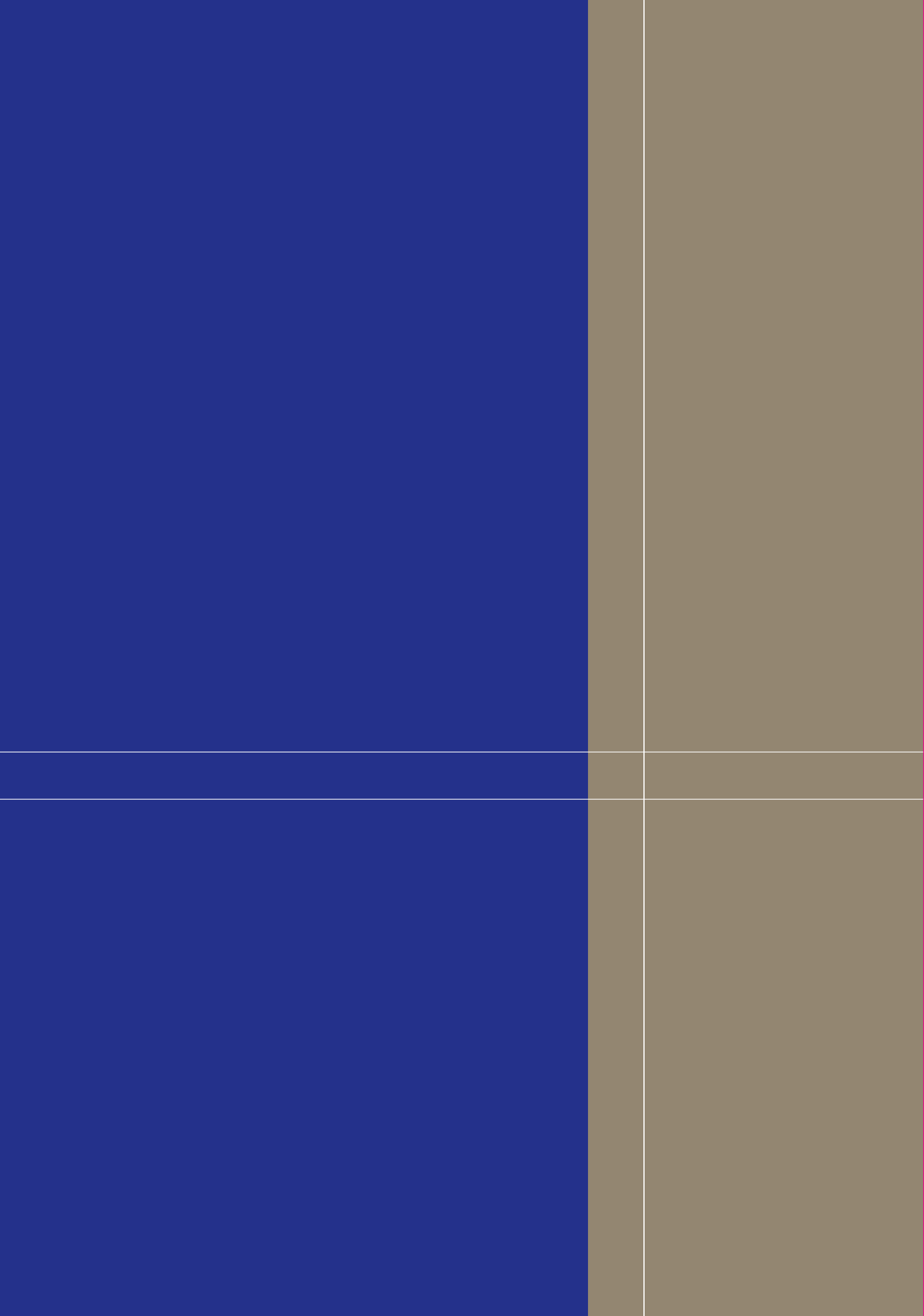


# **THE FLETCHER SCHOOL**

Leadership Program for  
Financial Inclusion

**Policy Memoranda**

**2011**



# **THE FLETCHER SCHOOL**

## Leadership Program for Financial Inclusion

Policy Memoranda 2011



## FOREWORD

These policy memoranda were prepared as part of The Fletcher School Leadership Program for Financial Inclusion, an innovative training initiative designed for banking regulators and policymakers from emerging and frontier markets to promote and further develop their work on policy and regulation in financial services for the poor. The three-part program includes: a two-week training session focused on key content issues in financial inclusion, the global context shaping these topics, and the relevant skills needed by regulators to effectively promote their policy objectives; a remote period to research, write, and perfect original policy memos pertinent to a timely in-country issue in financial inclusion; and a final working session at an international conference hosted by the Alliance for Financial Inclusion. In 2011, the program hosted nine regulators from eight countries: Ghana, Indonesia, Kenya, Mexico, Namibia, Peru, the Philippines, and Tanzania. Their policy memos are contained herein.

The training is held at The Fletcher School, the United States' first professional graduate school of international relations, and is administered by Fletcher's Center for Emerging Market Enterprises (CEME), which conducts research, training, and consulting in promotion of inclusive economic growth, effective and responsible leadership across borders, and strategic innovation in the emerging and frontier market space. The Fletcher School, part of Tufts University, is located in Medford, Massachusetts.

The program is led by Kim Wilson, Lecturer at The Fletcher School and CEME Senior Fellow, and Nicholas Sullivan, also a CEME Senior Fellow. Program advisors include Claire Alexandre of the Bill & Melinda Gates Foundation, David Porteous of Bankable Frontier Associates, and Michael Tarazi of the Consultative Group to Assist the Poor (CGAP).

The Fletcher School Leadership Program for Financial Inclusion is funded in its first year by the Bill & Melinda Gates Foundation.



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# INTRODUCTION

Kyle Muther

*Kyle Muther is a Master of Arts in Law and Diplomacy candidate (F'13) at The Fletcher School, Tufts University.*

The policy memos in this publication provide unique insights into the dynamic world of financial inclusion and financial services regulation. The authors—participants in the 2011 Fletcher School Leadership Program for Financial Inclusion—come from a wide variety of countries, professional backgrounds, and positions within their respective governments. The memos offer tangible examples of innovative policy strategies and solutions to complex challenges posed by ineffective capital markets, burdensome regulation (or lack thereof), and inappropriately designed financial instruments. Access to financial services provides individuals with the opportunity to manage risk, broaden their menu of choices, and smooth their consumption. Increasing financial access provides capital for enterprise expansion, protects against both covariate and idiosyncratic shocks, helps move money between family members across the world, and generally improves the well-being and economic sustainability of the poor. Theoretically, this promotes economic development, thereby contributing to poverty reduction. However, much of the developing world still does not have access to basic financial services.

Specific banking regulation aimed at financial inclusion is a new and constantly changing field. However, common themes emerge from the policy memos in this publication related to the current trends and policy options for banking regulators and policymakers in the developing world. Eight of the nine memoranda in this publication speak to two broad strands of current thinking and learning: 1) Identifying the appropriate regulatory framework that reduces usurious lending while also promoting financial inclusion; and 2) how best to address regulatory questions associated with technological innovations that can further financial access for the poor. The final memo explores yet another dimension—the issue of effectively regulating savings products.

Innovative strategic frameworks and policy options for central banks to promote financial inclusion and effectively regulate the microfinance sector are proposed by banking regulators and policymakers from Tanzania, the Philippines, Ghana, and Namibia:

- Generose Tabaro, *Manager of Payment Systems Oversight and Policy at the Bank of Tanzania*, recommends a policy strategy of enhanced coordination among regulatory actors that will accelerate the reduction of the gap in access to financial services in the country. Specifically, Tabaro proposes establishing a dedicated unit at the Bank of Tanzania and a National Financial Inclusion Workgroup. The National Financial Inclusion Workgroup, which would consist of relevant stakeholders from the public and regulators, should work with the Bank to align the individual strategies and put in place a reporting strategy for monitoring implementation of broader goals. The Bank should act as secretariat of this workgroup, which should be chaired by the Ministry of Finance.
- Pia Bernadette Roman-Tayag, *Head of Inclusive Finance Advocacy at the Bangko Sentral ng Pilipinas*, focuses on establishing a set of guiding principles to ensure a coherent and consistent approach, which includes regulatory changes, effective supervisory capacity, advocacy, and communication grounded within the foundation of financial education and consumer protection. Specifically, Roman-Tayag recommends mainstreaming financial inclusion into the bank's policy strategy through reconstituting the microfinance committee as the inclusive finance committee and expanding the inclusive finance advocacy unit.
- Franklin Belyne, *Assistant Director and Deputy Head of the Banking Supervision Department at the Bank of Ghana*, promotes the use of a tiered system of regulation, providing an orderly

process for the effective regulation of informal banking actors in Ghana, including Susu collectors (rotating savings and loan schemes) and moneylenders.

- Michael Mukete, *Assistant Governor of the Bank of Namibia*, proposes using the vast Namibian Post Savings Bank (NPSB) network to increase access to financial products. Specifically, Mukete envisages the provision of microfinance through the transformation of the NPSB into a full-fledged savings and retail bank under the Bank of Namibia's supervisory and regulatory authority.

The importance of technological innovation as a tool for financial inclusion is discussed by banking regulators and policymakers in Kenya, Indonesia, and Peru. Specifically, the important question of if/how to regulate branchless and mobile banking is a priority for many central banks today.

- Stephen Mwaura Nduati, *Head of the National Payments System at the Central Bank of Kenya*, provides an important introduction to the prospects of technological innovation furthering financial inclusion in Kenya. Mwaura recommends a serious effort at establishing a legal and regulatory framework that provides for the role of private sector banks and telecoms, government and regulatory institutions, and competitive dynamics, especially within the telecom and banking sectors.
- Siti Hidayati, *Senior Payment System Overseer at Bank Indonesia*, is encountering a different problem than Mwaura. The Bank started granting mobile money licenses some four years ago, but mobile money usage remains quite low. Hidayati teases out the possibility that the high number of mobile money agents may be a major constraint to mobile money adoption in Indonesia. Hidayati recommends that Bank Indonesia distinguish between cash-out transactions and remittances, allowing for reduced regulatory burden on the mobile money agents while at the same time discouraging money laundering and the financing of terrorism.
- Matu Mugo, *Assistant Director of Bank Supervision at the Central Bank of Kenya*, explores the tensions between the payment agent model run by telecommunications companies and the banking agent model. He advocates for proportional regulation based on risk and the types of services provided. Mugo promotes the idea of unbundling the services offered by either the bank or the banking agent and establishing a less rigorous regime for payment agents in comparison to banking agents, as they only provide basic payment services.
- Narda Sotomayor, *Head of the Microfinance Analysis Department at the Superintendency of Banking, Insurance, and Pension Funds in Peru*, discusses the principal elements of establishing a regulatory framework for e-money in Peru. Sotomayor, like Mugo, promotes a tiered approach to regulating both telecommunication companies and banks that provide e-money products. A key definitional issue arises as to whether e-money should be considered a deposit.

