature of risk underlying the fact that smart and effective regulation needs to substitute conservatism. It is nobody’s case to risk either depositor interest or systemic stability, but argue as to how both depositor interest and systemic risk can be taken care of in case NBFC-MFIs are allowed to accept deposits.

Central Bank regulations require NBFC-MFIs to maintain minimum capital adequacy (CAR) of 15% and as excess leverage can pose risk, to begin with SI-NBFC-MFIs can be allowed to mobilise deposits from members (not public) in 1:2 ratio of CAR: Deposits. Going forward, the maximum permissible level of deposits can be linked to the rating grade. As another layer of prudential regulation, the deposits with MFIs can be covered under deposit insurance scheme and MFIs be required to maintain minimum liquidity ratio like banks. While the above measures can adequately take care of apprehensions of putting poor people at risk, these will also end the present uni-dimensional relationship between the MFI client by creating a two way interaction where the MFI is also partly dependent on its relationship with clients to generate funds for intermediation. Diversification of liabilities in the form of deposits will also reduce liquidity risk for MFIs. Layered financial infrastructure starting from credit only NGOs, to restricted deposit taking NBFC-MFIs and finally banks will also be in line with examples from other countries with a strong microfinance sector. The Microcredit Regulatory Authority (MRA) in Bangladesh which supervises the operations of NGO-MFIs allows for compulsory, voluntary and term deposits subject to the various conditions like deposits should not exceed 80% of loans outstanding. Deposits now account for 35% of liabilities of NGO-MFIs in Bangladesh. Nepal was the first country in South Asia to introduce specific regulations for the microfinance sector: the Development Banks Act, 1996 and the Financial Intermediary Societies Act (FISA), 1998. The regulation provides for limited banking license- various categories of Microfinance Development Banks and now deposits account for ~47% of liabilities of MDBs.

It is not that poor who do not save with banks in India do not save; they continue to save with local grocery store or a local chit or relatives or under their mattresses. Is it acceptable just because...
they are outside the purview of the central bank? It is high time this issue is seen from the prism of financial inclusion and development rather than purely as a systemic issue.

**The Bogey of Cost**

The cost fixation needs to be fixed based on facts and not perceptions. It is well recognised that delivering services at the doorstep has a cost higher than branch based model. Given that, apples need to be compared with apples and on that count, Indian MFIs score above their global peers (Table 1) in Operating Expense Ratio (OER). As the costs are a function of funding cost, operational cost and risk cost any further lowering of cost can only come through reduction in funding cost. Under the present regulations, MFIs depend on equity (~20%) and wholesale loans from banks (~80%) for their funding. If MFIs are allowed to take deposits even in the ratio of 1:2 of CAR: Deposits, it can lower the lending cost by 3.6% (Table 2).

Thus, allowing well regulated NBFC-MFIs to accept deposits can create a win-win position by lowering the costs, allowing for a holistic relationship between MFIs and Clients as well as lowering the liquidity risk of MFIs by not being solely dependent on bank funding. On inclusion side, this can immediately add 20 million clients impacting 100 million (including their household members).

**Mobile Money Transfer**

Besides savings, remittances and micro insurance are much needed services required by the poor. Literature suggests that remittances through mobile phones are not only less costly but also allow customers to transact any time. The high penetration of mobile devices in India (936 million) needs to be leveraged for remittances. World over mobile money transfer has two architectures a) Carrier only model and b) Bank-Carrier partnership model. In India, Reserve Bank of India starting with initial guidelines in 2008 till date has remained focussed on the partnership model. Similar to the underlying approach in not allowing MFIs to accept deposits, reliance on bank-led approach, concerns on systemic risk and money laundering prevail for mobile money transfer. Before going into global examples of carrier only model and its advantages, the impact of existing policy on inclusion agenda needs to be understood. By prohibiting cash out at mobile vendor outlets, the policy precludes anybody without a bank account (65% of population) from making use of this service. Keeping aside the systemic concerns, it is difficult to comprehend the logic behind tying money transfers to bank accounts as it only benefits the included.

Coming to risks, the prudential regulations of non-bank mobile money providers based on international examples like M-Pesa in Kenya as well as outlined by Di Castri (2013) in his paper can effectively mitigate the risk of mobile money customers. The challenges of money laundering can be met through limiting the maximum amount of remittance and linking the mobile accounts to Aadhar. 300 million Aadhar numbers have been already issued and it is planned to cover the entire population by March 2013. This opens a critical policy window in mobile money transfer as linking of Aadhar numbers to bank accounts for direct transfer of government subsidy is already in progress. Perceived risks of money laundering are better met by lowering the rate of

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<tr>
<th>REGION</th>
<th>OER*</th>
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<tr>
<td>India</td>
<td>10.9</td>
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<tr>
<td>South Asia</td>
<td>12.8</td>
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<tr>
<td>EAP</td>
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<td>Africa</td>
<td>29.3</td>
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<td>LAC</td>
<td>20.2</td>
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*Source: M-CRIL, 2012*

**Table 2. Existing Cost Structure Compared with Deposit-based Structure**

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<th>Existing Cost Structure</th>
<th>Cost Structure with Deposits</th>
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<tbody>
<tr>
<td>Cost of equity (20%)</td>
<td>0</td>
<td>Cost of equity (20%)</td>
</tr>
<tr>
<td>Cost of bank loans (80%)</td>
<td>11.2</td>
<td>Cost of bank loans (40%)</td>
</tr>
<tr>
<td>Cost of operations</td>
<td>11</td>
<td>Cost of deposits (40%)</td>
</tr>
<tr>
<td>Risk cost</td>
<td>1</td>
<td>Risk cost</td>
</tr>
<tr>
<td>Total Cost</td>
<td>23.2</td>
<td>Total Cost</td>
</tr>
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*Source: M-CRIL, 2012*
financial exclusion and enhancing financial integrity through electronic transactions that can be monitored and traced more easily than cash. The potential of allowing carrier based transfer in speeding up financial inclusion can be gauged from the fact that of the 2.5 billion financially excluded people in the world, 1.7 billion have a mobile phone.

International experience in the form of M-Pesa provides an example of leveraging mobile device. M-Pesa was launched by Safaricom in Kenya in 2007 and now 70% of Kenya’s poor and unbanked households have at least one M-Pesa user. The M-Pesa transactions account for 70% of all electronic transactions in the country but account for only 0.2% of value underlying the small value and frequent need of money transfer by the financially excluded and especially the migrant population. The link between higher inclusion and carrier based model is clearly seen in Di Castri (2013, p. 11) paper wherein of the 14 fast growing mobile money deployments, 12 belong to carrier based model. The flipside of M-Pesa’s applicability to Indian market is presence of multiple mobile network providers in India as against monopoly of Safaricom in Kenya. Multiple service provider challenge can be met through building systems for interoperability across networks like banks.

The Reserve Bank of India has been gradually easing the norms for mobile money transfer like allowing “mobile wallet” in 2010 allowing up to 5,000 rupees with mobile operators that can be used for merchant transactions. Recently, mobile money transfer riding on India Post infrastructure for cash-in and cash-out has also started. It is hoped that in near future passion for financial inclusion will prevail over financial stability concerns on carrier based model. Global best practices in the form of matching liquidity and other risk mitigants can be adopted to address current concerns (Di Castri, 2013 & Tarazi M. & Breloff P., 201029).

Allowing NBFC-MFIs to accept deposits and allowing carrier based cash transfers have the potential of bringing much needed savings and remittance services to a minimum of 200 million. However, these measures need to be backed by action on the demand side to translate increased financial access to economic growth. Poverty being primarily rural in India, key demand factors such as rain dependent agriculture, low risk appetite of the poor and their inexperience in setting up micro-businesses need to be addressed through public investments in agriculture, availability of risk mitigation mechanisms and provision of support services.

It is hoped that if the above steps are taken, the speed of financial inclusion can be accelerated, inclusion can be made meaningful and people will be able to avail of services they require rather than services offered. The suggested roadmap comes with a caveat that implementing suggested changes in isolation will be counterproductive. For ex. allowing NBFCs to accept deposit without appropriate regulatory oversight can lead to putting depositor’s interest at risk. Let a thousand flowers bloom and compete under the facilitating eye of financial regulation and policy as against banking monopoly. Let market and customer loyalty provide answers on effectiveness rather than regulatory conservatism.

Endnotes


7. National Bank for Agriculture & Rural Development, the apex bank for rural development.


15. $1 = Rs.55.


25. Aadhaar is a 12 digit individual identification number issued by the Unique Identification Authority of India on behalf of the Government of India.


Financial Inclusion in Tajikistan: Challenges Today and Opportunities for Tomorrow

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Introduction

Over the last two decades, microfinance in Tajikistan has emerged as a key provider of financial support to the people in Tajikistan, particularly for the rural poor. At one time offering loans only, today’s microfinance institutions (MFIs) offer different suites of financial products and services including micro-savings, time deposits, and micro-insurance. Contemporary MFIs in Tajikistan have followed a similar trend and have strategically shifted from donor-funded lending organizations (MLOs) to comprehensive micro credit and deposit organizations (MDOs), with an added focus on mobilizing rural deposits. As part of their mission, MDOs concern themselves with the financial sustainability of clients as well as the institution.

Despite achieving this operational graduation, MDOs have not been able to create and/or maintain their financial credibility with either existing or potential clients. Moreover, they have difficulty operating professionally and cost-effectively, both of which are needed to generate significant rural savings. It is the primary responsibility of the government and the MDOs to address this problem together and formulate client-specific policies to enhance trust with the local people and garner country-wide savings potential.

Background: Emergence of Microfinance in Tajikistan

Microfinance was introduced in Tajikistan in the early 1990s when people were facing extreme socioeconomic problems after the country’s independence. With the help of international NGOs and donor funding, people started to receive micro-credit to cope with tough economic circumstances and improve their lives. However, in the absence of any legislation, these organizations operated without a legal framework and without any consistent financial regulation to keep a check on their financial and operational efficiency. This gap led to the development and adoption of a microfinance legal framework in 2004. However, the unregulated credit industry from 1990–2004 had already taken its toll in the shape of financially unsustainable and operationally vulnerable MFIs, which not only lacked market credibility but also failed to gain the trust needed to attract significant rural deposits. The deposit products and services offered by MFIs never met the domestic demand and potential for micro-savings.

Core Problems: Inefficient Financial and Professional Management

After the adoption of the microfinance legal framework, microfinance became a significantly large industry with good business prospects under stringent financial regulation from government institutions. This can be judged from the fact that currently, around 125 microfinance organizations—consisting of MLOs and MDOs—operate in Tajikistan (NBT, 2012). Despite that and the presence of commercial banks, the network of financial service providers is still weak in Tajikistan with on average 3.9 bank branches per 100,000 adult population, in comparison to 21 in the UK and 35 in Romania (Pandya and Wilkinson, 2011). Moreover, 53% of households in Tajikistan do not use any financial services and 35% only use one kind of financial service (Pandya and Wilkinson, 2011). This is despite the fact that, on average, each household in Tajikistan has around two sources of income and 36% of them are dependent on remittances from...
abroad (Pytkowska and Koryski, 2010). All of it reflects significant demand for deposit products and services and immense savings potential in the country.

Despite this large savings potential (EBRD, 2011), statistics show that deposits attracted by banks have been less than 20% of the country’s GDP—18% or $967 million USD, by September of 2012 (NBT, 2012). This is despite the fact that remittances—which can be a vital driver for mobilizing deposits—were 40% of the country’s GDP in 2012 (NBT, 2012; Pytkowska and Koryski 2010). Pytkowska and Koryski (2010) also state that 84% of households (73% of MFO clients) in Tajikistan keep their savings as cash. Less than half of the households in Tajikistan (40%) save and, in most cases, save irregularly, only when there is any money left after covering everyday living expenses (MIX, 2009; AMFOT, 2009). The median value of the annual savings is only TJS $900 ($200 USD) per household (MIX, 2009; AMFOT, 2009). The most important reason for not saving or not being able to save is lack of sufficient income as well as lack of adequate financial services provided by MDOs for attracting micro-savings (MIX, 2009; AMFOT, 2009). Even though commercial banks offer relatively better services than MDOs, these are largely inaccessible for potential micro-saving clients in rural areas (MIX, 2009; AMFOT, 2009; EBRD, 2011). Only 11% of saving households keep their deposits with a financial institution, which means that overall less than 5% of households entrust their savings with a bank or an MCDO (MIX, 2009; AMFOT, 2009). This is an added reflection of the financial credibility of the deposit products and services offered by MDOs.

All of this demonstrates that the financial industry, particularly the microfinance sector, has largely been unable to gain the financial credibility of potential clientele and attract significant savings from the local population (ADB, 2013). One of the plausible reasons for inability of the MFIs, particularly the MDOs, to achieve this has been inadequate financial management, monitoring, and evaluating systems and professional capacity, as well as the technical knowhow to deal with the problem (ADB, 2013). “Overcrowding in the sector has led to market inefficiencies in that microfinance institutions have been unwilling to compete with each other. And the large number of institutions, many with inadequate reporting systems, increases the cost and difficulty of regulatory supervision. Very little has been funded through deposits. There are indications that the larger microfinance institutions are close to their borrowing limits” (ADB, 2013).

At the beginning, MFOs generally were financed by donor organizations and international funding. Even though most MLOs became MDOs post-2004 regulation, the overall funds payable to internal and external financial institutions by the MDOs almost tripled from $50 million USD in 2009 to $154 million USD in 2012 (NBT, 2012). Though deposits attracted by MDOs increased from $5.5 million to $23.4 million USD during the same time, their increasing dependence on international funding reflects a systemic un-sustainability and lingering operational weaknesses since the early 1990s (NBT, 2012). At the same time, the loan portfolio of MFOs increased from $14 million USD in 2006 to $193 million USD in 2012, showing increasing dependence of clients on the credit disbursed by these organizations. This, in a way, showed that despite low levels of deposits being kept by the people within these organizations, lack of convenient financing options led people to go for options they would otherwise not have opted for in normal circumstances. Under this scenario, it is the primary responsibility of the main players in Tajikistan’s financial market, primarily the government, to make client-specific policies and strategies to allow these MDOs to gain financial credibility and incentivize the people to save money in formal institutions.

**Policy Recommendations for Government**

Three policy measures can be adopted to address these concerns: 1) stringent financial and operational regulation of the MDOs, 2) making necessary changes in the microfinance legal
framework, and 3) making financial literacy programmes for the local population as a pre-condition for all the MDOs, apprising them of the future benefits of micro-savings and deposits.

1. Financial and Operational Regulation

In terms of the first policy measure, there is an emerging need to establish a specialized government body which consistently evaluates the existing MDOs in Tajikistan and takes corrective legal and operational measures to address their weakening financial and professional capacity. The government of Tajikistan and the existing MDOs can be the main players in order to negotiate the feasibility of forming such a body in Tajikistan. Although the government of Tajikistan has recently established the Credit Bureau, the primary responsibility of this institution is only to monitor the financial performance of the MDOs rather than evaluate their financial and operational efficiency. Since the reality of stringent regulation will have far-flung effects in terms of strengthening the financial industry in Tajikistan, the government of Tajikistan has a particular incentive to cooperate with MDOs. Similarly, since there will be an increased likelihood of deposit mobilization for the MDOs with the establishment of such an agency and its technical services, it will also provide an incentive to the MDOs to participate in such initiative.

In addition, as one of the main reasons why MDOs have not been able to establish a sustainable relationship with deposit-keeping clients is the lack of financial and operational productivity, a government evaluator, with technical and financial knowhow and institutional capacity, will be able to enhance the current capacity of the microfinance industry with the help of the international agencies and consultants. Moreover, this will also help raise the level of trust and confidence among local people in the financial products and services of the MDOs.

2. Revising Microfinance Legal Framework

It has also become increasingly important that in the fast-changing microfinance industry, a better understanding of the needs and preferences of clients and the microfinance legal framework is consistently revised by the government central bank, National Bank of Tajikistan (NBT), to ensure that issues and concerns within the financial industry are dealt with on an immediate basis. A consultative group of all MDOs in Tajikistan may provide a convenient forum for the NBT to consistently remain in touch with the preferences and priorities of MDOs and the underlying structural changes required to facilitate deposit mobilization. These consultations would ultimately benefit the aims and objectives of the NBT by strengthening the financial sector in Tajikistan and also providing a chance for MDOs to consistently inform the government of their issues and concerns. Hence, the proposed initiative is likely to work for the benefit of both segments (government and MFIs) of the main stakeholders.

3. Financial Literacy Programmes

In terms of the third policy measure, it is proposed that current initiatives of the government with regards to the financial literacy of the people are complemented and are implemented country-wide. The National Bank of Tajikistan is trying its best to make the necessary amendments to the microfinance legal framework in order to ensure a level playing field for the financial intermediaries and current and potential customers. Recently, NBT’s working group exchanged visits to Armenia in order to improve the customer rights protection within the banking industry in Tajikistan and initiate financial literacy programmes for (potential) clients. However, this objective should be realized with coordination and help of the MDOs whose social mobilisers and banking officers can be involved to conduct the financial literacy programmes. This will not only enhance the professional capacity of these MDOs but also reinforce the trust and confidence of the local people on their products and services, which has also been one of the main priorities of NBT. Hence the proposed initiative will most likely be a win-win situation for the main players—specifically government and the MFIs—in complementing the value-addition of the financial industry in Tajikistan in meeting the financial requirements of the people.
Conclusion

Overall, it is widely accepted that savings held in formal institutions help the economy to grow through the process of money in circulation. With this in mind, all MDOs should know that micro-financing is not just about providing micro-credits. Savings are an equally important element. Moreover, as micro-financing is generally accepted as a service to the poor, it should be noted that financial illiteracy is also a form of poverty that should be coped with. In any case, it is believed that by following the above-stated policy measures and strategies, the current financial performance and deposit mobilization efforts of the MDOs can be complemented significantly, for the ultimate benefit of local people in particular and the country’s financial stability and growth in general.

References


ACCESS TO TRANSACTIONAL SERVICES: THE FIRST STEP TOWARD SUSTAINABLE FINANCIAL INCLUSION

María del Pilar Galindo Vergara
Advisor to Deputy Minister, Ministry of Finance and Public Credit, Colombia

Is Traditional Banking Well Suited to Reach the Poorer?

The high costs associated with the intermediation business, as well as the limited access to relevant information, is reframing the role of traditional banking in bringing access to formal financial services to the poor.

The purpose of this policy memorandum is, on one hand, to show how taking advantage of the installed capacity of telecommunication technologies will reduce some of the most important obstacles in financial inclusion, for example, high costs and limited access to relevant information; and, on the other hand, to point out the importance of bringing transactional services to the people as a sustainable way to pursue financial inclusion, even before other more sophisticated services, as savings or credit. In order to do that, granting the soundness of the financial system and the safety of the resources from the public, it is necessary to create a new financial license with less cumbersome regulations than those applied to traditional banking.

Access to Financial Services as a Social Equality Issue

For several reasons, the Colombian economy has not been able to provide the population with adequate levels of access to a wide spectrum of goods and formal services, such as basic facilities, health, education, postal services, waste collection, drinking water, etc. This lack of access, which is directly linked to people’s welfare, affects especially the poorest and expands social inequality.

Unserved people obtain these services from informal providers, subject to high costs, lack of information, without consumer protection, and without the fulfilment of minimum standards. This situation constitutes a poverty trap itself. And, what is true for general services, is also true for financial services.

Despite government efforts to broaden access to formal financial services, the cumbersome regulatory framework, operational issues, high costs, and other obstacles to providing these kinds of services have prevented the achievement of a true scaling-up of access, especially in marginal sectors of the population.

Only recently has the tremendous potential of new technologies been understood as a way to bring wider access and real scaling-up of financial services. This understanding has been true particularly in developing countries, which suffer from huge infrastructure delays and low bank penetration levels.

Access Without Usage, Is It Really Working?

In 2007 Colombia started to develop a branchless banking scheme, whose main purpose was to reach remote regions of the vast geography of the country, in order to deliver government benefits to people. Around the same time and with similar purposes, the Government issued Decree 4590 of 2008 setting out the regulation of electronic deposit accounts (EDAS).
Even if both branchless banking and EDAS started as a mean to ease Government-to-person payments, at the present they have evolved to become usable channels for financial inclusion and they are allowed to supply more products and services.

Familias en Acción as well as other welfare programs implied the opening of almost three million accounts across almost 100% of the Colombian territory. Indeed, of the 1,102 Colombian municipalities, only 11 do not have financial coverage. This coverage includes traditional banks but mostly branchless banking.

Table 1, which shows the share of Colombian adults who have an account, reveals increasing penetration in the latter years. From 2006 to 2011, the share of adults holding an account increased by 34%, reflecting both the G2P policy and the introduction of the EDAS and the simplified procedure to open accounts issued by the Financial Superintendence.

However, according to the Financial Superintendence, the average balance of these accounts is only COP$20,000, around USD$11 a year. In the same sense, the World Bank survey on demand shows that only 30.43% of Colombians older than 15 declare having an account, which could mean that, even if the financial institution registers a great amount of accounts and financial penetration, it is very likely that people do not even know they have an account, and obviously, they do not use it.

An analysis of the whole picture clearly shows that, even if the efforts made in the past have made it possible to gain wide geographical coverage and have increased access to some financial products, Colombia has not yet reached a real financial deepening since most of the accounts are not being actually used.

Table 1. Banking Access in Colombia

<table>
<thead>
<tr>
<th>Year</th>
<th>People with at least one financial product</th>
<th>Banking indicator*</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010 I</td>
<td>17.087,948</td>
<td>58.0%</td>
</tr>
<tr>
<td>2010 II</td>
<td>17.787,962</td>
<td>60.2%</td>
</tr>
<tr>
<td>2010 III</td>
<td>18.396,948</td>
<td>62.0%</td>
</tr>
<tr>
<td>2010 IV</td>
<td>18.558,773</td>
<td>62.2%</td>
</tr>
<tr>
<td>2011 I</td>
<td>18.717,561</td>
<td>62.4%</td>
</tr>
<tr>
<td>2011 II</td>
<td>18.890,691</td>
<td>62.7%</td>
</tr>
<tr>
<td>2011 III</td>
<td>19.113,923</td>
<td>63.1%</td>
</tr>
<tr>
<td>2011 IV</td>
<td>19.641,042</td>
<td>64.6%</td>
</tr>
<tr>
<td>2012 I</td>
<td>19.925,986</td>
<td>65.2%</td>
</tr>
<tr>
<td>2012 II</td>
<td>20.284,415</td>
<td>66.0%</td>
</tr>
<tr>
<td>2012 III</td>
<td>20.519,804</td>
<td>66.5%</td>
</tr>
</tbody>
</table>

Source: Banking Association (Asobancaria) and DANE.

* Banking indicator = number of adults with at least one financial product /Number of adults

Rethinking the Strategy

Why is it so difficult to bring financial services to most people, especially the poor? This question is a regular concern for a lot of policy makers around the world and certainly does not have an easy answer.

In Colombia, as in many other jurisdictions, the approach to financial inclusion started as a problem of access to credit. Policymakers focused their efforts in finding ways to bring resources from surplus units to deficitary ones. Of course, this kind of approach faced the typical obstacles of traditional banking products. The traditional banks have to deal with several regulatory issues; they must maintain adequate solvency margins; they must have administration systems for liquidity, credit, operational and other risks; they must guarantee high levels of personal data safety; and they need a lot of information from potential clients in order to manage risk effectively. At the same time, offering only saving accounts may not be profitable for the traditional banks simply because it is expensive. Therefore, banks are interested in clients who can be offered credit. Intermediation is where traditional banks make most of their profits.

In this context, the costs associated with intermediation mean that banks must search for a specific market in order to be profitable. Their target is not the entire population but a subset composed mainly of people who have a stable income.
In a country like Colombia, where more than 50% of the population is informal, the traditional banking approach to achieve financial inclusion seems to be unwise at best. Bringing financial services to the masses (most of them informal) requires a different way of thinking, a dramatic reduction of costs, and a certain expertise that the traditional system probably does not have, or even if they do, they cannot afford.

The problem is not solved just by providing credit or opening accounts using mobile technologies. On one hand, providing credit still requires performing credit analysis, gathering and studying information on the clients, having an effective collections scheme, and controlling operational risks. Because the behavior of credit directly affects the capital margins of the bank, the bank lacks incentives to assume too much risk when lending money. In other words, banks can use technology to provide credit, which will surely reduce some of their costs, but, even so, costs will still be very high. Moreover, even if costs were low, banks would not be willing to give credit to people they do not know, and even basic information is difficult to obtain in an informal market such as the Colombian one. On the other hand, opening and maintaining saving accounts is also expensive and, without the credit part of the business, just not profitable.

So, the usage of technology and cheaper channels by themselves will definitely not help to reach the poor if they are applied to traditional products. Something has to be done first: something that helps the market to gain information from informal population, something that really cheapens costs while meeting some of the needs of this population. In that sense CGAP says:

“Frankly, the m-payments platforms themselves are only part of the fun. Perhaps more exciting will be the ways these platforms (such as M-PESA and Coda) can be used as the “rails” on which innovative financial services can be offered—say, enabling people to pay for micro-insurance with micro-premiums, enabling “pay-as-you-go” energy or clean water access, or even enabling a new kind of microlending altogether.

Innovations like these unlock the potential of digital transactions for the base of the pyramid, and over time may stimulate additional offerings targeting a now empowered mass market, (…)”

That is why transactional services provided by a new financial institution, under a new financial license that is less cumbersome than the one granted to a traditional bank, can provide innovative services without all the regulatory charges and high costs typically associated with the intermediation business. The proposed institution would not need to deal with all the risks that traditional banks face; it would not need to gather or analyze information from people, or perform credit analysis, or have sophisticated risk administration systems, or have high solvency margins. The exclusive dedication to a specific kind of services would definitely reduce costs and make it possible to reach the poor. At the same time, the institution would help the market gain information regarding, for example, people’s payment behavior. This would be extraordinary valuable information for moving to other stages of financial inclusion, like credit.

The new license combined with the usage of technologies would reduce some of the most important obstacles Colombia faces to achieving deeper and more sustainable financial inclusion.

**A Recommendation**

- In a country like Colombia, financial inclusion should not start by deepening traditional products. They are expensive and therefore cannot reach a great number of Colombians. The proposed alternative offers a true reduction of costs.
- Transactional services such as remittances and payments are highly demanded and can be efficiently provided at low cost. Since they do not imply intermediation, a less cumbersome regulatory framework can be designed to provide this kind of service and thereby lead to a true reduction of costs and information barriers.
There are a lot of industries willing to reach this market because they already have a presence among the unbanked population. According to the Colombian Ministry of Telecommunications, there are 49,066,359\textsuperscript{15} mobile phone subscribers while Colombia’s population is 46,988,524\textsuperscript{16} people, which means a coverage of 104%. Most of the branchless banks are retailers (small stores, pharmacies, supermarkets), postal offices and cooperatives. They now have enough capillarity to reach most of the population, both in urban and rural sectors.\textsuperscript{17}

Colombia must take advantage of the enormous potential and capillarity of technology and other sectors that are already installed in most of the territory, and most important, who already have the confidence of the population.