Lastly, Luis Treviño Garza, *Director for Access to Financial Services at the Banking and Securities Commission in Mexico (CNBV)*, brings up a very salient issue within financial inclusion—the promotion of savings products and financial literacy programs targeted to the low-income segment of the population through conditional cash transfer (CCT) programs. In particular, the memo argues that policymakers from the Oportunidades (Formerly Progresá) CCT should develop the necessary regulations and policy mechanisms to deliver savings products and financial literacy programs via this CCT program.

The path toward financial inclusion is varied and complex. However, the critical analysis and out-of-the-box thinking that can be seen in the memos that follow form a key part of the conversation around inclusive regulation.

## **I. Frameworks for Advancing Financial Inclusion**



# ESTABLISHING A NATIONAL FINANCIAL INCLUSION NETWORKING FRAMEWORK<sup>1</sup>

Generose Tabaro

*Generose Tabaro is Manager, Payment Systems Oversight and Policy, at the Bank of Tanzania.*

## Problem Statement

The economic reforms undertaken during the 1990s in Tanzania led to significant developments in the financial sector, which resulted in an increase in the number of banks and financial services. However, despite the increase in financial services, the level of access to these services remains very low. According to the FinScope Survey (2009), the proportion of the adult population in Tanzania with access to formal financial services was 12.4 percent; 4.3 percent accessed financial services through semi-formal services, and 27.3 percent through informal services.<sup>2</sup> The FinScope survey was followed by an African Development Bank survey in 2010 (African Development Bank, June 2011), which indicated that the formal financial services access level had reached 22 percent.<sup>3</sup> More recent statistics indicate that it is closer to 33 percent, which suggests that there is additional potential for the growth of formal services. All in all, although the yearly incremental change is significant, access to formal financial services is still limited to a few.

Those excluded from formal financial services, mainly the poor, cannot integrate fully into the kinds of economic development enjoyed by those who do have access to formal services. This exclusion renders them particularly vulnerable to social and economic shocks. Access to financial services is crucial for economic growth and poverty eradication. Furthermore, the percentage of the population accessing informal services suggests that there is significant demand for financial services. Thus, in keeping with existing initiatives for poverty reduction, there is a need for constructing a strategic, coherent framework to minimize the access gap.

This paper reviews Tanzania's current financial inclusion framework and recommends a policy strategy that will accelerate the reduction of the gap in access to financial services in the country.

## Introduction

*Together, we can and must build inclusive financial sectors that help people improve their lives.*

—UN Secretary-General Kofi Annan,  
December 29, 2003

The level of access to formal financial services in Tanzania remains low. In order to reach improved levels of financial access, there is a need for a policy strategy that has a leapfrogging effect. The goal of financial inclusion initiatives should be to extend formal financial services to the entire adult population, which is 53 percent of the country's total population.<sup>4</sup>

Tanzania has initiated various sectoral policies that promote financial access. However, the existing frameworks are fragmented and lack a clear mandate or focal point for the coordination of strategies. The financial inclusion coordination principle requires creating an institutional environment with clear lines of accountability and coordination while also encouraging partnerships.

In order to maximize progress, government regulators and the private sector must establish a coordinated approach to a financial inclusion policy. Existing initiatives within the bank, coupled with strategic cooperation among stakeholders, will speed up closure of the country's financial services access gap.

## Existing Financial Inclusion Initiatives

Building inclusive financial sectors has increasingly become a priority of practitioners and policymakers both nationally and internationally. Tanzania recognizes the role of inclusive finance in empowering individuals economically and socially.

At the national level, the government has initiated various sectoral policies, which contribute to the promotion of financial access. These include:

- The National Strategy for Growth and Poverty Reduction, which is an operational strategy for implementing the country's Development Vision 2025
- The National Microfinance Policy of 2001, which provides a framework for coordinating development of the microfinance sector in the country, and
- The Cooperative Societies Act of 1991, which provides a framework for the registration of savings and credit cooperatives societies as privately owned financial intermediaries at the community level.

The Bank of Tanzania Act of 2006 and the Banking and Financial Institutions Act of 1992 also provide powers to regulate commercial banks and financial institutions, while the the Second Generation Financial Sector Reforms, articulate the objective of deepening financial access.

However, these policies and the existing institutional frameworks are not coordinated. They neither separately nor jointly offer a clear mandate or have a focal point for the coordination of interrelated financial inclusion initiatives. This lack of coordination results in a duplication of efforts and a low level of efficiency and effectiveness.

## The Need to Coordinate Financial Inclusion Initiatives

Financial inclusion is a multifaceted agenda with very broad categories, including microfinance, micro-insurance, micro savings, payment systems, agent banking, and the like. Stakeholders include the government ministries, nongovernmental organizations, interested members of the international community, regulators, financial and non-financial service providers, consumers, and the public.

The G20 countries have spelled out innovative financial inclusion principles to help create an enabling policy and regulatory environment for financial inclusion. These have been derived from the experiences and lessons learned from policymakers throughout the world, especially the leaders from developing countries. These principles are a reflection of the conditions conducive to spurring innovation for financial inclusion while protecting financial stability and consumers.

The principles articulate the need for a broad-based government commitment and policies that promote competition and provide market-based incentives for the delivery of sustainable financial access, promoting innovation, consumer protection, institutional cooperation, and accountability. The principles also advocate for improved data to use in making evidence-based policy and to measure progress within a proportionate policy and regulatory framework.

Whereas the principles put equal emphasis on the requirements, they all converge around commitment, coordination, and accountability for sustainable development. Thus, in order to hasten closure of the access gap, there is a need for a firmer and more coherent strategic framework to ensure commitment, accountability, and coordination at the national level.

## Financial Inclusion Coordination Framework

The coordination principle requires creating an institutional environment with clear lines of accountability and coordination within the government and among regulators, and also

encourages partnerships and direct consultation across government, business, and other stakeholders. A coordination strategy calls for a “champion” who will communicate and harmonize the strategies, not only among those directly involved but also among those involved in other related strategies and policies. The champion’s task will be to ensure that financial inclusion is supported by, and integrated with, the whole complex of activities relating to financial system development. The champion will also monitor developments and implementation, and play an advisory role in financial inclusion initiatives.

In this regard, the Bank of Tanzania, as the regulator of the country’s financial systems, is a natural choice for the role of champion.

## **Coordinating Financial Inclusion Activities**

The Bank has a number of initiatives that are geared toward achieving financial inclusion. Apart from incorporating the financial inclusion agenda in its Corporate Plan and Strategic Framework, there are functional units within the Bank that contribute to achieving financial inclusion. These include the Directorate of National Payment Systems, which has the overall mandate of overseeing and regulating payment systems; the Directorate of Banks Supervision, which deals with regulation and supervision of banking and microfinance institutions; and the Real Sector and Microfinance Policy Department in the Directorate of Economic Research and Policy, which deals with microfinance promotion policies.

The Bank has also initiated a workgroup, which involves staff for coordination purposes within the Bank. However, in order to provide the much needed attention to financial inclusion initiatives, the Bank may consider the following options.

### **Strengthening the existing functional units**

The Bank may consider granting one of the existing units a mandate to coordinate financial inclusion issues. However, placing the task under the existing functional units could have the following operational implications:

- Concentration would be primarily on core functional activities, and financial inclusion would receive little attention
- Addressing financial inclusion would receive too few resources, for example, in terms of staff and capacity

### **Establishing a financial inclusion unit**

The second option, which is more viable, is to establish a unit within the Bank that would specifically deal with financial inclusion issues. This unit would ensure that there is a coordinated approach toward implementing various financial inclusion initiatives and act as a focal point of that approach. The unit would be responsible for conducting studies and coming up with strategies for improving the existing situation. (See some of the suggested activities to be conducted by the unit in Annex 1.) The unit team would also formulate a mechanism for coordinating financial inclusion initiatives with the Bank and external stakeholders.

To stimulate the stakeholders’ sense of ownership and continuous involvement, the Bank could consider setting up a National Financial Inclusion Workgroup, which would draw members from the central bank, microfinance regulatory agencies, the Ministry of Finance the local government ministry, and leading financial sector development agencies. The proposed unit at the Bank would provide secretariat support to the workgroup.

The workgroup might include some sub-workgroups to deal specifically with the core pillars of financial inclusion, which could correspond with those of the Alliance of Financial Inclusion. These include the following workgroups:



- Financial inclusion data
- Consumer protection and literacy
- Financial integrity
- Market infrastructure

These workgroups would include members from relevant regulators and service providers and include representatives from among public users. Figure 1 illustrates the institutional set up of the National Financial Inclusion Workgroup.

## The Success of Financial Inclusion Strategic Frameworks Abroad

The advantage of a financial inclusion framework is that it would create an accountable organization that works constantly on financial inclusion initiatives and closely monitors implementation progress. The framework would also have a consistent and timely framework output with predictable outcomes. A coherent coordination framework would also bring about unified strategies and interrelated activities that are known to all parties.

Countries with financial inclusion strategic frameworks have made considerable progress. These include the Philippines, Mexico, Indonesia, Brazil, and Peru. For example, Bangko Sentral ng Pilipinas established financial inclusion advocacy units that report directly to the deputy governor. They have an explicit mandate to coordinate consultation with the government and other stakeholders on issues related to the development of a sound and balanced financial system. The workgroup model is also being used in Indonesia.

By creating and spearheading a coordination strategy, the National Banking and Securities Commission (CNBV) of Mexico has been able to conduct various studies and to develop qualitative and quantitative measurements of financial capabilities at a national level. Its achievements include the implementation of an electronic payment project whereby withdrawal of government payments by employees and pensioners can be made through a store-based agent network, thus bringing people into the formal financial system. CNBV is currently in the process of implementing government savings bonds for individuals to encourage saving.

Apart from the increase in product services, such as mobile and agent banking and microfinance services, these countries have not conducted comprehensive studies on whether the number of people accessing formal financial services has increased within the period of implementation. In other words, it is too early to know the impact.