It is necessary to pass a law that creates a new financial license with less cumbersome regulatory requirements that meets the kind of risks that the new institution would be managing. This institution will be able to get deposits from the public and provide transactional services. It will imply more competition for traditional banking and for non financial institutions that provide nowadays, postal remittances.

It is necessary that the new institution have both financial regulation and supervision. A balance between promoting financial inclusion and ensuring adequate prudential regulation will grant sustainability to the policy.

It is very important that the new law be technology-neutral and actor-neutral, which means that any player (financial institution, mobile network operator, postal sector company, among others) can apply for the new license and design the product with any of the available technologies.

**Endnotes**

1. There is no legal definition for what “transactional services” are in Colombian legislation. For the purposes of this memo, “transactional services” are understood as the subset of services that are not active operations of the financial institution and that can be performed even if the person who uses them is not a client of the institution. Financial services in Colombia have typically been classified depending on the place they occupy in the balance sheet of the institution. Active operations are those in which the financial institution is a creditor of the client and the client has the obligation to pay back a sum plus interest. This operation would be included in the active part of the balance sheet of the institution. Also for the purposes of this memo, saving accounts which remunerate the account holder are excluded from the definition of “transactional services” even though they are not active operations. Examples of “transactional services” are payments, remittances, balance consultations, collections, and transfers.

2. Branchless banking is defined as: “The delivery of financial services outside conventional bank branches. Banking beyond branches uses agents or other third party intermediaries as the primary point of contact with customers and relies on technologies such as card-reading point-of-sale (POS) terminals and mobile phones to transmit transaction details”. Guideline Note Mobile Financial Services: Basic Terminology. Mobile Financial Services Working Group (MFSWG). AFI. http://www.afi-global.org/sites/default/files/publications/MFSWG%20Guideline%20Note%20on%20Terminology.pdf.


4. Familias en Acción is a governmental initiative to deliver nutritional or educational benefits to children belonging to poor, indigenous or displaced families.

5. Is important to mention that in 2009, the Financial Superintendence issued the Circular 53 setting out a simplified procedure for the opening of accounts. This procedure relaxed some Know Your Customer (KYC) requirements for small accounts with specific conditions. This initiative also influenced the positive access indicators of Colombia in the latest years. Increases in access and geographical coverage are mostly due to KYC flexibility and G2P policies.


14. Colombian financial system does not have a financial institution which can perform exclusively transactional services. Therefore, all existing financial institutions will have to deal with high regulatory requirements and high costs.


Demand-side Considerations: Consumer Protection, Financial Education, Client Preferences
ENHANCING FINANCIAL INCLUSION THROUGH THE IMPLEMENTATION OF SUSTAINABLE FINANCIAL EDUCATION AND LITERACY PROGRAMS

Frezer Ayalew Mohammed

Frezer Ayalew Mohammed, Director, Microfinance Institutions Supervision Directorate, National Bank of Ethiopia

Statement of the Problem

Low or limited level of financial inclusion in a given country has been one of the major contributing factors for the existence of acute poverty and poor standard of living conditions for people living in those countries. The two main pillars that make financial inclusion a reality in a given country include: access to different financial services that meet the needs of customers at an affordable price, and regular and enhanced utilization of these services by customers.

In this regard, access to financial services extends well beyond the provision of credit to availability of well tailored saving and investment products, insurance (both life and general), access to appropriately priced money transfer services or remittances, etc. On the other hand, in order to harness the potential benefit of these services and achieve the desired impact to an individual, the financial system, and the overall economy at large, there should be increased utilization of these services by the public. Thus, the level of participation of the public in the financial system needs to be enhanced.

It should also be clear that access to financial services and use of financial services mean different things. “Access” refers to the availability of reasonable financial services at affordable prices, while “use” refers to the actual consumption of financial services. Accordingly, there might be customers who have access and use the service, customers who have access but do not use the service, and customers who do not have the access and hence don’t utilize the service.

Access to finance by itself doesn’t guarantee the automatic inclusion of the public to the financial services unless the issue of financial education and literacy programs is dealt with in parallel. Financial education and literacy refers to the knowledge of basic financial and economic concepts and the ability to use that knowledge and other financial skills to manage financial resources effectively for better economic well being. In this regard, to increase the level of utilization of financial services, consumers must understand how to use different financial services. To this end, implementing coordinated and holistic financial education and literacy programs in a given country deserves the utmost attention and commitment of policy makers and relevant stakeholders.

In Ethiopia, the level of financial inclusion, despite improvements shown in recent years, remains very low. Currently, it is deemed that only 20% of households have bank accounts and are linked with the formal financial system. Thus, given supply side constraints prevailing in the country’s financial system, the low focus given to the issue of financial education and literacy program has undeniably been one of the critical barriers of enhancing financial inclusion in the country. The population of Ethiopia is 86 million, of which approximately 17% is estimated to live in urban areas. In addition, Ethiopia has over 80 languages with 200 dialects. Considering the huge and diverse population, there is a strong need for the nation to implement a comprehensive, streamlined, and complementary financial education and literacy program by making appropriate policy interventions. This is important to enable the public to be well aware of the already accessible financial services, to utilize those services in a regular and effective manner, and to foster future utilization of new services whenever new accesses are created or new products are developed.
This policy memo highlights the various measures that need to be taken by policy makers to implement broad-based, coordinated, and sustainable financial education and literacy programs that foster inclusion.

**Background**

The main objective of the Ethiopian government is to achieve broad-based, accelerated, and sustained economic growth and to eradicate poverty in the country. The government has set a vision of being a middle income country by 2025. To this end, the government has been developing and implementing various poverty reduction strategy plans. The current plan under implementation [Growth and Transformation Plan (GTP) which runs from 2010/11 to 2014/15] envisages an accessible, efficient, and competitive financial system across the country. One goal is to increase the level of domestic savings as percentage of GDP from the existing 5% to 15% within the plan period.

The formal financial system in Ethiopia constitutes commercial banks, development finance institutions, microfinance institutions, and insurance companies. As of September 30, 2012, there were 16 private and 2 state-owned commercial banks, 1 state-owned development bank, 1 state-owned and 15 private insurance companies, and 32 microfinance institutions (of which 10 are majority-owned by regional governments). In addition, as semi-formal financial institutions, large numbers of financial cooperatives are found in the different parts of the country, providing financial services to their members. Despite the number of financial institutions, Ethiopia, similar to other developing countries, remains one of the most under banked nations in the world with access to finance being one of the lowest ranked.

Nevertheless, Ethiopia has taken major steps to improve access to finance in the past years. This is demonstrated by the increasing level of branch expansion (whereby one branch of National Bank of Ethiopia is serving 52,000 people as of September 2012) and the strong presence of microfinance institutions in urban and rural areas of the country. In addition, Ethiopia has been engaged in undertaking various financial inclusion initiatives that have the potential to improve access to finance for its citizens. Some of these interventions include:

- modernization of the national payment and settlement system,
- establishment of a modern and state of the art credit reference bureau (a bureau that can in-house bank and microfinance borrowers under one database),
- implementation of a Rural Financial Intermediation Program,
- implementation of Micro and Small Enterprises Development Strategy (in which MSE financing is part and parcel),
- introduction of mobile and agent banking regulatory framework and development of micro-insurance regulatory framework, and
- development of regulatory and supervisory framework for micro insurance.

Implementation of these initiatives will improve the level of access to finance in the country, but will be more effective in achieving the ultimate goal of financial inclusion if they integrate with financial education and literacy programs at a national level.

So far, little or no work has been done on the issue of financial literacy in a manner that is coordinated and broad-based. This is one of the critical barriers to financial inclusion in the country. In addition, the few financial education and literacy initiatives (mostly donor driven ones) have proven to be unsustainable and limited in scope. Moreover, these uncoordinated initiatives, despite some signs of success, have resulted in duplication of effort and are not always aligned with the national financial sector strategy.
Analysis

The Need for Financial Literacy

The level of financial knowledge and skills among the majority of people, particularly those living in the developing world, is very low. These people (including their businesses) who have a low level of financial literacy are unable to make wise financial decisions and therefore participate less in the formal financial system, adversely affecting their economic well-being and the growth potential of their respective jurisdictions. If these people are subjected to some form of financial education and literacy interventions and possess financial knowledge and skill, it is likely that they will participate in the financial system and be financially included accordingly.

The different stakeholders in Ethiopia (i.e., policymakers, regulators, financial service providers, etc.) need to recognize that addressing the issue of financial literacy is critical in the quest to achieve financial inclusion, which in turn has a strong bearing on financial stability and economic growth. It should be understood that enhanced financial inclusion leads to an increased level of savings in an economy that in turn fosters growth in investments, leading to creation of employment opportunities and enhanced productivity in an economy.

Meanwhile, most people do not know where or how to access financial services, nor do they understand its benefits. For instance, most people living in an urban setting (where access is not a problem) do not have a bank account.

Thus, it is essential for the public to know, understand, and develop the ability to evaluate and assess financial products and services and transact in the financial market accordingly. Many individuals and small businesses need guidance on the advantages and disadvantages of alternative forms of financing (such as peer-to-peer lending, supplier’s credit, etc.) and how best to present their investment project to potential financiers.

The Need for National Financial Education Strategy

Policymakers in both developing and developed countries have been increasingly aware of the importance of financial education. There are several advantages to developing a tailored national strategy. It can provide the pre-requisite for efficient financial education efforts at a national level and promote a smoother and more sustainable cooperation between interested parties and stakeholders. In addition, a strategy avoids duplication of resources and, more importantly, allows the development of articulated and tailored roadmaps with measureable and realistic objectives based on dedicated national assessments and innovative practices. This need for a harmonized and coordinated intervention in financial literacy is more crucial and apparent in diverse and populous nations such as Ethiopia. In addition, the fact that it involves many stakeholders, such as the National Bank of Ethiopia, government institutions (such as the Ministry of Education), financial institutions, civil society, and others, makes the need to have a national strategy very plain.

The experience of other countries suggests that adopting a unified and coordinated national strategy enables partners to leverage respective strengths, thereby exploiting comparative advantages and reducing the risk of duplication and unintended gaps. According to an OECD survey in 2012, the majority of the countries surveyed (36 developed countries) have already launched national strategies or are in the process of launching such strategies.

The main challenge to successfully implementing a national financial education strategy is to appoint a lead organization. A lead organization needs to provide focus, momentum, and effective coordination, and to ensure that the agreed strategy is implemented and is also kept under review. For this purpose, the National Bank of Ethiopia, which is the regulatory body of the financial system and the one responsible for ensuring financial inclusion, is in the best position to handle this assignment (at least in the initial years). In addition, the fact that the Central Bank
is a public sector organization that is independent from the financial service industry provides it more credibility and unique insight into financial inclusion and consumer protection issues.

**Policy Recommendations**

So far, the National Bank of Ethiopia, taking the lead role, has been undergoing different financial inclusion initiatives aimed at addressing supply-driven constraints. In order for both the existing financial services and the new initiatives to meet their ultimate objectives, committing resources and enhancing the financial literacy of the public in a coordinated and holistic manner is fundamental. To this end, the following policy recommendations specific to Ethiopia are proposed.

**Develop National Strategy for Financial Education**

This tailored national strategy, among other things, should unequivocally acknowledge the importance of financial education in the country, define financial education and its scope, identify different stakeholders to be involved in the process (including identification of a lead organization), establish a road map to achieve specific and predetermined objectives, and give direction on the sourcing and management of financial resources.

**Establish National Council for Financial Education**

Establishing this council, in line with the provision of the national strategy and as supported by the necessary legal mandate, is the next logical step. This council shall be responsible for guiding, coordinating, implementing, monitoring and reviewing the financial education and literacy program at a national level. The council, chaired by the National Bank of Ethiopia, shall be drawn from all relevant public and private institutions as represented by members who have the ability to influence policies and decisions (in their respective institutions/sector) and have the capacity to mobilize resources including financial resources. Given the specific roles and mandates each institution has in Ethiopia, the following are identified as the most appropriate ones to be included in the national council:

- National Bank of Ethiopia
- Ministry of Finance and Economic Development
- Ministry of Education
- Ministry of Women, Children and Youth Affairs
- Federal Micro and Small Enterprises Development Agency
- Ministry of Government Communication Affairs,
- Federal Cooperative Agency
- Ethiopian Bankers Association
- Association of Insurance Companies
- Association of Ethiopian Micro Finance Institutions
- development partners

**Develop a National Financial Education and Literacy Framework**

This framework should consider the national strategies and objectives and should cover relevant topics found in the financial service ecosystem including credit, saving, insurance, payment system, use and handling of currency, budgeting and cash management, financial policy and regulation, etc. In addition, this framework should be developed with the view of undertaking a sustainable, coordinated, and prioritized financial education program in the country through the application of effective dissemination strategies. At this juncture, it should be sensible to mention the need to get the developed national framework translated into the major languages that are widely spoken in the country.
Develop Regulations for Implementation of the National Strategy

Depending on the actual content and provisions specified in the national strategy, there might be issues that require existence of legal frameworks/directives that would enforce certain courses of actions by each stakeholder—for example, contributing funds for implementation of the strategy in a sustainable manner by financial service providers, etc. To this end, the National Bank of Ethiopia, which is the regulatory organ of the financial system, will be responsible for the development and issuance of National Financial Education and Literacy Framework and other corresponding regulations/directives after undertaking in-depth discussion and consultation with relevant stakeholders, including the National Council for Financial Education.