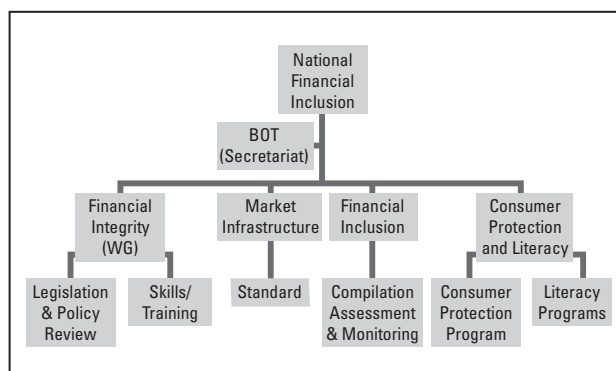
The only disadvantage of this option is the added costs the Bank has to incur in establishing the unit, which include reallocation or employment of staff and the necessary support. However, compared with the benefits this may bring, the costs can be considered minimal.

## Recommendations

Financial services are increasingly becoming a public good, such that the availability of banking and payment services to the entire population without discrimination is a key goal of national policymakers. Safe savings, appropriately designed loans for low-income households, and appropriate insurance and payment services can increase production and help people to support themselves, acquire assets, decrease risk, and work their way out of poverty. Experience has shown that even the poor demand credit and savings opportunities.

Recent surveys made by Daryl Collins and his colleagues (Collins et al., 2009) show that the poor are active money managers: they often numerate and track their transactions; they can and do

**Figure 1. National Financial Inclusion Workgroup Structure**





save; they rely on informal savings mechanisms that can be flexible but are frequently expensive and unreliable. The majority of Tanzanians would be willing and able to save and borrow if appropriate products and savings mechanisms, terms, and conditions were available.

Our national financial inclusion efforts should include the formulation of a national networking framework that will engage the basic principles for innovative financial inclusion, which are commitment, coordination, and accountability.

Tanzania should begin by establishing a dedicated unit at the Bank and a National Financial Inclusion Workgroup. The Financial Inclusion unit at the Bank should specifically deal with the implementation and oversight of financial inclusion activities and act as a focal point for the financial inclusion agenda within the Bank and at the national level. The National Financial Inclusion Workgroup, which should consist of relevant stakeholders from the public and regulators, should work with the Bank to align the individual strategies and put in place a reporting strategy for monitoring implementation of broader goals. The Bank should act as secretariat of this workgroup, which should be chaired by the Ministry of Finance.

With the benefits of enhanced coordination, it is conceivable that up to 50 percent of the population could be enjoying the benefits of financial services within the three years.

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## **Annex 1: Financial Inclusion Main Activities**

1. Review the current situation to identify gaps in the existing policies that have an impact on financial inclusion and propose changes.
2. Coordinate financial inclusion initiatives among stakeholders.
3. Analyze the present situation of financial inclusion, particularly looking at the opportunities for developing inclusive finance initiatives.
4. Identify the potential demand for financial inclusion and the key economic indicators that are likely to influence the development of financial inclusion policy.
5. Evaluate the current services in the market by different players.
6. Liaise with donors with a view to determine their strategy to support microfinance industry.
7. Identify best practices of financial inclusion available in other developing countries that suit the economic situation in Tanzania.
8. Provide an overview of the current legal, financial, and institutional setting for financial intermediary services, making recommendations on changes to promote a more enabling environment.
9. Define clearly the objectives, scope, and methodology for financial inclusion policy.
10. Develop financial performance standards for supporting institutions, especially those outside the regulatory framework.

## **Key Actors' Roles and Responsibilities**

11. Outline policy actions to mitigate low financial education and challenges in addressing them.
12. Identify problems that necessitate improved financial education.
13. Identify long-term risks to financial inclusion from the excluded segment of the population that is associated with poor financial education.

## **Endnotes**

1. This paper is in compliance with the requirement to deliver a policy memo advocating a particular financial inclusion innovation or policy change as part of the Fletcher School Leadership Program for Financial inclusion.
2. These are registered entities subject to all relevant general laws, but not subject to bank regulations and supervision.
3. The African Development Bank Survey.
4. Tanzania National Bureau of Statistics.

# A CORPORATE STRATEGY TO DEVELOP A MORE INCLUSIVE FINANCIAL SYSTEM

Pia Bernadette Roman-Tayag

*Pia Bernadette Roman-Tayag is Head, Inclusive Finance Advocacy, at the Bangko Sentral ng Pilipinas.*

## Introduction

The Bangko Sentral ng Pilipinas (BSP) has taken serious and deliberate measures to establish a supportive regulatory environment for market-based solutions that address financial access issues. Since the General Banking Law of 2000 recognized microfinance as a legitimate banking activity and mandated that the BSP set the rules and regulations for its practice within the banking sector, the BSP has issued over 20 circulars and undertaken various initiatives, for microfinance in particular and financial inclusion in general. These have resulted in over 200 banks now providing microfinance services—up from just a handful in 2000—that reach nearly one million households with an outstanding portfolio of PhP 7.3 billion. Innovations in products and delivery channels using technology have also brought about advances in financial inclusion. The BSP and the Philippines government have therefore been lauded globally for the significant strides they have made in microfinance and financial inclusion. For two years in a row, the Economist Intelligence Unit’s global survey of microfinance has ranked the Philippines number one in the world in terms of policy and regulatory framework for microfinance and number two overall, which includes other criteria such as institutional development and investment climate (an improvement from number three in 2009).

Despite this initial success, there is still much to be done. Widespread lack of access to financial services is still a pressing challenge. Only 26 percent of the adult population in the Philippines is banked. Approximately 37 percent of municipalities do not have a banking office. Existing banking services are biased toward higher income areas, leaving many of the low-income areas significantly underserved. For example, more than 50 percent of the country’s deposit accounts are found in the National Capital Region, where bank density (number of people served by one bank) is 4,100, compared to the Autonomous Region of Muslim Mindanao at 138,000. Coverage of municipalities in the National Capital Region is 100 percent, compared to 8 percent in the Autonomous Region of Muslim Mindanao. In a survey of midsize non-metro cities, over 60 percent of the households still keep their savings at home. Many Filipinos, especially the poor, are therefore left wanting for much needed financial services.

## Background

### Financial inclusion as a worthy policy objective

The success of microfinance has demonstrated how a previously marginalized sector can be effectively mainstreamed and served in a sound and sustainable manner. Learning from the lessons of microfinance, the BSP set the more ambitious and broader goal of building an inclusive financial system or expanding access to financial services for all. The BSP believes that financial inclusion is a worthy policy objective. Financial inclusion contributes directly to economic development and social cohesion and is therefore something that should be pursued, along with the promotion of financial stability.

### What has the BSP done?

In 1997, the Philippines was one of the first countries to establish a clear national strategy for microfinance that was anchored on the principle of market-based microfinance policies. The emphasis was on the private sector as the leading provider and the government as playing a sup-

portive role through policy, regulation, and capacity-building. In 2000, the BSP declared micro-finance as its flagship program for poverty alleviation to complement the mandate of the General Banking Law.

In 2002, the BSP created a Microfinance Committee, Microfinance Unit, and a Microfinance Core Group (now the MicroSME Finance Specialist Group, or MFSG) that began to focus on the development of an enabling policy and regulatory environment for microfinance. In 2007, the BSP was the first central bank in the world to establish an office dedicated to financial inclusion when it converted the Microfinance Unit into the Inclusive Finance Advocacy Staff (IFAS).

### Where are we now?

The institutional set-up of the Microfinance Committee, Microfinance Unit, and Microfinance Core Group was instrumental in building a clear policy and regulatory framework for micro-finance. The BSP has used this solid foundation to take additional strides toward financial inclusion. In the last 12 months, the BSP has established new issuances and specific measures that have the potential to increase access to finance in a significant way. These issuances ensure the following:

- **Wider range of products.** BSP has recognized micro-enterprise loans, micro-agri loans, housing microfinance loans, microdeposits, and micro-insurance.
- **Expanded physical network.** This allows banks to establish microbanking offices specifically designed to reach unserved or underserved areas.
- **Expanded virtual reach.** This creates the framework for an e-money ecosystem, which banks can use to transact with their clients in a more efficient and cost-effective manner. This builds on the success of existing e-money products such as Smart Money and GCash.
- **Lower barriers to customer acquisition.** This addresses a main obstacle (i.e., compliance with anti-money laundering regulations) in serving the unbanked yet bankable by allowing risk-based customer acquisition due diligence, as well as outsourcing and relying on third parties for the required “know your customer” in opening accounts.

Taken together, the BSP sees these recent issuances as groundbreaking measures that can unlock the potential to reach the large unbanked population in our country.

### Where do we want to go?

While much has been accomplished, more needs to be done. Moving forward, the goals and objectives of financial inclusion can be found in the recently approved Philippine Development Plan 2011–2016. In this plan, this inclusive financial system is characterized by the following:

- The provision of a wide range of financial services (credit, savings, payments, insurance, innovative products) to serve the demands of different market segments
- The availability of financial products that are appropriately designed, priced, and tailor-fitted to market needs and capacities
- The participation of a wide variety of strong, sound, and duly authorized financial institutions utilizing innovative delivery channels to provide financial services to more Filipinos
- The effective interface of bank and non-bank products/delivery channels, technology, and innovation to reach the financially excluded

## Analysis

In light of the continuing need for financial inclusion initiatives, it is important to reflect on the current BSP initiatives, as well as on the structures for implementation to see how the objectives can be attained more effectively and meaningfully.

The following are the main units/bodies principally involved in financial inclusion issues:

1. **The Microfinance Committee.** This is the key driver of policy recommendations to the Monetary Board, as well as the authority that approves various initiatives and activities related to financial inclusion. At present, it is comprised mainly of offices from the supervision and examination sector, with the IFAS as secretariat. It does not include the other departments in the BSP that may also be involved in activities related to financial inclusion.
2. **Inclusive Finance Advocacy Staff.** The IFAS, which was previously the Microfinance Unit, is a lean office with a three-staff complement benefiting from the inputs of a microfinance consultant. With the increasing scope of work related to financial inclusion, the IFAS has maintained its lean structure. While this has been effective to date, the current push for greater financial inclusion will require a more significant staff complement.
3. **Micro-SME Finance Specialist Group.** This is the specialist group in charge of supervision and examination of banks with significant micro-SME portfolios.