Conclusion

Countries such as Indonesia can be considered a good role model for implementation of national financial education and literacy programs. Indonesia has endorsed a legal framework on financial education, has included important stakeholders by establishing a special taskforce on financial education, and has achieved an important milestone in improving the financial literacy level of its population and the level of financial inclusion in the country.

Similarly, Ethiopia, within a period of 3–5 years, should implement a national financial education and literacy framework through effective leadership and enhanced cooperation of key stakeholders in a manner that leads to greater participation of the public in the financial system in a continued manner. In addition, the process should be implemented by putting in place the appropriate road map with specific and predetermined objectives and an effective monitoring and evaluation system.

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DEVELOPING A FRAMEWORK FOR FINANCIAL CONSUMER PROTECTION IN VANUATU

Simon Tiwok

Manager for Domestic Markets and Financial Inclusion, Reserve Bank of Vanuatu

Problem Statement

Weak competition in the financial services sector, combined with the absence of any mechanism that enhances greater transparency and fair market practices, is generally linked to inefficiency. This inevitably translates to high bank fees and charges and high interest rates on borrowing. Generally, the high cost of banking services is linked to over-indebtedness, low consumer confidence, and low economic development.

Vanuatu has no consumer protection mechanism, and like most other low-income countries, the level of competition within the financial services sector is weak. Interest rates on lending, bank fees, and charges are generally considered to be high when compared to neighboring similar economies (Arubilake and Karae, 2011). The issue of high banking cost remains a major political and public concern due to its impact on income and standard of living, particularly to low income earners and rural population groups.

Davies and Vaught (2011), in their review of interest rates and bank profitability in the South Pacific, further confirmed that the average interest rate spread for Pacific Islands is slightly higher than the level in the Caribbean and South Asia. For example, interest rate spread for Vanuatu is higher than it is in Barbados, Grenada, and St. Kitts and Nevis. The report also confirmed that, in the Pacific Islands region, the weighted average lending rate for Vanuatu is higher than the level in Fiji Islands and Papua New Guinea (PNG) until 2009 (refer to Figures 1 and 2).

Figure 1. Average Interest Rates Spread – Cross-Country Comparison

<table>
<thead>
<tr>
<th></th>
<th>Vanuatu</th>
<th>St. Kitts &amp; Nevis</th>
<th>Grenada</th>
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<td>2009</td>
<td>7.73</td>
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<td>5.73</td>
<td>7.47</td>
<td>6.10</td>
<td>6.51</td>
<td>9.90</td>
</tr>
<tr>
<td>2012</td>
<td>7.24</td>
<td>4.96</td>
<td>6.51</td>
<td></td>
<td>5.88</td>
<td>10.30</td>
</tr>
</tbody>
</table>

Figure 2. Weighted Average Lending Rates – Cross-Country Comparison

<table>
<thead>
<tr>
<th></th>
<th>Vanuatu</th>
<th>St. Kitts &amp; Nevis</th>
<th>Grenada</th>
<th>Barbados</th>
<th>Fiji</th>
<th>PNG</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>10.92</td>
<td>8.48</td>
<td>10.70</td>
<td>9.66</td>
<td>7.52</td>
<td>10.20</td>
</tr>
<tr>
<td>2011</td>
<td>10.28</td>
<td>9.10</td>
<td>10.33</td>
<td>8.75</td>
<td>7.42</td>
<td>10.70</td>
</tr>
</tbody>
</table>
Background

Increased financial consumer protection supervision has become inevitable since the global financial crisis. “Without adequate consumer protection, the benefits of financial inclusion can be lost” (Alliance for Financial Inclusion [AFI], 2010). Financial consumer protection fundamentally focuses on addressing market failure (AFI, 2010) and centers around three fundamental principles: disclosure, fair market treatment, and redress mechanism. Financial service providers are pushed to be more transparent in their business conduct, disclose key information about their products, and treat consumers fairly and ethically. Generally, an effective financial consumer protection supervision framework, complemented with adequate financial education, effective prudential supervision, and financial inclusion, should raise the consumer confidence in the financial system and promote equitable development and financial stability. A greater level of confidence raises the usage of safe financial services, attracts new clients, enhances stability in the financial system, and promotes inclusive developments (Rutledge, 2010).

Financial inclusion priorities, for Vanuatu, are set forth in several documents:

2. the Commitments to the Maya Declaration (Annex II);
3. the 2020 Money Pacific Goals (Annex III); and

Consumer protection is identified as a priority area in all the four programs and in January 2012 the PIWG designated Vanuatu, among its members, to take the lead in framing a financial consumer protection framework.

The commitment to advance financial inclusion in Vanuatu was further reinforced by the findings of the Financial Services Sector Assessment (McCaffrey, 2011), which estimated that 81 percent of the total population has no access to any formal financial services. The low level of access may be essentially attributed to the cost of the services, the low consumer understanding of the value of financial services, and the geographic challenge. For Vanuatu, the main objective of the National Financial Inclusion Taskforce is to enable financial access to at least 51 percent of the population by end of 2015.

Analysis

The Link between Financial Consumer Protection and Financial Inclusion

Financial inclusion is generally about delivering sustainable financial services such as savings accounts, credit, insurance, and money transfer services at affordable cost to disadvantaged and low-income people. Such objectives led to significant innovations in financial products and services, such as agent banking or In-Store Banking by Westpac Banking Corporation Vanuatu, and mobile financial services by Digicel Vanuatu, the National Bank of Vanuatu and Westpac Banking Corporation Vanuatu.

The sophistication of financial products and the inexperience with new or existing products warrant consumer protection to minimize the danger of reckless lending and borrowing practices. The benefit of financial consumer protection, in combination with financial education and other policy initiatives, is wide. At the client level, consumer protection would increase consumer confidence in using competitive and safe financial products and services and reduce over-indebtedness. To financial services providers, more confidence may lead to more clients and more business. Further, since financial consumer protection always goes hand-in-hand with financial education, service providers would also benefit from more well-informed clients
who understand their financial obligations. Overall, greater consumer confidence and usage of financial services would promote financial stability and equitable development.

The Link between Access to Finance, Interest Rates, and Financial Inclusion
Interest rates, as with bank fees and charges, are a key factor that affects usage of financial services. Higher interest rates reduce the possibility for firms to make profit out of an investment and prevent small businesses from growing larger.

Interest rates on micro-credit are generally high due to the large administrative cost involved. But when the market is left unchecked, some service providers abuse their market power and increase profit at the cost of inexperienced clients who, in the end, may be left over-indebted.

Lower interest rates are an incentive to use financing, just as lower fees and charges are incentives to use other financial services. Disclosure, especially of price-related terms and conditions, and fair business practices are proven mechanisms that may drive down the cost of financial product and services and encourage greater access and usage by the underserved population.

Success of Financial Consumer Protection Framework in Malaysia and Peru
With financial consumer protection, as with many other policy issues, there is no one particular policy framework that works for every country. It is, however, important to recognize that since the onset of the global financial crisis in 2008, consumer protection has gained a larger position in policy debates within the international community. A number of financial consumer protection guidelines were subsequently released to assist countries in assessing and measuring their existing laws, policies and regulation with the objective of strengthening their financial structures to promote equitable development.

Considering the four policy areas promoted under the Maya Declaration, consumer protection is the most popular with AFI members (AFI, 2012). While many countries have had some form of consumer protection in the past, evidence showed that, when addressed in combination with financial education policy, financial consumer protection frameworks that were tailored to fit the three guiding principles—transparency, fair treatment, and the redress mechanism—eventually generated positive results.

Malaysia. After the Asian financial crisis of 1997, the Bank Negara Malaysia took the lead in improving financial stability by enhancing consumer protection and market conduct. The whole program started in 2001 with the launching of the Financial Sector Master Plan (FSMP) phase 1, which outlined a decade-long reform (2001–2010) to enhanced consumer financial education and transparency in providing financial services, the establishment of legal redress mechanism, the expansion of a Banking Mediation Bureau and the Insurance Mediation Bureau, the introduction of anti-trust regulation, and the establishment of a deposit insurance fund.

The comprehensive framework, which included market-conduct regulation and supervision, avenues for redress, and consumer literacy, was built progressively over time, in collaborations with consumer associations and the industry. The program was ultimately expected to enhance financial stability, consumer confidence and fair market competition with minimal cost to the industry (AFI, 2011). The IMF country report number 13/52 on the Financial Sector Stability Assessment of Malaysia, published on February 2013, eventually confirmed that the Malaysia economy has weathered the recent global financial crisis well, mainly due to the well developed supervisory and regulatory regime under the FSMP.

Peru. Peru has an extensive regulatory and supervisory framework for consumer protection that emphasizes transparency, fair treatment, disclosure, and sales/marketing practices (SBS and CGAP, 2010). SBS has the mandate to supervise and enforce the policies while the resolution of consumer complaints is handled by the financial institutions themselves, the Consumer Protection Commission, or the Financial Ombudsman.
The disclosure requirement necessitates that financial services providers publish information about costs of financial services and products daily in the newspaper. When this information was first published, interest rates dropped by as much as 15 percent in 6 months (AFI, 2010).

**Policy Options**

**Option 1: Maintain the Status Quo**
Doing nothing literally implies that the protection of financial consumers’ interest should be left to market forces as per the current practice. Given the analysis above, it is recommended that the “do nothing” option should be avoided.

**Option 2: Government Takes the Leading Role in Setting Up a Framework for Financial Consumer Protection**
While the option to develop a framework is seen as a positive choice, the proposed leading institution in this option—the government—may have some challenges in terms of policy priorities and financial resources. The greatest risk here is that a change of government may divert resources away from consumer protection priorities, if consumer protection is not in line with the political priorities of a new government. Given the challenge, it is not recommended that the government takes the leading role but should be involved as an important stakeholder to facilitate access and usage of financial services by low-income earners, women, small business and other underserved segment of the population.

**Option 3: RBV Takes the Leading Role in Setting Up a Financial Consumer Protection Framework**
The Reserve Bank of Vanuatu has the resources to take the leading role, has access to market information that may be useful to make informed decisions, and has access to professional knowledge through its good working relationship with the international organizations such as AFI, PFIP, and the development partners. Option 3 is in line with the Vanuatu Financial Inclusion Strategy and Action Plans, the Commitments to the Maya Declaration, the PIWG approved 2012 Work Plan, and the 2020 Money Pacific Goals.

RBV’s leading role in developing a framework for financial consumer protection is in line with its principle objectives as outline by the RBV Act [CAP 125] Part II, Section 3, Subsection (d) “to promote a sound financial structure” and (e) “to foster financial conditions conducive to the orderly and balanced economic development of Vanuatu.”

**Recommendations**
The Reserve Bank of Vanuatu should take the lead in setting up a framework to supervise financial consumer protection in Vanuatu. Such framework should take into account the principles of 1) disclosure and transparency, 2) fair trading and sales practices and, 3) a redress mechanism. This will complement the existing financial education efforts, the prudential supervision framework and the other financial inclusion initiatives. The implementation process could be as follows:

1. Requiring all financial services providers to update a “key fact sheet” or “summary statement” for all financial services/products and make it available to clients before during and after a financial contract is signed. The summary statement should be available at all times in simple English and Bishlama, should be about 1 to 2 pages long, and should contain all the basic information that would allow the client to make an informed decision before making any commitment.

2. Require commercial banks to develop a “code of business practice” that should clearly highlight fair treatment of clients, disclosure obligation, and complaint handling procedures.
3. Incorporate a financial consumer complaint/supervision desk within the Reserve Bank of Vanuatu. The desk will be responsible for handling financial consumer complaints that financial service providers cannot resolve.

4. Amend the Financial Institution Act to include a clause on the disclosure of “price related terms and condition” of financial products and services and a clause on “fair competition” that respects “consumer interest.”

To expand protection to clients of non-supervised financial service providers, the Reserve Bank of Vanuatu could develop a memorandum of understanding to work with the Vanuatu Financial Services Commission (VFSC) and the Department of Cooperative and Business Development Unit (DCBDU) to cooperate in protecting the clients of savings and loan societies and other non-supervised financial institutions. The prospect of setting up an independent financial consumer ombudsman may be considered in the long run.

The implementation of this framework should be easy as the Government, VFSC and DCBDU were part of the National Financial Inclusion Workshop in August 2012 that initiated the Vanuatu National Financial Inclusion Strategy and Action Plans.

Conclusion

The collaboration between RBV, the government, and the relevant stakeholders in the developing a financial consumer protection framework is expected to minimize the cost of development and implementation process. It is anticipated that the framework would be build on readily available infrastructures, would be cost-effective and would be simple enough for every client to understand. It would focus on building confidence to attract new clients into the financial system. On balance, it is expected that the framework, complemented with other policy initiatives, would enable a win-win situation between financial service provider and client, and would promote financial stability and enhance access and usage of financial services.