At present, the activities for financial inclusion include regulatory changes, advocacy initiatives, supervision concerns, and financial literacy efforts, among others. Aside from the three aforementioned bodies, some of these activities are currently being undertaken by other offices and departments within the BSP.

While this current portfolio of financial inclusion initiatives has achieved initial success, certain challenges remain that must be addressed to implement the financial inclusion agenda more effectively. These challenges include the following:

1. **Limited coordination.** While the diversity of disciplines that are involved in financial inclusion allows for a richer output, much can also be lost when there is limited coordination. The lack of coordination often leads to the following:
  - Duplication of efforts
  - Underutilization of technical skills and capacities that are otherwise already available within the BSP
  - Varying, or sometimes even conflicting, messages
  - Lack of the “big picture” view of the overall financial inclusion framework of the BSP
2. **Financial inclusion not the core function.** For a majority of the departments, work related to financial inclusion is not a core mission. Because of this, financial inclusion work is only afforded second-order priority. Proper follow-through and meaningful monitoring is often neglected. This results in pockets of financial inclusion work rather than a complete and coordinated effort.

## Options

To continue with the push toward greater financial inclusion, the BSP may maintain the current setup, since it has already been effective for the last 10 years. This will entail less cost and will also not necessitate organizational changes.

On the other hand, the BSP could implement an enhanced organizational and implementation setup that builds on existing success while addressing the current limitations.

## Recommendation

The need for increased financial inclusion likewise demands a greater focus and more deliberate implementation strategy. Toward this end, the following implementation strategy is proposed:

### Guiding principles

In implementing the financial inclusion strategy, it is necessary to establish guiding principles to ensure a coherent and consistent approach. In this regard, the BSP Financial Inclusion Strategy is anchored on the following guiding principles:

1. Financial inclusion is a worthy policy objective and something that can be pursued alongside the promotion of stability and efficiency in the financial system.
2. Financial inclusion and financial stability can be mutually reinforcing. Household-based evidence has shown that access to financial services (i.e., savings, loans, insurance) has a positive impact on people's lives, especially the poor. This creates a broad-based foundation for the financial system. The benefits of a stable financial system are seriously constrained if it only serves a small portion of the population. Moreover, recent financial crises have underscored the negative effects of financial exclusion in the stability of financial markets, and in economic development in general.
3. Financial stability and financial inclusion are not inevitable. Both demand at least the same measure of energy, imagination, and serious attention.
4. In addressing financial access issues, market-based solutions are not only feasible but preferable. Governments tend to be unsuitable providers of financial services and are instead better positioned to establish a supportive regulatory environment for the said market-based solutions to work. These solutions of course present real and valid risks, but these are concerns that can be managed. Regulators must maintain an active dialogue with the market.

### General approach

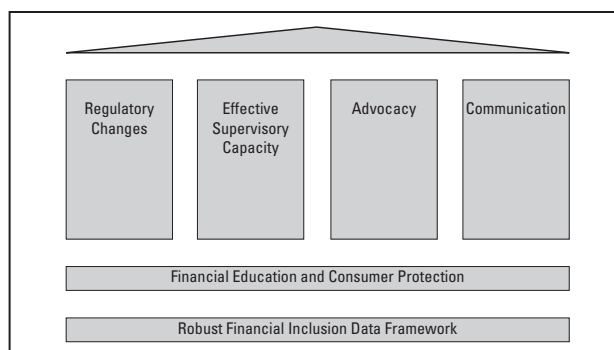
Anchored in the above principles, the general approach for the Financial Inclusion Strategy is as follows:

1. Promote an enabling environment based on the proportionate application of sound and generally accepted regulatory and supervisory principles. It is important that all players and financial service providers are properly and proportionately regulated to ensure consumer protection and financial system stability and integrity.
2. Enable the delivery of a wide range of services, such as savings, credit, insurance, payment services, and remittance. To reach all markets, including those that have been previously unbanked, these products must be appropriately designed and priced and delivered by institutions that have the authority and capacity to safely and effectively provide or deliver such services.
3. Allow banks and non-banks to leverage linkages and partnerships to expand their range of products as well as their delivery channels to reach the financially excluded more effectively.
4. Facilitate useful innovations to operate in an environment where the risks associated with such innovations are adequately understood and addressed, and where there is a judicious and proportionate application of sound principles.

### Structure and resources

To build on existing success and address the current limitations, a proposed organizational and implementation setup is recommended. This setup can be used as a starting point for work and coordination on a national scale.

**Figure 1. Framework and Key Components of the Financial Inclusion Strategy**



- 1. Regulatory changes.** Entails the crafting of the necessary enabling policies and regulations to build an inclusive financial system or the changing of existing ones in line with the objectives, as defined. Key components include policy research, market surveillance, and policy development.
- 2. Effective supervisory capacity.** Involves the continuous training and capacity-building of supervisory units involved in the various financial inclusion undertakings. This includes, among others, the MFSG and the Core Information Technology Specialist Group.
- 3. Advocacy.** Includes complementary initiatives that promote and advocate for specific initiatives that contribute to financial inclusion, such as but not limited to the Credit Surety Fund, various savings promotion programs, and programs that provide business development and business linkages.
- 4. Communication.** Encompasses multi-stakeholder coordination, including (a) other government departments/offices involved in financial inclusion; (b) international fora/ regional groupings (i.e., G20, APEC, ASEAN, Alliance for Financial Inclusion, CGAP); (c) the local public and private sectors; (d) the media; and (e) the general public.

These four components shall be well grounded with the foundation of a comprehensive and effective Financial Education and Consumer Protection Framework and a Robust Financial Inclusion Data Framework. The former recognizes that, as financial inclusion efforts become successful, there is a greater need for the public, especially new participants in the financial system, to be equipped with the necessary knowledge, skills, tools, and mechanisms to ensure that they are adequately informed and protected. The latter will ascertain that progress can be effectively measured and that policies are truly evidence based.



**1. Reconstitution of the microfinance committee as the inclusive finance committee.** The reconstitution will now include the other departments involved in various work related to the key components mentioned in the previous section.

In addition to the existing membership of the Microfinance Committee, other offices such as the Economic and Financial Learning Center, Department of Economic Statistics, Supervisory Data Center, Office of Supervisory Policy Development, CITSG, and the Corporate Affairs Office could be included. This will provide a venue for synchronization of messages and coordination of initiatives.

**2. Expansion of the inclusive finance advocacy staff.** It is proposed that the technical team be increased to six (supported by administrative staff). The technical team will include individuals classified into three categories: (a) strong research, writing, and analytic skills, preferably with a background in economics, finance, or economic development; (b) strong quantitative background, preferably statistics or a degree that allows the ability to process, organize, and interpret large amounts of data, manipulate data, and interpret results; and (c) project management experience.

IFAS is to oversee/be involved in the following:

- Development and monitoring of an overall policy roadmap for financial inclusion
- Data collection and analysis to benchmark the current state of financial inclusion, monitor progress, and measure impact; work here will also be coordinated with DES, SDC, and external data gathering bodies
- Implementation of the recommendations of the recently completed technical assistance from the Bankable Frontier Associates
- Local and international stakeholder communication and coordination: will include reaching a wider local and international audience, relating to media, participating in various relevant fora, and coordinating with donors and other government offices, among others
- Implementation of various advocacy initiatives
- Coordination with the relevant offices involved in consumer protection and customer redress
- Involvement in the BSP Economic and Financial Learning Program
- Internal technical/substantive support to BSP officials on financial inclusion
- Serve as an information hub of financial inclusion





# FINANCIAL INCLUSION AND REGULATORY POLICY

## The Case of Ghana's Informal and Semi-Formal Financial Institutions

Franklin Belnye

*Franklin Belnye is Assistant Director and Deputy Head of the Banking Supervision Department at the Bank of Ghana. With the exception of the policy documents quoted and cited in this memo, the views expressed and the conclusions reached are those of the author and not of the Bank of Ghana as a corporate entity.*

### Background

There is some consensus that a broad-based financial sector can contribute to economic development and poverty alleviation (United Nations, 2006). Access to financial services provides people with the opportunity to manage their risks, broaden their menu of choices, and smooth their consumption patterns. This promotes development, thereby contributing to poverty reduction. This raises concern for a country such as Ghana, which has a fairly well diversified banking and financial system, and yet relatively low financial inclusion. The FinScope Ghana survey of 2010 (FinMark Trust, 2010) indicates that only 56 percent of the adult population is financially served and 44 percent is financially excluded. Among the financially served, as much as 15 percent is served only by informal financial institutions.

Thus, the central bank's financial inclusion efforts, including the creation of rural and community banks, as well as savings and loan companies to help promote financial access for the rural folk and urban poor, have positively impacted access to financial services. Nevertheless, much still remains to be done. The proliferation of a new layer of financial intermediaries below rural and community banks and savings and loans companies, which are enjoying growing patronage, is evidence that financial access remains a challenge.

### Problem Statement

The recent emergence of a new wave of unregulated informal and semi-formal financial intermediaries, comprising individual Susu collectors,<sup>1</sup> Susu companies, money lenders, financial NGOs, and financial service companies, which are ostensibly catering to the financial service needs of the lower echelons of the financial pyramid, presents both opportunities and challenges.

While the FinScope survey indicates an important role for informal financial service providers in financial service delivery to the poor and the marginalized, operations of such individuals and entities often pose a number of risks to patrons. These risks, if not addressed, can threaten confidence in the financial system. Apart from occasional reports of companies going bust or proprietors running away with depositors' funds, there are concerns that such providers are levying usurious lending rates and/or using unorthodox lending and recovery practices, which creates a sense of insecurity among operators and patrons.

This policy memo explores ways of achieving a cost-effective system of supervision that promotes the orderly growth and integration of such intermediaries into the formal financial system while protecting patrons from fraud and other malfeasance.

### Analysis

#### Statistics on providers in this space

The Ghana Cooperative Susu Collectors Association (GCSCA) boasts a membership exceeding 1,500 collectors countrywide. This number excludes a number of freelance collectors that are

not affiliated with the GCSCA. Information available from the Ghana Police Service identifies 160 individuals, enterprises, and companies licensed to carry on money-lending operations. While the numbers of Susu companies and financial service providers are less certain, they probably number about 50 such entities. In terms of deposit mobilization, it is estimated that they intermediate about GH¢50–60 million (equivalent to US\$30–40 million), which is significant, given the segment of the market covered.

### **Variety of institutions in this space**

There are a variety of players in this intermediary space. They range from individual Susu collectors and money lenders, Susu companies, financial services providers (or mini-savings and loan companies), and financial nongovernmental organizations, most of which are companies limited by guarantee. The variety of institutions calls for a tiered approach to regulation and supervision. Tiered regulation implies that regulation should be differentiated and suited to each particular segment of this mixed market.