References

Endnotes

1. Current total population is estimated at 250,000 people of whom around 75 percent lives in rural areas.
3. The recent ones included the "Good Practice for Consumer Protection" (World Bank, 2012), the "Consumer Finance Protection with a particular focus on credit" (Financial Stability Board, 2011), and the "G20 High Level Principles on Financial Consumer Protection" (OECD, 2011).
5. SBS: Superintendency of Banking and Insurance of Peru; CGAP: Consultative Group to Assist the Poor.
6. A national language that is widely understood and spoken in Vanuatu.
BALANCING DEMAND AND SUPPLY-SIDE FACTORS AS KEY TO EFFECTIVE FINANCIAL INCLUSION: THE CASE OF ARMENIA

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Introduction

During the last 15–20 years, a number of measures aimed at enforcing financial intermediation have been initiated in Armenia. Those measures were directed toward the development of institutional and infrastructural capacities that support financial service providers (supply-side factors) enhancing the provision of financial services. Nevertheless, the financial inclusion level has traditionally remained very low. It is clear from surveys that the main reasons of not using the financial products are lack of financial awareness and low trust toward financial institutions, showing that improving only supply-side factors has not been enough to raise confidence toward financial institutions and significantly increase financial penetration. To tackle this problem, the Central Bank of Armenia (CBA) has initiated consumer protection and financial literacy (CPFL) reforms to strengthen demand-side factors. Armenia is recognized as a success story in the area among developing countries. This paper describes the CPFL system in Armenia and explains why CPFL is fundamental for financial inclusion and suggests that a balanced approach to policy making is necessary to support effective financial inclusion.

Why CPFL Is Fundamental for Financial Inclusion

Armenia is one of the former Soviet Union countries that started its transition to market economy in 1991–1993. At the beginning of this transition, it was a small, low-income country with GNI per capita of $330 USD. Currently, Armenia is a lower middle-income developing economy with a GNI per capita of around $6,200 USD (Global Findex, 2013).

As a heritage of Soviet culture, at the starting years, the most popular financial products were saving accounts in the banks and, to a lesser extent, loans. The population's trust in banks was high. This led to a rise in the number of private banks, and some charged incredibly high interest rates of up to 300% annually. The regulation regime was liberal at the time.

However, the trust in banks was jeopardised due mainly to the denomination of money and bankruptcy of most private banks in 1991–1995. In 1993, the introduction of the national currency, high inflation, and an unstable macroeconomic environment devalued the savings of the population to almost zero. During 1993–1996, around 30–50 private banks ran into bankruptcy, leaving thousands of deceived depositors. The trust in financial institutions shrank and the financial inclusion ratios dropped to the lowest levels thus seen.

The main reasons for financial instability and the drop in confidence were believed to be the lack of integrity and poor management of banks, as well as a very loose supervisory regime. Hence, if the supply-side factors were improved, the trust toward banks would be recovered. With this belief, in the past 15 years, the Central Bank of Armenia has taken many steps on the supply side to restore confidence in financial institutions and increase financial inclusion. Firstly, the regulatory regime has been strengthened in line with Basel standards to increase the banks' financial stability. In 1999, to support lending, a public credit registry was created with one of the largest spans of coverage and credit depth of information in the world (Global Findex, 2013). Another institutional setup was the creation of the ARCA national payment cards system to support non-cash
payments by establishing an inexpensive payment settlement system. Deposit guaranteed funds were established in 2004 to promote reliability in the Armenian banking system, enhance the public confidence, and protect the interests of depositors, thus supporting deposit accumulations in the banks. In 2002, a new law on Credit Organizations was adopted to support micro-lending, the area where banks traditionally have not been keen to enter; since then, 31 credit organizations have been established. A number of other reforms have been done to improve bank secrecy, reduce bankruptcy of banks, support corporate governance, and aid other aspects of the financial institutions’ stability.

Due to all those reforms in 2004, Armenia had a strong banking system accounting for 99% of assets of all financial institutions. However, still not enjoying satisfactory growth rates in the financial sector, the policymakers believed that the problem was inefficiency of disaggregated regulatory and supervisory regimes of the financial industries. The financial markets and products become more integrated and the boundaries between markets more blurred. In addition, regulators of different segments—banking, insurance, and securities markets—often are not harmonized and sometimes conflicting policies exist. Moreover, for such a small sized economy, duplicating administrative costs can be considered a luxury. To increase the synergy effect of regulation, supervision, and development policies in all financial sectors, in 2006 the Central Bank of Armenia became a unified regulator of all financial institutions.6

The CBA, continuing a strongly held belief that the key to success in financial inclusion is development of supply-side factors, as a mega-regulator initiated reforms in insurance and securities markets as well. To boost the insurance sector, reforms were introduced that radically changed the landscape of insurance markets, bringing them largely in line with IAIS standards. As part of those reforms, mandatory third-party liability insurance was introduced to instil a culture of being insured among population. Due to reforms in asset securitization and the mortgage market, long-term mortgages became a reality, affording more consumers the opportunity to get mortgage credit.

Due to all those reforms, financial access ratios in Armenia have become comparable and sometimes higher than other Commonwealth of Independent States (CIS) and Central Europe countries. For example, according to a financial access survey report (IMF, 2011), in 2011, commercial bank branches per 1,000 km² was 16.3, commercial bank branches per 100,000 adults was 18.8, ATMs per 1,000 km² was 35.4, and ATMs per 100,000 adults was 40.9. To compare, CIS ratios of bank branches per 1000 km² ranged from 0.15 to 10.46 (Kazakhstan and Georgia, respectively), Hungary had a 14.8, and the Czech Republic had 27. Branches per 100,000 adults for CIS countries comprised 1.6–37 (Ukraine and Russia, respectively). ATMs per 1000 km² ratio for CIS countries was from 2.38 (Tajikistan) up to 22.6 (Georgia) and 57 (Ukraine).

However, despite all those reforms, the financial sector remains shallow and financial inclusion remains very low. Currently, the financial sector is dominated by 21 banks that account for 91% of the private financial system’s assets, with the share of non-bank credit organizations at 5%, and insurance and capital market at 2% of GDP (CBA, 2011). In 2011, adults with accounts at a formal financial institution composed only 17.5% of the market compared to 45% in Europe and Central Asia, with deposits to GDP accounting for 24.5%. In 2012, according to a nationwide survey (WB survey, 2012) 66% of the population had savings kept under a mattress, while only 6% had bank deposits. Domestic credit to GDP was only 36% in 2011, compared to 141% of Europe and Central Asia and 59% of lower middle-income countries (Findex Global, 2013). According to the WB report (2012), 32% of adults used a loan originated from their family or friends, while only 19% used a loan originated by a formal financial institution7 (including banks, credit organizations, and pawnshops) in 2011; an estimate of 40% or more of the population is being excluded from using the formal financial system.
Informal financial schemes are not allowed in Armenia, though some forms of access to credit exist. The law prohibits any credit or savings activity as business. Any such business activity should be licensed and supervised by the Central Bank. However, though there is no research on what types of informal financial schemes exist in Armenia, small-scale informal money lenders and friends and family members remain a traditional source for credit, while the savings “under the mattress” concept remains common.

Along with low financial inclusion ratios, consumer confidence in financial institutions also remained low. In a 2008 USAID survey, 71% responded that the lack of “confidence” in the banking sector is the reason why they don’t have a bank account (PALM, 2008), 43% noted bad prior experience, and only 5% noted difficulties with poor physical access to banks. In a 2008 survey by the International Labour Organization, almost three-quarters of households noted that they were unaware of the availability of savings products or their terms and conditions.

The academic literature is relatively slim on evidence of consumer protection and financial literacy as factors for financial inclusion (being relatively new as policy areas), though the evidence available supports a positive correlation. For example, the International Network of Financial Education (INFE, 2012) analyzed the results of surveys of 14 countries and found a positive association between financial literacy and financial inclusion. Campbell et al. (2011) justifies the necessity of consumer financial protection (on cases of mortgage choice, payday lending, and retirement saving) from market failure, arguing that consumers should understand the limitations of their financial situation (even if presented with all the information that, in principle, is required). Consumer protection becomes important both because unregulated financial markets may be inefficient and because they may generate undesirable distributional outcomes.

The main conclusions for policymakers were that the low-level of trust toward financial institutions and the low level of financial literacy were the main reasons why people avoid formal financial institutions. It was clear from the surveys that improving only supply-side factors has not been enough to raise confidence in financial institutions and significantly increase financial penetration. One-side policy was effective to increase financial access, however not effective enough to increase the usage of the financial products. Consumer protection and financial literacy (CPFL), demand-side factors, need to be developed as well to improve understanding of the risks and rewards of financial services, and increase self-confidence of consumers in using financial services. A balanced approach in policymaking, pursuing development of both supply-side and demand-side factors, is necessary to build confidence in the financial system and encourage financial inclusion.

Without strong support of academics on the effectiveness of CPFL, it is important during the design and implementation of policy to have its impact evaluation mechanisms in place. Other factors, such as information technology and product innovations, can also have an impact on the levels of financial inclusion. The proposed balanced-approach policy is based on the results of surveys, according to which the unawareness of consumers of financial possibilities and how to use them was an essential factor for low financial inclusion in Armenia.

**Consumer Protection in Armenia**

In response to these challenges, the CBA was advised to initiate reforms to strengthen demand-side factors to enhance financial inclusion.

The CPFL reforms started in 2006 with the design of the CPFL model and institutional structure. Based on this, in 2007 the institutional framework necessary to support sustainable and effective realization of consumer protection was set up. Amendments were made to the law for
the Central Bank of Armenia to add a mandate for the CBA to “ensure essential conditions for protection of the rights and lawful interests of the financial system consumers.” In 2007, a Consumer Protection and Market Conduct Division was established under the department of Financial System Stability and Development Department.

The Armenian CPFL system is based on four pillars: market conduct regulation, market conduct supervision, financial literacy, and dispute resolution.

**Market Conduct Regulation and Supervision**

It is essential to set up rules of behavior for FIs and enforce their implementation. If there is no transparency and fair provision of financial services, the trust in FIs and hence the usage of financial services would be low. The main laws that were accepted in 2007 were the following: a Law on Consumer Credit, a Law on Deposits, and a Law on Financial Mediators. For regulatory purposes, a number of supervision tools were established, including on-site inspections, monitoring of transparency, and monitoring of product terms.

**Financial Literacy**

Financial literacy projects are targeted to strengthen the awareness, skills, and self-confidence of individuals using financial services while protecting their rights. The main challenge with financial literacy is that it covers different slices of the population, requires participation of many stakeholders, and demands huge and long-term financial resources to support sustainable funding. The Steering Committee on National Financial Education Strategy was established in 2012 to establish a platform where all stakeholders can collaborate together on strategy and implement it effectively.

**Dispute Resolution System**

Complaints about FIs, mediators, and the CBA are handled by the dispute resolution system. A customer with a complaint should first apply to the FI, then to a financial mediator. The mediator can render decisions on individual cases, while the CBA can render decisions in regard only to FIs. Mediators can only examine complaints with cash or property claims. Consumers can apply to CBA in any instance; however, it is encouraged that only the complaints that are out of the scope of the mediator are reviewed by CBA.

**The Office of the Financial System Mediator (OFSM)**

The OFSM was launched in early 2009 based on the Law on the Financial System Mediator adopted on June 17, 2008. The creation of this institution in Armenia was conditioned by the need for a specialized extrajudicial structure to resolve individual consumer complaints and disputes between consumers and financial institutions at no cost to the consumers, and to ensure the swift, effective, and impartial review of claims. The alternatives for this institution—courts and arbitration—are time-consuming, costly, and complicated. The OFSM is an independently managed institution founded by the Central Bank of Armenia and financed by financial organizations.

Reforms in consumer protection started with designing a model for the country and a strategy to move forward. Like other small developing countries, Armenia was challenged by many factors, including a lack of country-wide policy consensus, effective coordination among governmental agencies, and resources for full-scale and sustainable institutionalization. However, the most difficult strategic decision among these concerned the limited resources available, and whether to take a holistic approach (moving all pillars simultaneously) or a sequenced approach to CPFL development. Choosing a holistic approach would mean that not all aspects of financial markets would be covered simultaneously, but those aspects that would be covered could be addressed from all four perspectives.

The main arguments against the holistic approach were that if the proper legal framework was set up, then the financial institutions would follow the rules: they would be fair, transparent, and
explain to the consumer the risks they would carry, and there would be no need for expensive financial literacy and a redress mechanism. However, even a brief experience in the area showed that even if financial institutions theoretically accept the importance of protection and financial literacy of consumers, the inner conflict of interest often takes over the general theory and they fail to properly implement CPFL rules. The counterbalance is needed by having financially literate customers. Moreover, interest financial institutions are not always keen for a fair resolution of customers’ complaints, especially if those complaints are numerous and can threaten their profits. As a counterbalance, there is a need for an independent redress mechanism.

**Recommendations**

Financial inclusion is a function of at least two sets of factors—supply side and demand side. Having only a strong financial system is not enough for people to trust it, since an understanding of the risks and rewards of financial services, an awareness of institutions, products, and possibilities in the market, as well as an awareness of their rights, are also important. But literate consumers will avoid financial institutions if they lack integrity and financial stability. A balanced holistic policy should be implemented to simultaneously improve both sides of the market in order to build confidence in the financial system and promote financial inclusion.

**References**


**Endnotes**

1. The views expressed and the conclusions reached are those of the author and not of the Central Bank of Armenia.
2. The World Bank classification.
4. Public credit registry coverage reports the number of individuals and firms listed in a public credit registry with current information on repayment history, unpaid debts, or credit outstanding. The number is expressed as a percentage of the adult population.
5. Credit depth of information index measures rules affecting the scope, accessibility, and quality of credit information available through public or private credit registries. The index ranges from 0 to 6, with higher values indicating the availability of more credit information, from either a public registry or a private bureau, to facilitate lending decisions. (0=low to 6=high)
6. Banks, insurance companies, insurance intermediaries, non-bank credit organizations, investment companies, stock exchange and depositary, payments and settlement organizations, money transfer organizations, pawn shops, foreign exchange dealers, and agencies.
7. CBA is a mega-regulator and supervises all types of financial institutions. Formal lending institutions include banks, credit organizations and pawn shops; formally deposits can be taken only by banks. Lending and deposit tak-
ing activities can be held only with the licence from CBA, thus there are no other types of credit and deposit taking institutions that are not regulated.

8. After the collapse of the Soviet Union, during 1991–1993 the lifelong savings of the population were devaluated to almost zero. At the beginning of transition, 1993–1995, under almost no state control nearly 70 private banks were established, gathering the savings in dollars. Most of those banks eventually declared bankruptcy, leaving a large number of deceived depositors. The memory of lost savings is still very alive among the population.

9. Governmental organizations (Ministry of Education, Ministry of Finance, Ministry of Social Affairs), private sector (associations of banks, insurance companies, etc.), and non-governmental organizations are involved in steering committees.

10. Following the holistic approach, credit and deposit products were chosen as the policy focus at the initial stages.

11. For example, gaining profit versus restraining the consumers from using their products, and spending on financial education.


BRANCHLESS BANKING IN PERU: OPPORTUNITIES AND CHALLENGES FOR FINANCIAL EDUCATION AT THE BOTTOM OF THE PYRAMID

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Introduction

This memo addresses the topic of financial education interventions for beneficiaries of social transfers in Peru’s rural areas, in the context of branchless banking. Specifically, it assesses the challenges that the introduction of new technologies and banking schemes pose for financial education interventions aimed at recipients of conditional cash transfer programs.

The migration from cash and branch banking to electronic money and branchless banking presents opportunities to foster financial inclusion, especially of those who do not have physical access to financial services, while reducing costs of service provision. However, there are several challenges that the State, financial institutions, and financial education providers need to take into account in order for this shift to be successful. Inadequate mobile telephone coverage, lack of customary use of text messaging, and language barriers, among other factors, can complicate the transition.

The Peruvian government sees financial inclusion, defined as the access and use of quality financial services by all segments of the population, as a means to increase the impact of governmental social policies and programs. It has the potential to contribute to the wellbeing of vulnerable populations by fostering asset capitalization, helping them escape poverty and increasing their access to economic, educational, and labor opportunities. By the same token, financial education constitutes a tool for financial inclusion and “. . . addresses the information asymmetries that contribute to the financial exclusion of the poor. Through effective communication of information about good money management, practices regarding earning, spending, saving, and borrowing money, and managing the increasing range of financial options, financial education is a valuable tool to reach those at the bottom of the pyramid.”

In a context in which electronic money is promoted as an advantageous alternative to cash for government-to-people (G2P) payments, this memo analyzes which challenges these innovations pose for financial education and how to develop schemes that help recipients of conditional cash transfers acquire the competencies to use financial services such as payments, savings, insurance, and credit.

Financial Inclusion in Peru: A Work in Progress

Peru’s business environment for microfinance is widely considered one of the best in the world. The country has a capable and prestigious regulatory body in the Superintendency of Banks, Insurance, and Pension Funds (SBS). An extensive variety of financial institutions provide an array of financial services to different segments of the population. A law that regulates electronic money was passed in January of 2013. Aided by this institutional framework and a 12-year-long sustained economic growth, the total number of savings accounts as a percentage of the adult population has increased from 46.53% in 2007 to 88.05% in 2012.

However, bank penetration, measured as the ratio of deposits to GDP, was only 32.07% in December of 2012. Currently, financial institutions operate in only 38.96% of the country’s 1835 districts. Roughly 4 million people (15% of the population) live in the remaining 1120 districts.
Furthermore, the presence of formal financial institutions in rural areas is scarce as is the supply of financial services suited to meet the needs of the population. Hence, it does not come as a surprise that inhabitants of these areas tend to be neither informed about the financial system nor inclined to use formal financial services.

Peru is currently designing a national strategy for financial inclusion (herein, ENIF). The Ministry of Economics and Finance, the Ministry of Development and Social Inclusion (MIDIS), the Superintendency of Banking, Insurance and Pension Funds (SBS), and the Central Bank are cooperating to such aim.

MIDIS, created in October 2011, has identified financial inclusion as a dimension of social inclusion and is currently preparing a financial inclusion strategy specifically for Peru’s vulnerable population, which will be placed under the ENIF. MIDIS’ financial inclusion strategy is informed by the notion of financial capability, which transcends financial literacy. Going beyond the awareness and comprehension of financial concepts, financial capability includes knowledge, the ability to act on it, and the opportunity to act. MIDIS’ envisions that, by 2016, one million citizens from its target population will possess the skills to use financial services, and have access to a supply of quality financial services that meet their needs.

Among the social programs placed under MIDIS, the conditional cash transfer (CCT) program JUNTOS (together) holds the highest potential to help boost financial capability. In fact, financial inclusion interventions aim at enhancing capabilities for management, accumulation and efficient use of assets, thus contributing to the improvement of living standards of CCT programs’ beneficiaries. JUNTOS provides a bimonthly transfer of approximately US$ 65.00 to rural households living in poverty and extreme poverty. In exchange, JUNTOS requires beneficiaries to meet certain conditions related to children’s school attendance and medical checkups. By the end of 2013, the program is expected to reach more than 700,000 households.

Banco de la Nación (BN), the State bank, executes JUNTOS payments through zero-cost savings accounts. Roughly half of JUNTOS beneficiaries have a debit card that can be used at ATMs and at affiliated establishments, although the lack of such establishments in most rural areas hinders such use. In areas without BN presence, payment is outsourced by the bank to cash transportation companies, which deliver transfers at specific points of payment. Under this scheme, people have virtually no contact with their savings accounts; many of them do not even know they have one. Furthermore, the fees per transfer paid by JUNTOS to BN to cover the operational costs under the transportation company scheme are considerably higher than those paid when transfers are made at a bank’s branch, sometimes even higher than the transfer itself. Under both schemes, beneficiaries often travel long distances on dangerous roads in order to reach the bank branch or the point of payment.

Lack of knowledge regarding financial services affects beneficiaries paid under both schemes. A study published in 2011 found that, from a sample of 1800 JUNTOS beneficiaries, fewer than one percent knew what a bank statement or an interest rate was. Furthermore, fewer than 50 percent knew that they had a savings account or what the SBS was.

MIDIS and JUNTOS are currently assessing different schemes to improve payment delivery. Such schemes seek to expand the financial sector’s presence to currently unattended locations through banking agents, points of sale (P.O.S.), mobile banking, and other mechanisms.

The Case for Financial Education of CCT Recipients

In line with the financial capabilities approach, MIDIS has established guidelines for financial inclusion interventions aimed at vulnerable populations. These guidelines state the opportunity to articulate CCT programs that target the rural poor, such as JUNTOS, with financial education
interventions that seek to develop financial capabilities. Evidence suggests that Peru’s CCT recipients have little knowledge of formal financial services, and may be missing the opportunity to benefit from them. Thus, financial education could boost their asset management skills, help them make the most of their savings accounts, and make informed decisions regarding the use of formal financial services.

Financial education could be even more important if we consider that CCTs constitute a regular source of income that may attract credit institutions. Thus, financial education can improve their skills to assess the risks and advantages of taking a loan and thus make informed decisions.

In recent times, there has been a wide array of financial education interventions aimed at Peru’s rural populations, especially at JUNTOS beneficiaries. There is evidence that some of these experiences have achieved at least some success. According to Trivelli et al. (2011), women involved in a financial education pilot project demonstrated interest in the financial system, found it useful and, when informed, demanded tools to use it. They internalized the importance and advantages of saving in a formal financial institution. Furthermore, the women learned to optimize their use of money, reduce vulnerabilities when facing emergencies, and explore small investments. Perhaps even more auspicious was the claimed empowerment effect: the same report stated that women’s self-esteem increased and that they built a new sense of citizenship.10

Branchless Banking: Policy Considerations for Financial Education of CCT Recipients

Branchless banking is defined as “. . . the delivery of financial services outside conventional bank branches, using agents and third-party intermediaries as the principal interface with customers, and relying on technologies, such as card-reading points-of-sale terminals and mobile phones, to transmit transaction details.”11 In Peru, several financial institutions have established bank agents, although mostly in urban areas. Mobile banking and the use of e-wallets are virtually nonexistent. However, it is expected that the recently enacted Electronic Money Law will prove the decisive institutional arrangement to foster these services. At the same time, G2P payment schemes, such as the JUNTOS Program, are seen as a suitable platform for mobile banking, due to the potential scale of the business. In this context, financial education, as Cohen et al. (2008) point out, can provide a bridge between branchless banking and low-income clients.

However, there are several issues that merit consideration. Some are related to Peruvian demographics. JUNTOS’ beneficiaries constitute a very diverse group. They speak different languages and dialects (Spanish, Quechua, Aymara, and Ashaninka, among others) and belong to different cultural groups. There is also a lack of written traditions in languages other than Spanish, which can complicate service provision through text messaging.

Other issues are related to the lack of familiarity with technologies associated with branchless banking. Mobile phone coverage, ownership, and usage have significantly increased in the last decade. In 2011, there were more than 29 million mobile phones in Peru, almost one per every person.13 Notwithstanding, there tends to be a coincidence between areas with no coverage or poor coverage and areas affected by poverty and extreme poverty. Therefore, the state of infrastructure and mobile phone coverage and use makes it advisable to start promoting the shift in those areas that present more favorable conditions—that is, those can present both acceptable mobile phone coverage and presence of the financial sector. At the same time, it is necessary that the State work to expand such conditions to the rest of the Peruvian territory.

Even if people are accustomed to using mobile phones, they may not be accustomed to using them as a tool to access financial services. Moreover, text messaging is not as common in Peru as in other parts of the world. A 2012 study found that rural people used the phone mostly to talk
and to read messages. They did not send SMS messages partly because they could not confirm
that the other person had received the message, and partly because of difficulties using the key-
board.\textsuperscript{14} Taking into account similar considerations, another study advocated for the use of call
centers or voice recognition systems (IVR) as an alternative to SMS-based services.\textsuperscript{15}

Furthermore, as stated in the previous section, even those JUNTOS beneficiaries who are paid
at bank branches tend not to use other formal financial services. And the ones who do will have
to get used to the replacement of bank agencies, cash, and receipts by mobile phones, electronic
money, and text messaging. Here, an important consideration has to be devoted to the issue of
trust. Traditionally, trust in government tends to be very low in Peru, and might prove an obsta-
cle for the implementation of public policies. The “immaterial” nature of branchless banking
can raise further concerns among citizens regarding the security of their money in a country
where bank fraud has left its mark. At the same time, there is a lack of knowledge regarding cul-
tural or social significance that different groups may attribute to the use of cash.\textsuperscript{16}

**Public Policy Recommendations**

Cohen et al. suggest that financial education for branchless banking “... should deliver the mes-
 sage that branchless banking ... can be cheaper, safer and more convenient” that branch bank-
ing.\textsuperscript{17} As Peru starts migrating from cash to cash-lite, a public policy aimed at advancing financial
education of JUNTOS’ beneficiaries should include the following considerations.

**Evidence-based Interventions and Knowledge Sharing**

Knowledge obtained from financial education interventions should be systematized and
shared. Pilot projects, monitoring and evaluation, and constant identification and assessment
of international best practices can help obtain valuable data and lessons for future scaling up
of interventions.

**Adaptation of Financial Education Schemes to Branchless Banking**

Financial education in Peru’s rural areas is provided by the governmental agencies, financial
institutions, and NGOs. These interventions must address the use of cards or mobile phones,
without turning into information provision schemes that abandon the ultimate goal of finan-
cial education: to help expand the capabilities and skills that allow people to make informed and
efficient financial decisions.

One alternative is to include a “technology” module that addresses the use of mobile telephones,
debit cards, and other devices. The inclusion of this module in a financial education scheme
should ensure that users understand e-money, the instrumental nature of technological devices,
and their relationship with financial services in the less palpable context of branchless banking.

**Quality Promotes Use, Use Generates Capability**

By providing services suited to fulfill the needs of CCT recipients, financial service providers can
foster the impact of financial education interventions through a “learning by doing” dynamic.

**Culturally and Gender Sensitive Interventions**

Awareness of culture and gender is needed in order to address the concerns, needs, and aspira-
tions of each population segment. Hence, financial education should be provided in the native(s)
language(s) of the audience and should take into consideration cultural and social aspects, such
as previous exposure to financial institutions and services, literacy levels, and social significance
that could be attributed to cash.

Different segments of the population may respond differently to different education methods.
Classroom training, the most used method in Peru’s previous financial education interventions,
may prove not to be the most efficient or scalable option. Therefore, such interventions could also
be replaced or complemented with other channels such as television or radio spots, soap operas, text messages, and written materials, among others.

Engage Local Actors
It is necessary to build trust among the poor regarding branchless banking services and tools. Branchless banking interventions will require that the State, financial service providers, or both launch advocacy and information campaigns along with financial education interventions. As a part of the ecosystem required for the functioning of branchless banking schemes, local businesses acting as bank agents can play a very important role in helping people get used and adopt technological alternatives. They could be trained to promote branchless banking services, provide information, and demonstrate how to use these services to their customers. Furthermore, by using the relationship they already have with the population, agents can help diminish fear and distrust in such services.