### **Criticality of their role in increasing access to financial services**

Although Ghana has witnessed an expansion in the bank branch network over the last few years, from under 400 in 2005 to over 700 at the end of June 2011, these remain concentrated in the major cities and urban centers and relatively wealthier southern parts of the country. In addition, their flashy, swinging glass doors and suit-clad staff remain intimidating to both the urban and rural poor. Informal financial intermediaries like those being described remain attractive, and sometimes are the only ones available in some localities. Introducing some formality into their operations and recognizing their status and role can enhance confidence in them as intermediaries, and thereby expand access to financial services.

### **Problems brought up in the past: Sudden collapse/disappearance, undue risk to patrons, "illegality," etc.**

There have been a number of incidences of the sudden collapse and disappearance of Susu companies and financial service providers, often with catchy headlines in the print media implying inaction or negligence on the part of the Bank of Ghana, the institution entrusted with regulation of deposit and credit-granting activities. Within a space of one month, three such incidences were reported in one region, involving about GH¢150,000 of savings. Shortly after, another case was reported in the Afienuya area (Accra region), where a collector bolted with GH¢74,000 of depositors' funds. These incidences arise principally because of imprudent use of mobilized resources and reflect a lack of expertise on the part of the collectors. These developments not only cost patrons their hard-earned savings, but also hurt confidence in the wider financial system.

### **Past response of the central bank**

In the past, the Bank of Ghana took the position that these institutions were insignificant relative to the wider financial sector and therefore did not pose any risks to the financial system. In addition, regulating such small-scale operators was thought to be costly and a waste of scarce supervisory resources. However, as the spate of reported collapses increased and the headlines became rampant, the bank moved in 2008 to close down a number of operations countrywide. This attracted some public outcry, including from political figures. The bank responded to this by relaxing its stance and began to look at ways of installing a cost-effective system of regulation and supervision.

### **Rationale for regulation**

Regulation is necessary not only to restrict entry exclusively to competent persons and entities, but also to ensure orderly exit. It is also appropriate that regulations address permissible activities and the appropriate level of capital for operations and risk mitigation. Regulations should also put in place a system of prudential reporting to the regulator to ensure adequate data for analysis and policymaking. That way, sanity could be restored to the sector in a cost-effective

way while allowing innovation for financial inclusion. Regulations should seek to provide a transition path from informality to formality, thus allowing bigger operators to incorporate or register a business name while still allowing individuals to operate as Susu collectors or money lenders, provided they associate with an umbrella association for purposes of sharing best practices and collating data on operations.

### Proportionality principle

The challenge that arises is one of proportionality; how to ensure that regulation and supervision are not so burdensome as to drive operators underground or kill initiatives, or so demanding of regulatory resources as to outweigh the benefits of extending regulatory oversight to the sector. The solution can be found in a system of “tiered regulation,” whereby the bigger and systemically important operators are subject to direct regulation and supervision by the Bank of Ghana, while the smaller ones are subject to indirect supervision through self-regulatory umbrella associations. The central bank could also promote the formation of umbrella associations for the different types of institutions to serve as a platform for information exchange, good practice dissemination, and the exertion of some form of peer pressure on their membership to ensure good conduct.

### Options for regulation

- 1. Maintain the status quo.** This is always a default option—let things stay as they are. The risk is that we have to live with the occasional failures and the bad press for the central bank. It will also deny the central bank access to good data and information on the contribution of that sector to financial intermediation. As a nation, we could lose the benefit of actually harnessing the potential of these operators to achieve and expand financial inclusion.
- 2. Close down all such “illegal” operations.** The central bank is vested with power to “police” the financial system and can therefore order the immediate closure of operations that it determines to be “illegal” or “unauthorized.” Indeed, this has been done before (in 2008) and it resulted in a public outcry, including complaints from politicians who thought the central bank was unnecessarily high-handed in its treatment of their constituents. That option may therefore not be appropriate, especially as we approach another election year in 2012. Besides, without continuous monitoring and closures, such institutions resurface after a while and therefore defeat the whole exercise. This option also eliminates the potential benefit of expanding financial inclusion through the services that these institutions provide.
- 3. Establish a tiered system of regulation.** A third policy choice is to put in place a system of regulation and supervision commensurate with the risks posed by these institutions and operators. This approach avoids the backlash associated with doing nothing and/or outright closure of institutions, although it comes with challenges. It also allows a nurturing of these institutions as instruments for financial inclusion, while providing a transition route to both formality and upgrading into the formal sector. Given the variety in the size, scope, and mode of operations of the players, designing a suitable regulatory system is challenging. The solution is to divide institutions into those that can be directly supervised by the central bank and those that should be supervised indirectly through self-regulating umbrella associations.

### Direct regulation of bigger players

In order to maximize efficiency in the use of supervisory resources, it is appropriate to focus supervisors’ attention on the bigger players in this space. The collection of data on balance sheet size, loan portfolio, and other key parameters will assist in stratifying all players by size and scale of operations. Based on this, those that meet a minimum threshold can be subject to direct supervision through rules and guidelines that define minimum capital requirements, permissible activities, governance structure, and prudential reporting, among others. A dedicated unit within the Banking Supervision Department that is staffed with suitably qualified individuals could be made responsible for their oversight.

## Indirect regulation: Promotion of self-regulating umbrella organizations

For small players, such as the individual Susu collectors dotted all over the country, direct regulation and supervision may be burdensome and not cost-effective. The obvious option would be to encourage all such operators to belong to an umbrella association that establishes some minimum operating norms for compliance by all members, with the approval of Bank of Ghana. Such an association already exists for Susu collectors, and extending the same to money lenders or financial service providers below the threshold would be appropriate. The rationale is to provide a forum for members to learn good practice and for the regulator to interact with the widely dispersed members through the leadership of the association. The umbrella associations could be supported with capacity-building for their leadership and members, recognition, and also access to on-lending funds as incentives to get individual operators to take interest in belonging to these associations.

## Recommendation

The third option, which is to establish a tiered system of regulation, appears to be the best choice under the circumstances, as it is supportive of financial inclusion, provides for an orderly operation and development of the sector, and affords the Bank of Ghana the opportunity to discharge its mandate in a cost-effective manner.

## Implementation Process

Initially, a unit dedicated to the supervision of microfinance institutions, manned by ten staff, was set up within the banking supervision function. This was followed by the development of rules and guidelines and licensing requirements, which were discussed with all stakeholders before being finalized for adoption and implementation.

The draft rules and guidelines were first discussed with top management in the Bank of Ghana and the board of directors, and then presented at stakeholder meetings in Accra and Kumasi, to which operators in the microfinance space were invited. Staff of the Bank of Ghana also made presentations to umbrella associations separately, and aspects of the guidelines were clarified. After the stakeholder meetings, the guidelines were finalized and published in mid-July 2011, followed by a transition period of six months in which all operators were required to either complete or start the licensing process, otherwise their operations would be deemed illegal and subject to outright closure.

For the purposes of the regulation and supervision, microfinance activity was divided into four tiers:

- Tier 1 comprises savings and loans companies, finance houses, and rural and community banks; these are already regulated under the Banking Act of 2004.
- Tier 2 comprises Susu companies and other entities engaged in financial services that involve deposit taking, credit extension, or both.
- Tier 3 comprises money lenders (who are not deposit taking) and financial nongovernmental organizations, which are companies limited by guarantee and non-deposit taking.
- Tier 4 includes all individual Susu collectors and individual money lenders, as well as individuals trading with a business name but not incorporated; this category will be regulated through an umbrella organization, such as the Ghana Cooperative Susu Collectors Association.

Subsequent to the publication of the rules and guidelines, the Bank of Ghana has received support from Responsible Finance, a German initiative, to build the capacity of umbrella organizations and enable the Bank of Ghana to achieve its supervisory objectives in the microfinance sector.

## **Attachments**

1. Operating Rules and Guidelines for Microfinance Institutions
2. Licensing Requirements for Microfinance Institutions

## **References**

FinMark Trust, FinScope Ghana, 2010

United Nations, Building Inclusive Financial Systems, 2006

The following items do not appear in the memo; they are part of the annexed information below:

Money Lenders Ordinance, 1952, Act 176 (repealed in 2008)

Non-bank Financial Institutions Act 2008, Act 774

Republic of Ghana, Banking (Amendment) Act 2007, Act 738

Republic of Ghana, Banking Act 2004, Act 673

# **BANK OF GHANA**

## **Notice to Banks, Non-Bank Financial Institutions and the General Public**

### **Notice No. BG/GOV/SEC/2011/04**

#### **Operating Rules and Guidelines for Microfinance Institutions**

In pursuance of the provisions of the Non-bank Financial Institutions Act, 2008 (Act 774) and the Banking Act, 2004 (Act 673) as amended by Act 738, the Bank of Ghana hereby issues the following Rules and Guidelines for the information of the general public and for compliance by all individuals and entities operating in the microfinance sub-sector. For the avoidance of doubt, Rural and Community Banks (RCBs), Savings and Loans Companies and other financial intermediaries already regulated under the Banking Act shall continue to be so regulated. All other intermediaries such as Susu companies and Susu collectors, money lenders and other financial service providers shall comply with this Notice.

#### **Regulated Activity**

1. The taking of deposits and the granting of credit for whatever tenor constitutes regulated activity under the Banking Act, 2004 as amended and the Non-bank Financial Institutions Act. Except where expressly exempted in writing by the Bank of Ghana, persons and or institutions undertaking such activity require a licence issued by the Bank of Ghana.
2. All institutions or persons engaged in activities that involve deposit taking or the granting of credit shall obtain a licence or an exemption from the Bank of Ghana before commencing or continuing such activities.
3. Institutions that were in existence or persons engaged in such activities before the coming into force of the Non-bank Financial Institutions Act 2008 or this Notice, whose source of authorization is a repealed legislation such as the Money Lenders Ordinance (Cap 176) are hereby directed to take steps to be re-licensed by the Bank of Ghana.