Endnotes
3. Law N° 29895 - Ley que regula las características básicas del dinero electrónico como instrumento de inclusión financiera.
5. From a comparative perspective, Peru’s bank penetration, measured as the ratio of ODC (Other Depository Corporations) deposits to GDP, as per used by the International Monetary Fund, is 31.39, which is significantly smaller than in Bolivia (43.09), Brazil (53.78), Colombia (35.20), and Chile (35.58). Source: Superintendencia de Banca, Seguros y AFP, Op. Cit.
7. According to information provided by JUNTOS, 417,748 (64.9%) beneficiaries were paid at 252 Banco de la Nación branches, whereas 216,652 beneficiaries (33.7%) were paid by transportation companies at 359 points of payment. Finally, 9288 beneficiaries (1.4%) were paid at other financial institutions branches, under agreements between these institutions and Banco de la Nación.
9. Ibid.
10. Ibid.


National Strategy
IMPLEMENTING A NATIONAL FINANCIAL INCLUSION STRATEGY: THE NIGERIA EXPERIENCE

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Assistant Director and Head, Microfinance Management Office, Central Bank of Nigeria

Introduction

During the Alliance for Financial Inclusion Global Policy Forum held at Riviera Maya, Mexico, in September 2011, Nigeria committed to reduce the percentage of its adult population that are excluded from financial services to 20% in 2020. Pursuant to this, Nigeria launched its National Financial Inclusion Strategy on the 23rd of October, 2012. The launching was performed by the President of the Federal Republic of Nigeria with the participation of the UN Special Advocate for Inclusive Finance for Development, Her Royal Highness, Queen Maxima of the Netherlands.

Improved access to financial services would increase economic activities, generate employment, enhance income, reduce poverty, and support economic, political, and social empowerment of the population. However, the achievement of the strategy’s targets and the realization of its benefits depend on successful implementation of various measures by the identified stakeholders.

This policy memorandum states the purpose of the National Financial Inclusion Strategy for Nigeria in Section 2, followed by the benefits of inclusive finance in Section 3. Section 4 identifies the key stakeholder roles and responsibilities, while Section 5 highlights the stakeholder management challenge. Recommendations are proposed in Section 6 and Section 7 concludes the paper.

The Purpose of the National Financial Inclusion Strategy

The National Financial Inclusion Strategy for Nigeria:

• conceptualizes a commonly shared vision for financial inclusion and demonstrates the benefits;
• articulates a series of actions for reducing the percentage of those that are excluded from financial services with a view to engendering greater participation in economic activities;
• defines the stakeholders and apportions their respective roles and responsibilities; and
• establishes a mechanism for monitoring and measuring progress toward the set targets.

The strategy development process involved an analysis of best practices in financial inclusion from the experiences of countries like Malaysia, Mexico, Brazil, South Africa, Indonesia, Kenya, India, Philippines, Ghana, and Uganda, among others. Also, indigenous stakeholders including apex financial services regulators such as the National Insurance Commission, Pension Commission, National Communication Commission, Securities and Exchange Commissions, as well as selected members of the Bankers Committee, ministries, departments and agencies of government were interviewed. The draft was then exposed for public comments and input, after which a summit was held to conclude the process.

The overall purpose of the strategy is to define actionable programmes and interventions that would support Nigeria’s goal of reducing adult financial exclusion from 43.6% in 2010 to 20% in 2020 as encapsulated in the Maya Declaration.1 Out of the 80% that would be included, the strategy proposes that 70% will be in the formal sector, while 10% will be in the informal sector. The formal sector players include deposit money banks (commercial banks), development financial institutions, microfinance banks, finance companies, primary mortgage institutions, bureau de change, discount houses, insurance companies, pension fund administrators, and the capital
market. The informal sector providers are dominated by cooperative societies, non-governmental organizations, microfinance institutions, credit unions, and rotating savings and credit associations, among others.

In arriving at the specific product and channel targets for inclusion, a benchmarking analysis with best-in-class countries (mainly Kenya, South Africa, Indonesia, and Mexico) was carried out, followed by the application of relevant assumptions. Based on this, the percentage of adult Nigerians that would be included in identified financial services was as follows (Table 1):

To support the above product targets, channels for outreach are to increase in terms of outlets per 100,000 population as follows (Table 2):

**Benefits of Inclusive Finance in Nigeria**

Financial Inclusion is economically legitimate because of its benefits. Policymakers benefit from the perspective of increased economic activities. Increases in agricultural production would result in reduced food prices and hence effective management of inflation. Improved exports resulting from an entrepreneurship boom will enhance foreign exchange earnings, foreign reserve accretion, ability to shore up the value of the local currency, and achieve a stable exchange rate. The use of electronic devices for payment would reduce expenditure on currency issue and management, while participation of more people in the financial market place will provide a more complete picture of the financial system and create the basis for properly advising government on their spending patterns and fiscal responsibility.

The financial services providers, by penetrating the unserved market with credit, savings, payment, insurance, and pensions services, will make more profits from charges for such services. The benefits of financial inclusion to micro, small, and medium entrepreneurs (MSMEs) arise from increased access to credit, savings, payments, and insurance. Credit and savings will specifically catalyze investment/productive activities, create wealth, generate employment, and considerably reduce poverty. Globally, financial inclusion holds promise for empowering more people by promoting growth in gross domestic product per capita income and addressing financial crises/instability across countries. It would reduce income inequality and enhance economic opportunities across the broad spectrum of the world population.

---

**Table 1.**

<table>
<thead>
<tr>
<th>Services Types</th>
<th>Inclusion Level in 2010</th>
<th>2020 Inclusion Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payment Services</td>
<td>21.6%</td>
<td>70%</td>
</tr>
<tr>
<td>Savings Services</td>
<td>24.0%</td>
<td>60%</td>
</tr>
<tr>
<td>Credit Services</td>
<td>2%</td>
<td>40%</td>
</tr>
<tr>
<td>Insurance Services</td>
<td>1%</td>
<td>40%</td>
</tr>
<tr>
<td>Pension</td>
<td>5%</td>
<td>40%</td>
</tr>
</tbody>
</table>

Source: National Financial Inclusion Strategy for Nigeria

**Table 2.**

<table>
<thead>
<tr>
<th>Channel</th>
<th>2010</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Branch of Deposit Money Banks</td>
<td>6.8</td>
<td>7.8</td>
</tr>
<tr>
<td>Microfinance Bank Branches</td>
<td>2.9</td>
<td>5.0</td>
</tr>
<tr>
<td>ATMs</td>
<td>11.8</td>
<td>203.6</td>
</tr>
<tr>
<td>POS Mobile Agents</td>
<td>13.3</td>
<td>850.0</td>
</tr>
<tr>
<td>Mobile Agents</td>
<td>0</td>
<td>62.0</td>
</tr>
</tbody>
</table>

Source: National Financial Inclusion Strategy for Nigeria
Identified Key Stakeholder Roles and Responsibilities

The broad roles and responsibilities for the stakeholders were as follows:

<table>
<thead>
<tr>
<th>Stakeholder</th>
<th>Assigned Roles and Responsibilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks</td>
<td>To establish mini-branches, use agents and shared services platforms to extend payments, savings, credit, and other services to the population, particularly those living in rural areas.</td>
</tr>
<tr>
<td>Microfinance Banks and Related Institutions</td>
<td>To establish branch networks, act as agents to commercial banks, draw resources from the micro, small, and medium enterprises development fund for on-lending to their clients and reposition themselves to perform various financial services.</td>
</tr>
<tr>
<td>Insurance Firms</td>
<td>To develop products that will meet the insurance needs of middle- and low-income segments and increase insurance penetration in rural and peri-urban areas.</td>
</tr>
<tr>
<td>Pension Fund Administrator</td>
<td>To enlighten the public about pension and develop products for private sector participation in the Unified Pension Scheme of the Federation.</td>
</tr>
<tr>
<td>Development Partners</td>
<td>To provide technical support for microfinance banks and institutions in their quest to develop appropriate financial inclusion products, delivery methodologies and support initiatives that will support local and international data on financial inclusion.</td>
</tr>
<tr>
<td>Regulators (Banks, Insurance, Pensions, Capital Market, Identity Management Company.)</td>
<td>To create enabling frameworks, guidelines, and environments to guide financial service providers to develop and deliver financial inclusion services to the public.</td>
</tr>
<tr>
<td>Public Institutions</td>
<td>To assist in the conduct of relevant surveys, the development of a data gathering mechanism for financial inclusion and shared services platform, and to enable financial service providers offer low-cost services to clients.</td>
</tr>
<tr>
<td>Telecommunication Firms</td>
<td>To provide technology infrastructure and platform, particularly low-cost alternatives that support increased penetration of various forms of financial services nationwide.</td>
</tr>
</tbody>
</table>

Stakeholder Management Challenge

The diversity of stakeholders, differences in their institutional mission, vision, and mandates, as well as their physical geopolitical distribution could create divergences in strategy implementation and pursuit. Some of the stakeholders might not have financial inclusion on the front burner of their strategic plans and might be unwilling to provide adequate resources to support the performance of their assigned roles and responsibilities. This might slow down the pace of implementation.

The primary providers of financial services including the deposit money banks, microfinance banks, development finance institutions, and informal service providers are expected to act in concert to ensure that services are provided to the population. They might not have clear understanding of this concept and of their particular and peculiar roles and how to complement themselves. This could create a conflict of interest and undermine their effectiveness. Some of the
institutions that are expected to act as agents, such as NGOs and financial cooperatives, are not regulated by the Central Bank of Nigeria. They might need special approaches to provide uniform understanding on the workings of the guidelines and this process could take time and undermine the pace of uptake of agent banking in the country.

Recommendations

In order to ensure that the implementation challenges are addressed and the prospects of achieving the national targets are realized, it is recommended that the following actions should be taken:

Establishment of Units to Coordinate Implementation in Various Agencies

As provided for in the strategy document, there would be a Secretariat in the Central Bank of Nigeria to coordinate implementation. The Secretariat would be situated in the Bank due to the goodwill it enjoys among key stakeholders, and its willingness to commit resources to execute implementation. The Secretariat would take responsibility for ensuring that each of the stakeholders perform their roles and responsibilities. It is strongly recommended that the stakeholders, particularly the financial services providers, government public institutions, and telecommunication companies, should have units that will drive implementation at their respective levels. Staff of such units should be trained on financial inclusion subject areas such as mobile banking and payments, agent banking, financial literacy, consumer protection, and microfinance to enable them to actively support the implementation process.

Provision of Adequate Resources to Fund Implementation

Financial inclusion programmes translate into tangible benefits. These benefits can only be optimized if implementation proceeds according to plan. Stakeholders such as the government and its agencies, regulators, and infrastructure service providers, would need to provide their business plans and individual budgets to fund the activities of their financial inclusion units. Issues related to research, data gathering, analysis and publication, financial education, and curriculum development and adoption will require support that might occur in an abrupt manner and sometimes outside the annual budgets of individual agencies. This calls for a central pool of funds to be contributed to by regulators, the main financial service providers such as banks, and managed under a jointly determined governance and supervision arrangements.

Technical Forum on Financial Inclusion Implementation

Owing to the diversity of stakeholders, an institutionalized forum for discussing and brainstorming on technical issues related to implementation should be enunciated. The forum should be structured to readily provide progress reports on the targets that have been outlined in the strategy. Regulators, government, financial services providers, and other public and private sector interests should update participants and share experiences, seek for understanding on matters that are not very clear, and have a comprehensive view of the entire agenda. This will stem possible conflict of interest and foster synergy and complementarity in the entire implementation process.

In order to enrich such sessions, efforts should be made to actively participate in global discussions and peer learning programmes with a view to identifying workable solutions and devising means of adopting and adapting them to local peculiarities. The implementation Units should strongly network with global players such as the Alliance for Financial Inclusion (AFI), Consultative Group to Assist the Poor (CGAP), World Bank, Global Partnership for Financial Inclusion (GPFI), etc. to achieve adoption of relevant innovations.

Review and Monitoring Mechanism

In order to ensure public accountability, entrench credibility, and put implementation of on track, a strategic device for reviewing and monitoring impact is essential. This should be designed
through a joint effort of the key stakeholders such as the federal government, regulatory agencies, financial service providers, academia, and the private sector. Data on progress should be regularly gathered, analyzed, published, and used as basis for strategy and implementation reviews.

**Conclusion**

Financial Inclusion strategies are essential to the achievement of increased access to financial services. Implementation of an appropriate strategy requires broad-based collaboration, as diverse stakeholders play key roles in the achievement of the objectives.

Specific targets for services and channels, as well as actions that will lead to achieving them, are critical to having lasting success. Equally, roles and responsibilities to identified stakeholders need be properly understood and performed, while monitoring, evaluation, and objective reporting would prove worthwhile in securing patronage by all.

Benefits derivable from inclusive finance across the broad spectrum of stakeholders should create the incentive for constructive support for implementation. Appropriate coordinating units, armed with adequate budget, networking capabilities, technical competence will go a long way to driving financial inclusion strategy in the right direction and toward the achievement of its intended goals.

**Endnote**

1. The Maya Declaration is the first global set of commitments by developing and emerging governments to support financial inclusion programmes in their home countries. Nigeria was one of the maiden countries that made the commitment in Riviera Maya, Mexico, in September 2011.
FINANCIAL SERVICES FOR THE UNBANKED:
PROBLEMS AND PROSPECTS IN BANGLADESH

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Background

Achieving sustainable development through faster economic growth with stability is a key global policy objective, yet continues to challenge macroeconomic policy makers worldwide. Financial inclusion, an important vehicle for attaining equitable distribution of income is considered one of the preconditions for attaining more inclusive growth and sustainable development (Rahman 2011, and Kelkar 2010). The more people covered with quality financial services, such as holding bank accounts, making deposits, and getting access to loans, the more broad based investment and employment generation activities can take place and thus a more likely equitable distribution of income can result.