#### **Categorization of Activities**

For the purposes of this Notice the following categorization shall apply to all activities in the microfinance sub-sector:

1. Tier 1 activities shall comprise those undertaken by Rural and Community Banks, Finance Houses and Savings and Loans Companies-These institutions are regulated under the Banking Act, 2004 (Act 673).
2. Tier 2 activities - Those activities undertaken by
  - i) Susu companies and other financial service providers, including Financial Non-Governmental Organizations (FNGOs) that are deposit taking and profit making.
  - ii) Credit Unions. However, credit unions are not regulated under this Notice. A Legislative Instrument under the Non-Bank Financial Institutions (NBFI) Act, 2008 will soon be passed to regulate their activities.
3. Tier 3 Activities - Those activities undertaken by
  - i) Money lenders
  - ii) Non-deposit taking Financial Non-Governmental Organizations (FNGOs).

Money lenders and Financial NGOs are encouraged to belong to an umbrella Association. FNGOs desiring to take deposits shall convert from companies limited by guarantee to companies limited by shares.

4. Tier 4 activities: Those activities undertaken by
  - i) Susu collectors whether or not previously registered with the Ghana Cooperative Susu Collectors Association (GCSCA);
  - ii) Individual money lenders.



Individuals and entities engaged in the above activities are encouraged to form associations for the purpose of furthering their objectives and or dealing with regulators and other stakeholders.

## Regulatory Requirements

### *Tier 1 Activities*

These are regulated under the Banking Act 2004 (Act 673), ARB Apex Bank Regulations, 2006 (LI 1825), the Non-bank Financial Institutions Act, 2008 (Act 774) and respective Notices and Circulars issued by the Bank of Ghana.

### *Tier 2 Activities*

The following regulatory and supervisory requirements shall apply to all Tier 2 category activities:

1. Business form: All Tier 2 activities, except credit unions, shall be undertaken by companies limited by shares. Companies undertaking Tier 2 activities shall include the word 'microfinance' in their names.
2. Capital: Institutions in this category shall hold an initial minimum paid up capital of not less than GH¢100,000.00 for one unit office. The opening of branch(es) shall be subject to higher capital requirements. Tier 2 institutions shall, in addition to the minimum capital requirement determined by the Bank of Ghana also maintain a minimum capital adequacy ratio of 10%.
3. Branch expansion: Tier 2 institutions shall be eligible to establish branches subject to prior approval of the Bank of Ghana and compliance with the higher capital requirement as determined by the Bank of Ghana.
4. Permissible Activities: Tier 2 institutions shall undertake the following:
  - i) Accept deposits from the public. No single deposit shall exceed 5% of the Company's paid up capital.
  - ii) Make loans to their customers as follows:
    - [a] a ceiling of 5% of the company's net worth for unsecured exposures;
    - [b] a ceiling of 20% of the company's net worth for secured exposures; and
    - [c] a ceiling of 1% of the Company's net worth per member of the group for group loans
  - iii) Tier 2 institutions may only undertake any other services with prior written authorization of the Bank of Ghana.
5. Non Permissible Activities: Tier 2 institutions shall not undertake the following:
  - i) issue checking accounts;
  - ii) engage in foreign exchange business; and
  - iii) engage in any trading activities or hold any stocks of goods for sale to their clients.
6. Prudential Oversight:
  - i) Tier 2 institutions shall submit periodic prudential reports to the Bank of Ghana, of varying periodicity as may be determined by the Bank of Ghana.
  - ii) Tier 2 institutions may be subject to on-site supervision of such periodicity as may be determined by the Bank of Ghana.
  - iii) An operating licence shall be subject to annual renewal upon satisfactory performance and payment of the appropriate licence renewal fee.

### *Tier 3 Activities*

1. Business form: All Tier 3 activities shall be undertaken by companies limited by shares (Money lenders) or companies limited by guarantee (FNGOs). Companies undertaking money lending activities shall include the words 'Money lending' in their names. Companies undertaking non-deposit taking microfinance activities shall include the acronym 'FNGO' in their names.
2. Capital: Tier 3 institutions shall maintain a minimum paid-up capital of GH¢60,000. In addition, they shall maintain a gearing ratio not exceeding eight (8) times their capital.

3. Branch expansion: Tier 3 institutions shall be eligible to establish branches subject to the prior approval of the Bank of Ghana and compliance with any other conditions determined by the Bank of Ghana.
4. Permissible activities: Tier 3 institutions shall undertake the following:
  - i) The granting of micro-loans to their customers provided an unsecured loan shall not exceed 10% of the paid up capital of the entity.
  - ii) The raising of funds, excluding deposits, from high net worth individuals, wholesale sources and donors. This activity shall be subject to observance of a minimum tenor for borrowing of not less than 90 days and a gearing ratio of not more than 8 times the paid up capital.
  - iii) Any other services subject to written authorization by the Bank of Ghana.
  - iv) In the case where money lenders or non-deposit taking FNGOs receive deposits as collateral for lending, these shall be held in an escrow account with a designated commercial bank.
5. Prudential Oversight
  - i) Tier 3 institutions shall submit periodic prudential reports to the Bank of Ghana, of varying periodicity as may be determined by the Bank of Ghana.
  - ii) Tier 3 institutions may be subject to on-site supervision of such periodicity as may be determined by the Bank of Ghana.
  - iii) An operating licence shall be subject to annual renewal upon satisfactory performance and payment of an annual licence renewal fee.

#### *Tier 4 Activities*

Tier 4 activities comprise those activities undertaken by individual Susu collectors, Susu enterprises (with a registered business name), individual money lenders, and money lending enterprises. They may operate in a defined geographical area such as a market or a suburb.

- i) Business form: Tier 4 activities may be undertaken by individuals or by enterprises with a registered business name. All Tier 4 operators shall belong to an umbrella Association such as the Ghana Cooperative Susu Collectors Association (GCSCA). The registered business name of susu enterprises shall include the word 'susu.' The registered business names of money lending enterprises shall include the words 'money lending.' Individual money lenders are advised to form an Association as a platform for educating and informing each other as well as a forum for interacting with regulators and other stakeholders.
- ii) Capital: There shall be no minimum capital requirement for an individual Susu collector or money lender. However, each registered member of an umbrella Association shall contribute to an Insurance Fund to be set up by the Association.
- iii) Permissible Activities: Tier 4 institutions shall engage in Susu collection or money lending only. Susu collection involves the periodic collection of deposits from the general public and the refund of such accumulated deposits at the designated times for a fee. Money lending shall involve the granting of credit for such tenors as agreed between the lender and the borrower.
- iv) Branch expansion: Tier 4 operators shall carry out their activities within a defined geographical area such as a town, city, a market, or a suburb and shall not operate branches, except with the prior written approval of the Bank of Ghana.
- v) Prudential Reporting: Umbrella Associations of Tier 4 institutions shall collect and collate statistics on the operations of their members and furnish this to the Bank of Ghana periodically as may be determined.



**Licensing Requirements**

The licensing requirements for microfinance institutions are attached to this Notice as Appendix 1 and the same is a part of this Notice.

**Effective Date of Notice**

This Notice takes immediate effect and is applicable to all existing and prospective operators in the microfinance sub-sector.

**Transitional Period**

Existing operators have a period of six months from the date of this Notice to take steps to regularize their operations with the Bank of Ghana or wind up.

**Amendments or modifications to this Notice**

The Bank of Ghana may amend or modify this Notice as it deems fit from time to time.

Alex Bernasko  
The Secretary  
July 11, 2011

# LICENSING REQUIREMENTS FOR MICROFINANCE INSTITUTIONS

## A. TIER 2 AND TIER 3 INSTITUTIONS

### 1. Restrictions of Eligibility to Corporate Entities

No person other than a body corporate, incorporated in Ghana, shall be eligible to apply for a licence to carry on Tier 2 or Tier 3 microfinance business.

### 2. No person shall carry on Microfinance business unless it has obtained from the Bank of Ghana a license for that purpose.

### 3. Restrictions on shareholding

i) Shareholding of microfinance institutions such as Susu companies, deposit taking financial NGOs and money lending companies shall be restricted to only Ghanaians.

ii) Shareholding in non-deposit taking microfinance institutions may be exclusively Ghanaian, exclusively foreign, or jointly Ghanaian and foreign.

### 4. Application procedures

#### i) Application for a licence

Every application for a licence shall be made in writing to the Director, Banking Supervision Department, Bank of Ghana, Accra, and shall be accompanied by:

[a] A certified true copy of the Certificate of Incorporation and Regulations of the company.

[b] Names, addresses, occupations of persons who would hold significant shares directly or indirectly in the proposed venture, and the respective values of such holdings as well as their corporate affiliations.

[c] A completed personal questionnaire on the particulars of the directors and senior persons to be in-charge of the management of the business, including their background, financial position, business interests and particulars of other business concerns under their control or management.

[d] A feasibility report including a business plan and financial projections of the company for the first five years of operation.

[e] Information on capital and sources of funds; and

[f] Such other particulars as the Bank of Ghana may require.

#### ii) Interview

The Banking Supervision Department shall interview the applicant with respect to the application.

### 5. Minimum Paid-Up Capital

#### Tier 2 Activities

All Tier 2 entities shall require not less than GH¢100,000.00 [one hundred thousand Ghana cedis only] as minimum paid-up capital.

#### Tier 3 Activities

All Tier 3 entities shall require not less than GH¢60,000.00 [sixty thousand Ghana cedis only] as minimum paid-up capital.

### 6. Approval in principle

The Bank of Ghana may issue an 'approval-in-principle' to the applicant on such terms and conditions as it may consider necessary and appropriate, if it is satisfied that:

- i) the applicant would carry on the business with integrity, prudence and the required professional competence; and
- ii) the applicant has the capacity to raise the initial paid-up capital required to hold a licence.

7. Pre-operating conditions

The Central Bank may issue the final approval and licence to the applicant after satisfying itself that the following pre-licensing conditions have been met.

- i) Minimum paid-up capital - the company has raised the minimum paid up capital
- ii) Premises: The company
  - [a] has provided evidence of title deeds/lease agreements
  - [b] has approvals by relevant authorities
  - [c] has adequate business premises, staff operating area, ventilation, lighting, etc.
- iii) Has demonstrated security of the premises, including adequacy of alarm systems, fire extinguishers, vaults or safes, etc.
- iv) Has in place up to date insurance covers - fire, burglary, fidelity guarantee, etc.
- v) Possesses Operational plans and policies approved by the Board.
- vi) Has accounting procedure manuals, computers and appropriate softwares, etc.
- vii) Has in place adequately trained and sufficiently experienced staff as well as competent key personnel.
- viii) Has submitted its first year pre - operating financial statement of affairs.
- ix) Has met any other conditions imposed by the Bank of Ghana.