In general, financial inclusion is known as increased coverage of financial services for the financially neglected segments of the population from formal and officially regulated/supervised entities like banks, non-bank financial, and microfinance institutions. However, the task of making the financial services available for the unbanked segments of the population is not easy. Challenges are rooted in various social and infrastructural issues like income, education, and cultures within a society. Therefore, it is very important to look for the factors causing such financial exclusion in a developing country like Bangladesh. Accordingly, this memo makes an attempt to identify the unbanked in Bangladesh, question why they are unbanked, pinpoint specific causes for limited financial coverage, and then propose a plan to address these causes.

Who Are the Unbanked?

According to a recent World Bank report (World Bank, 2011), people with low incomes and no education are least likely to avail services from formal financial institutions. The degree of exclusion is higher for youth and women, as they have relatively lower income and education. In low income economies, 78% of rural residents and 65% of urban residents do not have any formal bank account (Demirguc-Kunt & Klapper, 2012). Bangladesh is no exception to this statistic. People with low incomes and no or very little education are the most deprived group, particularly true for youth and women located in rural areas. Of the 160 million estimated populations, about 120 million are in rural areas of which 71% have no deposit accounts in banks (Table 1).

About 62% of the total population and 35% of the urban population remained excluded from formal financial services, despite developments in the domestic financial markets and steady expansion of bank credit in Bangladesh. The prevalence of financial exclusion for the youth and women are even higher. World Bank data shows that only 20% of low-income females have an account at a formal financial institution.

Why Are People Unbanked?

There is a saying that “a country is poor because it is poor.” Therefore, the possible answer to the question posed above would be “people are unbanked because they cannot reach the bank.” Low income and low or no education are key factors in financial exclusion. Travel distance to and

Table 1. Population (Estimated) and Bank Accounts Statistics (as of March 2013)

<table>
<thead>
<tr>
<th></th>
<th>(in millions)</th>
<th>(in percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total population</td>
<td>160</td>
<td>100%</td>
</tr>
<tr>
<td>Rural</td>
<td>120</td>
<td>75%</td>
</tr>
<tr>
<td>Urban</td>
<td>40</td>
<td>25%</td>
</tr>
<tr>
<td>Total deposit accounts</td>
<td>61</td>
<td>38%</td>
</tr>
<tr>
<td>Rural accounts</td>
<td>35</td>
<td>29%</td>
</tr>
<tr>
<td>Urban accounts</td>
<td>26</td>
<td>65%</td>
</tr>
</tbody>
</table>

Sources: Bangladesh Bureau of Statistics (BBS) and Bangladesh Bank (BB).
from the bank and related paperwork also hinder financial access. As a result, small-holder farmers, landless laborers, self-employed workers, urban slum dwellers, migrants, ethnic minorities, youth, senior citizens, and women in general are the most excluded people from formal financial services in Bangladesh. People of remote, coastal, and sparsely populated areas with poor infrastructure and difficult physical access remain excluded from financial services as well.

Think about someone who lives in a rural area with no bank branches around. He does not have a permanent income source or fixed asset to provide as necessary collateral. He doesn’t have enough education to understand all the terms and conditions for opening an account or taking a loan from a bank. This is the reality of most people living at the bottom 40% of the economic pyramids in Bangladesh, the majority of whom are under the poverty line. The situation for a woman is even worse, as she cannot move alone with no/very limited rights to her parents’ or husband’s property. Now, if we really want to make formal financial services available for them, we need to think and plan very seriously.

Activities of Financial Inclusion in Bangladesh

Bangladesh Bank (BB) as the central bank of Bangladesh has launched a comprehensive financial inclusion campaign to reach out with financial services to un-served and underserved population segments and economic sectors. Motivated by their Corporate Social Responsibility (CSR) obligations, banks have also enthusiastically engaged themselves in the financial inclusion campaign, innovating cost effective service modes of delivery to reach out to diverse new customer groups. These initiatives have been supported by developments in IT infrastructure with nationwide connectivity for online banking, the introduction of mobile phone-based banking, and fully automated inter-bank clearing and settlement of paper-based and electronic fund transfers.

The initiatives of financial inclusion include extending the volume of credit along with the branch and ATM networks into rural areas, mass scale opening of no-frills bank accounts with nominal deposits for poorer people, adopting new cost saving remote delivery modes for financial services like mobile phone/smart card based banking, agricultural and SME financing, and financing schemes for renewable energy generation projects. BB has supported these initiatives by putting in place a necessary enabling infrastructure, including a fully automated interbank clearing and settlement platform for paper-based and electronic payment instruments, an upgraded online credit information bureau, and some refinance lines for banks against their SME, and environment-focused lending. A brief review of BB’s initiatives in this regard may be seen in the Appendix.

Ways to Address the Problems in Financial Inclusion

Financial inclusion could be used as a vehicle for sustainable development, which could be a further source of competitive advantage and growth of financial industries. Inclusive financial development would promote quality of growth by spreading benefits across all social groups and regions, and would not worsen inequality by neglecting the distributive aspect of growth benefits. Thus, different factors or constraints need to be identified for quick, successful, and broad-based financial inclusion. Appropriate policy strategies are required to remove those constraints and various incentives are to be offered to rural poor and other unprivileged people, to speed up the pace of financial inclusion.

The barriers to financial inclusion so far identified include affordability in terms of low income and high services costs, low/no education, travel distance, and excessive paperwork. The lack of financial education, such as financial illiteracy, and a lack of transparency on the part of financial institutions, creates information gaps and thereby hinders financial access, leaving a large section of the population out of formal financial services. In order to increase the coverage of financial services for the un-banked through addressing the above barriers, a national strategy for financial inclusion with the following policy options is recommended.
1. To access the magnitude and nature of the financial exclusion, the Bangladesh Bank, in coordination with the government, may conduct an in-depth survey. Based on the findings/recommendations of the survey, the Central Bank in consultation with concerned ministries (e.g., Ministry of Finance) of the government could take the lead in formulating a national strategy for financial inclusion with specific time-bound goals of financial inclusion. For example, 10% of the bottom 40% will be under formal financial services by the next two years. The strategy should also outline a road map for ensuring active participation of all the stockholders concerned, like non-bank financial institutions (NBIs), micro-finance institutions (MFIs), and NGOs.

2. Bangladesh Bank should take direct measures to reduce and rationalize the cost of formal financial services. This could be done through reducing various service charges of banks and allowing un-banked people to avail banking services at low cost by issuing central bank circulars. Appropriate mechanisms from the Bangladesh Bank should also be in place so that these instructions are properly followed.

3. Appropriate measures are required to keep all the no-frill accounts alive by motivating the account holders to use those accounts for savings and loan purposes. The government could do this by using these accounts for all G2P payments.

4. Initiation of mobile based banking services should not be limited only to money transfer. It should be extended for all other financial transactions purposes like paying bills, shopping, savings, etc., to attract customers' interest. Besides, licensing requirements for mobile banking services should be an “easy one” so that other competitors could come in the market and provide the services at competitive prices.

5. Following the success of sharecropper loans and women entrepreneurship development loans, Bangladesh Bank may offer similar types of special loan facilities for unserved people at subsidized interest rates. Special purpose loans like those for SMEs and crop diversification could be another way of addressing the issue.

6. To address the rural and remote area coverage problem, special efforts are required for financial institutions to have some cost-effective mechanisms in expanding rural branching. Bangladesh Bank’s recent initiative of agent banking seems to be a move in the right direction, as it would allow a bank to offer its services without having a physical presence. To facilitate branchless banking in remote areas, Bangladesh Bank may expedite the process of the agent banking initiative.

7. Financial markets are now very complex with new credit and investment financial products provided by financial intermediaries, and with asymmetry of information, which makes it very difficult to use financial resources. To facilitate informed decisions and familiarity with various financial products, Bangladesh Bank and concerned ministries may take necessary steps to inform the mass population by increasing the level of their financial literacy through media campaigns and advertising.

8. The central bank of Bangladesh may take effective steps to leverage the potential synergies in partnerships between banks, MFIs, NGOs and telecom/mobile phone service providers in bridging the remaining gaps in financial inclusion with due attention to the risk management, consumer protection, and systemic stability issues that may arise in these new arrangements. In addition, Bangladesh Bank may take a holistic scheme to redesign the business strategies of financial institutions (banks, in particular) to incorporate specific plans to promote financial inclusion of low-income groups, treating it both as a business opportunity as well as a corporate social responsibility. As a result, financial inclusion may emerge as a new opportunity for commercially profitable business for the financial institutions while effectively contributing to quality growth for sustainable economic development.
Appendix

BB’s Recent Financial Inclusion Augmenting Initiatives

Agricultural Lending: All commercial banks operating in Bangladesh (state owned or privately owned, domestic or foreign) are now extending agricultural credit, directly or indirectly through regulated Micro Finance Institutions (MFIs) or through value chain intermediaries. Alongside close monitoring of credit volumes, a specialized BB department exercises oversight on hassle free credit disbursement and other customer-friendly programs. Mobile phone–based financial service delivery processes promoted by Bangladesh Bank are expanding rapidly, and are expected to facilitate cost effective agricultural credit delivery and recovery to and from farmers in remote rural locations.

Credit for Sharecroppers: Sharecropper farmers have long been excluded from the formal financial system because they lacked collateral. In FY2010, BB launched a refinance scheme worth Taka 5.0 billion for landless sharecroppers in partnership with Bangladesh Rural Advancement Committee (BRAC), the largest non-bank MFI in Bangladesh. This is a first-ever initiative for this productive group of farmers. The scheme is promoting social collateral where peer pressure ensures loan repayment and mitigates default risks. As of September 2012, under this scheme, BRAC has provided loans to almost 481 thousand sharecroppers in 250 upazilas in 48 districts. BB has provided BRAC with a refinance facility against this. Apart from this, state-owned banks also extend loans to sharecroppers, a sizable number of whom are women farmers. Agricultural credit totaling Taka 10.86 billion was disbursed by these banks in FY2012 to around 500 thousand sharecroppers.

Credit at Concessional Interest Rates: Agricultural credit at concessional 4 percent interest rate per annum is being extended by banks to farmers for growing spices, lentils, and oilseeds. Banks receive a six percent interest subsidy from government through BB against these loans. Local productions of these specialized crops are already contributing significantly toward reduction of import dependence.

Credit for Crop Diversification: An ADB assisted crop diversification credit project is extending credit for growing higher value crops (vegetables, fruits, flowers, spices, oilseeds) in the country’s poverty ridden northwestern region. The new second version of the project is disbursing these loans through BRAC, under oversight of two private sector banks (BASIC and Eastern Banks).

No-frill Accounts for Farmers and Other Underprivileged People: In a major financial inclusion initiative, banks have opened more than thirteen million new bank accounts in names of small farmers and other rural and urban people of small means at no charge, with nominal initial deposits as low as Taka ten (about twelve U.S. cents). These accounts are being used by the account holders for receipt of agricultural input subsidies, and social safety net payments besides being used as a savings and payments medium.

School Banking and Financial Literacy Initiatives: With a view to fostering savings habits and financial literacy among the young, banks have launched “School Banking” initiatives in schools. Besides, a DFID supported financial literacy campaign is going on to create mass awareness of benefits of opening bank accounts and using to best advantage of account holders.

SME Credit Programs: Considering SME development as one of the important development agenda of the country, BB has initiated a comprehensive policy and programs on SME credit with an indicative target for SME loan disbursement prioritizing small entrepreneurs, women entrepreneurs with special emphasis for manufacturing, and services sectors. This has been following a separate business strategy in financing SME with speedy loan sanction and disbursement with an Area Approach Method for area specific cluster development strategy.
Mobile Banking Services: Mobile banking services, which build on the infrastructure of mobile banking operators, have been introduced to modernize and ease banking transactions in Bangladesh. Mobile Financial Services (MFS) are acknowledged worldwide for their cost-effectiveness and ability to process rapid transactions. They extend opportunity of banking services in the remote rural areas. In order to bring the vast unbanked/under-banked population under the umbrella of formal financial services, BB has taken steps through issuing “Guidelines for Mobile Financial Services’ to introduce bank-led mobile financial services. Disbursement of inward foreign remittances and domestic funds; payments of utility bills, salary, allowances, pensions; buying and selling of goods and services; balance inquiries; tax payments; government subsidy payments; and payments of the benefits of social safety nets can easily and quickly be provided through mobile financial services.

MFS has created the opportunity of fast and cost-effective transaction even to the remotest corner of the village as well as it has given access to modern banking services to the rural poor including the social safety net beneficiaries. It is also promoting the habit of savings of the rural people, particularly the sharecroppers (Bayes & Patwary). In this way, each mobile phone is turning out to be a small bank, contributing positively to the increased fund-flow to the rural areas of the country. As a result, Bangladesh’s rural economy is being rejuvenated, widening the real base for participatory growth of the country.

References

Endnotes
1. Based on 2122 kcal food intake per day.
2. Include both the off emergency humanitarian and disaster relief with continuing support of initiatives widening advancement opportunities for the weaker, less fortunate population segments in terms of health care, education, and training.
3. Please see the Appendix for more details.