8. Fees

Tier 2 and 3 microfinance institutions shall pay the following fees:

- i) Processing fee: GH¢500.00
- ii) Licence fee: GH¢1000.00
- iii) Annual licence renewal fee: GH¢500.00

B. TIER 4 OPERATORS

1. Application and Licensing Procedure

Tier 4 operators shall:

- i) Obtain and complete a preliminary registration form for licensing as a Susu collector or money lender.
- ii) Register as a member or affiliate with the umbrella Association for Susu Collectors or Money Lenders.
- iii) Submit the completed preliminary form, together with a personality profile form endorsed by the executives of the umbrella Association to the Bank of Ghana.
- iv) Be licensed after obtaining satisfactory reports on background checks undertaken.

2. Fees

- i) Application processing fee: GH¢100.00
- ii) Licensing fee: GH¢500.00
- iii) Licence renewal fee: GH¢250

Any enquiry in respect of this Notice may be addressed or directed to:

The Head, Banking Supervision Department  
Bank of Ghana (9th Floor, Cedi House)

P.O. Box GP 2674  
ACCRA  
Tel: 0302 665034; Fax: 0302 662038  
E-mail: [bsd@bog.gov.gh](mailto:bsd@bog.gov.gh)

## **Endnote**

1. Susu is a traditional methodology of savings with several variants, the most common of which is where an individual known in the community collects periodic savings from other individuals on the understanding that the total savings will be returned at the end of the specified period, less a commission of a day's savings. In other variants, people may agree to contribute a specified amount and give the total to one member of the group, repeating by rotation until every member is served and the cycle begins again. In this memo we refer to the first type, where individuals, business enterprises, and companies undertake this activity using the methodology.

# THE ROLE OF NAMIBIA POST SAVINGS BANK IN FINANCIAL INCLUSION

Michael Mukete

*Michael Mukete is Assistant Governor of the Bank of Namibia. Previously, he served as Director of Banking Supervision and Director of the Financial Markets Department.*

## Introduction

There is a lack of banking institutions in Namibia that provide microfinance to micro-enterprises and individuals. Consequently, the majority of the lower income groups (i.e., the micro and small enterprises and poor people) are either excluded from banking services or do not have access to a wide range of retail banking products. Existing microfinance institutions have a limited geographic presence. The one microfinance bank recently established only services the northern part of the country.

Namibia is forfeiting a valuable opportunity to expand the reach of microfinance institutions. Post offices are essential for social and financial inclusion, particularly in developing and emerging countries. According to the World Bank Financial Access Study (2009), it is estimated that over 70 percent of countries use post offices to deliver financial services, taking advantage of the low operational costs associated with this infrastructure to enhance financial outreach.

This memo proposes a review of the role that the Namibia Post Savings Bank (NPSB) could play in broadening access to financial services for the poor. This would entail the provision of microfinance through the NPSB as a commercially viable bank that can achieve both sustainability and greater outreach because it has more than 120 branches, compared to a combined total of only 100 branches for commercial banks.

## Background

Worldwide, microfinance is considered among the most visible innovations in anti-poverty policy. In the three decades since the first microcredit loan was given to a group of Bangladeshi women, the number of microcredit borrowers has increased dramatically. The majority of the people in developing countries had no access to credit from banks before microcredit became available, and when they needed to borrow to pay for an illness, to grow a business, or to fix a roof, most people would go to money lenders and pay exorbitant rates. While this is still the case in many countries, nowadays people can also borrow from microfinance institutions at significantly lower rates.

Many other credit delivery channels to the poor have previously been attempted in various countries. However, very few seem to have worked; for example, state-run banks in some countries collapsed in the face of widespread corruption and defaults. These days, however, there are many microcredit institutions in various countries that are led by dynamic entrepreneurs who have mastered quality service delivery on a large scale, such as those found in some parts of Asia, including Malaysia and India. These institutions have at the same time managed to find ways to become financially sustainable and to keep growing rapidly. This evolution of microfinance institutions is a welcome development because of the relatively positive impact that it can have on low-income people and micro, small, and medium enterprises through accessing finance at lower rates.

The world has also seen the reorganization of post offices, viewed in most instances as viable financial delivery channels. Over the past two decades, many postal savings institutions have undergone institutional reorganization, moving away from being a part of the post offices' operations. These changes allow for the expansion of the scope of postal financial services, with some

postal savings institutions embracing new activities and transforming into full-fledged savings and retail banks. Clearly, further developing the potential of postal banking would provide more financial services to more people and businesses currently unserved or underserved, given the wider branch networks associated with post offices.

In Namibia, a Financial Inclusion Council, chaired by the prime minister, includes ministries that have financing programs aimed at vulnerable groups. The purpose of the Council is to create a platform for coordinating policy directions, as well as to establish an institutional framework for monitoring and evaluation. Assisting the Council is an advisory body made up of the Central Bank, the non-bank financial institutions, regulators, all development finance institutions representative of the banking industry, the private sector, and nongovernmental organizations.

In Namibia, the “Financial Sector Development Strategy 2021” is being developed, and one of its key goals is financial inclusion. Specifically, the strategy aims to broaden access to banking services from 51 percent to 80 percent of the population (FinScope Survey 2007). Various strategies to increase financial inclusion are being contemplated, including an amendment to the Banking Institutions Act to broaden the definition of banks by recognizing the “Tier II” banks that are taking microfinance deposits. It is thus important to consider reviewing the NPSB’s mandate, given the unique role it can play. The advisory body is chaired by the Central Bank’s governor. Being the custodian of the Post Office, the Ministry of Information Communication Technology is also a member to the Council.

## Analysis

Namibia enjoys a well-developed and sophisticated banking system made up of four commercial banks. Complementing the commercial banks is the first-ever deposit-taking microfinance bank, which was licensed in 2010. The microfinance bank is operating on the Grameen Bank model, which uses group lending to target poor people without collateral. This new microfinance institution only maintains a presence in the northern part of the country in three locations.

Commercial banks, on the other hand, have responded positively to the government call to extend their service to pre-urban areas with a notable increase in their branch networks, which are mainly located in urban centers in all political regions of the country. Despite this expansion, the FinScope Survey 2007 indicates that many lower income groups still lack access to financial services.

This access gap could partly be explained by commercial banks’ reluctance to expose themselves to the perceived risks and cost of administering microloans. Thus, the “Financial Sector Development Strategy” is looking at various strategies aimed at increasing both the supply and the demand of financial services for the poor and lower income groups. The role of commercial banks is part and parcel of this strategy.

Taking a cue from Malaysia, a country that is ranked number one in the world in terms of access to finance (CGAP Financial Access Report, 2010, 2010), commercial banks can play a significant role if they explore what is referred to as “blue ocean opportunities” in providing banking services to the poor and lower income groups and make a profit from those services. According to Bank Negara, a survey carried out in Malaysia in 2010 revealed that over 80 percent of credit to small and medium enterprises (SMEs), including micro-enterprises, was provided by commercial banks, underscoring their indispensable role. However, it should also be noted that it is government intervention through targeted regulatory actions and targeted sector lending and advocacy that encouraged commercial banks to increase lending to lower income groups.

To complement the role of commercial banks, the Malaysian government, through the National SMEs Development Council, developed a framework for microfinance, transforming Bank

Simpanan Nasional (BSN) into a specialized microfinance institution with a mandate to provide microfinance to micro-enterprises and to individuals operating a business to fulfill the high demand for micro-enterprise financing. The key objective of transforming BSN is to operate on a sustainable basis and adhere to prudent banking practices.

From 2003 to 2005, BSN was only involved in microcredit, which simply revolved around giving out uncollateralized small loans up to about US\$6,000. However, with the government push in the SME sector, the role of BSN has been enhanced to become a provider of microfinance, which includes savings and advisory elements. The recipients are targeted industry players and the maximum loan size is approximately US\$15,000. To date, BSN has more than 373 outlets, which act as distribution centers where access to microfinance is available.

The above analysis clearly shows the need to increase the provision of microfinance services in Namibia. The key question, however, is whether Namibia shouldn't also review the role of NPSB by making it a full-fledged microfinance bank that provides a wide variety of retail banking products, just like the successful BSN in Malaysia. The section below outlines some of the relevant issues that need to be taken note of as we consider NPSB for that role.

## **The Status Quo of Namibia Post Savings Bank**

The NPSB is a department within the Namibia Post Office that offers traditional savings products. In 2007, Namibia Post Office entered into a 50/50 percent joint venture with internationally known Net 1 Universal Electronic Payment System in order to offer a viable and affordable financial solution in Namibia, especially for the vast majority of the country's non-banking citizens. The Smart Card introduced by Namibia Post Office is a chip-based debit card with multifunctional wallet allocations. Smart Switch Namibia provides Smart Cards and point-of-sale devices to more than 120 NPSB branches in the country. It effectively replaced their clients' old dark-blue savings books.

While the Smart Card has been successful so far in terms of rollout, this viability is hindered by the fact that the system operates within a "closed loop" environment. In other words, NPSB clients cannot use their cards at point-of-sale devices operated by commercial banks. Consequently, Namibia Post Office has been exploring the possibility of gaining access to the national payment system.

In addition to the Smart Card development, NamPost expanded its business by venturing into microfinance credit through a newly established, wholly owned subsidiary company. This is because the Post and Telecommunication Act of 1992 (the Establishment Act), limits NPSB to offering savings deposits services and not to provide credit. That being the case, there is a need to review NPSB's mandate to give it the power to offer full retail banking services, with a special focus on microfinance products. The services should include granting of microloans and advances and payment services to its micro and small enterprises.

The transformation of NPSB into a full-fledged retail bank can be achieved by granting it a full banking license. On the other hand, in terms of the Banking Institutions Act of 1998, as amended, NPSB is exempted from the application of the law regulating deposit-taking institutions. However, the law also has a provision for the minister of finance to lift the exemption by issuing a notice in the *Government Gazette* upon the recommendation of the Central Bank. This was done in July 2011, and NPSB now falls under the regulatory powers of the Central Bank. Going forward, the Central Bank will come up with differentiated regulations, taking into account that NPSB is still a department within the Namibia Post Office that is not allowed to grant credit.

Therefore, to make NPSB a full-fledged bank, it is important that the reform be carried out within the framework of a broad postal sector reform agenda. This means that establishing adequate



policies, enabling legislative and regulatory frameworks that address governance issues, and restructuring core postal services should be undertaken simultaneously so that the Namibia Post Office remains financially sustainable.

It is worth noting that in a number of countries where a payment function (postal checking services) has been established to complement the postal savings function, the trend is to integrate both under the same operational units, sometimes merged into a single entity that forms the postal bank. The rationale of these developments is twofold: savings and payment services are basic functions for a bank, and valuable synergies can be harnessed in this process. In the case of Namibia Post Office, to ensure access to the national payment system, it is necessary that the payment function become an integral part of the proposed new NPSB so that the new entity can offer a wide range of retail banking products, including a special focus on micro-enterprises.

## Options

### Option 1

With a view toward optimizing the use of the branch network (120 across the country) and to strengthen the efficiency and quality of the services offered to the public, the NPSB should be made a full-fledged retail bank that participates in the payment system. The practical implementation of this option is relatively easy, given the political will demonstrated in the formation of the Financial Inclusion Council, which brings together all stakeholders with a view to ensuring the coordination of financial inclusion policy.

Admittedly, in considering this option, there is a need to strengthen the human capital, as managing a full-fledged retail bank requires a certain set of skills. It also requires a paradigm shift in terms of the professional working culture.

The other issue worth mentioning is that under this option, since NPSB becomes a full-fledged retail bank (with a separate board of directors from the holding company, Namibia Post Office), the Bank of Namibia, as the regulator of the country's banking institutions, will provide a better guarantee of diligent corporate governance.

### Option 2

Keep the mandate of the NPSB unchanged and encourage the formation of joint ventures with commercial banks. The status quo means that Namibia Post Office will continue to have its two subsidiaries offering microfinance loans and Smart Card technology. This means foregoing the opportunity and synergies offered by bringing the savings unit, lending, and payments within a single entity.

On the other hand, access to payment systems in terms of clearing and settlement systems shall remain an obstacle to the growth of the business in meeting the changing demands of the clients and may remain uncompetitive in product offerings. Oversight by the Central Bank, while possible through a lifting of the exemption from the Banking Institutions Act of 1998 (as amended) by the minister of finance through a Notice in the *Government Gazette*, is still likely to pose regulatory challenges. This is because the Central Bank has to come up with differentiated regulations that could be difficult to implement and enforce, given the obscurity of business lines and governance challenges that come with having the savings bank as a department within the Post Office with no separate board.

## Recommendations

Option 1 should be implemented, as it is most likely to deliver financial services to the unbanked and underbanked sectors of the population. It is recommended that:



- Namibia Post Savings Bank should be transformed into a full-fledged savings and retail bank under the Central Bank supervisory and regulatory authority. This is clear, given its unique positioning in terms of its geographical presence in all the corners of the country. With the recent establishment of the Financial Inclusion Council, the stage is set for key stakeholders to agree on this initiative.

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Enhancing Financial Inclusion through Technological Innovations

Stephen Mwaura Nduati (Head, National Payments System, at the Central Bank of Kenya).



## **II. Technological Innovations and Regulatory Challenges**



# ENHANCING FINANCIAL INCLUSION THROUGH TECHNOLOGICAL INNOVATIONS

Stephen Mwaura Nduati

*Stephen Mwaura Nduati is Head, National Payments System, at the Central Bank of Kenya.*

## Introduction

Access to financial services is increasingly recognized as a key to unlocking economic opportunity for the poor. Moreover, making financial systems work more effectively is a widely shared goal among policymakers across the world.

Admittedly, bringing financial services to the poor, especially the rural poor, is the biggest challenge for broad-based financial inclusion. Poor infrastructure and telecommunications, as well as heavy bank branch regulation, restrict the geographic expansion of branch networks. In Kenya, there are fewer bank branches per rural resident than per urban resident. Barriers associated with the cost of building physical infrastructure or the combination of low income and low population density leaves most rural areas incapable of supporting branch locations. Non-bank financial institutions help fill this gap. Progress in mobile communications technology and encryption systems has changed the economics of financial service provision, particularly in remote areas, rapidly expanding the number of people able to access these services. M-PESA in Kenya, for example, has made great strides forward by using retail agents, who cash in and cash out money transfers all over the country. Allowing banks to operate through agents, including partnerships with postal networks and retailers, reduces the fixed costs associated with geographic expansion and holds great promise for improving access to financial services, especially in poor and remote areas. However the development and implementation of appropriate regulations to safeguard both consumers and the banking system is tricky—trickier than regulating straightforward money transfers.

This memo highlights Kenya's broad objective with respect to enhancing financial inclusion and identifies the potential role technological innovation, coupled with appropriate policy frameworks, could play.

## Background

Largely due to Safaricom's 2007 rollout of M-PESA and subsequent initiatives by other mobile service providers (Airtel and Essar in 2009; Mobipay and Orange in 2010, MobiKash in 2011), payments and banking outlets in Kenya have been extended by roughly 40,000 agents. The next stage of development has begun, and growing numbers of banks are establishing links between banks and mobile payment providers. Against this background, there is a need to continuously review the evolving environment and determine the best policy options to sustain the momentum.

In its Vision 2030, the Kenyan government identifies the nation's principal goal as the achievement of middle-income (MIC) status.<sup>1</sup> In financial inclusion terms, MIC status today means that at least 60 percent of a nation's adults are banked.<sup>2</sup> Based on current population projections, a formal inclusion target of 60 percent would translate to an additional 21 million people entering the banking system between 2010 and 2030. This is a massive increase over today's banked population. The increase in incomes associated with the shift to MIC status will provide a push toward this level of inclusion, assuming that Kenya's financial system is no less efficient than those in other MIC countries. However, the exceptional progress Kenya has seen in recent years gives hope that technological innovations, coupled with appropriate policies in the financial system, could push inclusion beyond the limits of the current frontier and simultaneously provide a stronger impetus for economic growth.

The Central Bank of Kenya's (CBK) policy objectives with respect to retail electronic payment systems and instruments remain the same as for the payment system as a whole, namely, to promote and oversee the development of safe, sound, and efficient payment, clearing, and settlement systems. CBK considers such systems to be part of the core infrastructure of the financial sector. With respect to retail, one additional objective is added: in the words of the committee on payment and settlement systems (CPSS)<sup>3</sup> General Guidance for National Payment System Development, written in 2006, "more access for more people" (Guideline 11). This objective is entirely consistent with the CBK's wider objective of promoting financial inclusion in support of Vision 2030.

Current CBK initiatives geared to its overall policy objective include the recently enacted National Payment System Act, 2011, which seeks to strengthen the above mandate by expressly providing for the oversight of all payment systems, including large-value payments and retail payments, such as payment cards and innovative mobile money transfer services, among others. In line with the provisions of the National Payment System Act, 2011, CBK has drafted regulations for the supervision of electronic retail transfers and e-money issuers. In developing these regulations, the Bank has collaborated with many stakeholders, including banks and mobile phone companies.

## Analysis

According to David Porteous, achieving financial inclusion of 60 percent will require a steep decline in financial sector transaction costs.<sup>4</sup> Cost penalties that are particularly relevant in Kenya (though also observed in other parts of the world) include the small size of the market at both the national and local levels, which is partly attributable to low population density and pronounced economic isolation, especially in rural areas. This factor is compounded by deficiencies in transport and communications, as well as extremely low transaction sizes and the inappropriateness of some traditional banking products to the needs of small clients. In Africa, on average, less than 20 percent of households have access to formal financial services, with low population densities, poor transport and limited communications infrastructure contributing to a lack of supply in extensive regions of the continent. Even where such services are available, low-income individuals and small and medium businesses may have difficulty in meeting eligibility criteria such as strict documentation requirements or the ability to provide collateral.

Consultative Group to Assist the Poor has made similar observations indicating that a major obstacle to financial inclusion is cost. Relevant costs include not only the cost incurred by banks in servicing low-value accounts and extending banking infrastructure to underserved, low-income areas, but also the cost incurred by poor customers in terms of the time and expense needed for them to reach bank branches.<sup>5</sup>

Another issue is the difficulty of assessing credit worthiness and enforcing contracts. Low levels of perceived creditworthiness in Kenya relate to the poor quality and scarcity of information about individual risks, and to a high incidence of shocks (weather, health, social disruption) exogenous to the agents and often systemic or at least covariant. A "high-road" scenario sees Kenya dramatically reducing its dependence on cash—a key source of cost—and shifting to a "cash-lite" economy, with electronic payments replacing all but the smallest transactions. For this to occur, the Kenyan economy must get over the hump—the point at which cash is no longer used so intensively because people are able to transact electronically—so that the demand for cash-in and cash-out transactions declines.<sup>6</sup>

But for this to happen, several prerequisites must be addressed. Formal financial services must reach well beyond the urban markets where they are concentrated today. The delivery channels to support this outreach must be both ubiquitous and affordable. To reach the position where most people have and can use an electronic account requires first that the "wheels of cash be

greased”: it must be made as easy and cheap as possible to convert cash to electronic value, and vice versa. This means that there must be a wide range of locations where customers can deposit and withdraw cash in exchange for electronic value: bank branches, ATMs, and retailers, including banking agents and other types of cash-handling outlets.

The volume of Kenyan bank branches and ATMs at present is in line with Kenya’s per-capita income; the country already has more than 30,000 access points for M-PESA alone and more than 40,000 total, and 43 cash handling agents per 100,000 people. Based on these numbers, Kenya already has proportionately more cash-handling agents than Brazil.<sup>7</sup> These cash-handling agents are therefore already the most widespread channel for financial services in Kenya today. Until the cash-lite scenario is realized, financial providers need every incentive to acquire cash-handling agents, agents need incentives to handle cash, and customers must have good reasons to use their local agents.

The success of these retail payment products has had a positive impact on both demand and supply for retail payment services and led to a surge in the number of applicants seeking authority to roll out such value-added payment products. Indeed, the mobile-based money transfer services have greatly enhanced access to financial services, which is one of the key objectives of the Kenyan government’s Vision 2030.

Although the banks may have the resources to meet the overhead costs of setting up new systems that can help reach rural households and meet the financial service needs of small farmers, they have to work hard to make sure that the unit costs of operating these systems are sufficiently low. The use of technology by banks in Kenya, as in other countries, incorporates developments in hardware, software, and, to an ever-increasing extent, the Internet.

At the same time, the government can assist banks and other private financial intermediaries in this regard through efforts to build and repair various hard and soft infrastructures that are essential to the success of efforts to expand financial inclusion.<sup>8</sup> Many of the products conventionally offered by banks and even by microfinance institutions in Africa are ill-adapted to poor customers’ needs. By moving beyond what is generally established, modern technology offers some possibilities for leapfrogging some of the obstacles placed by slow-adjusting infrastructures and other African environmental challenges.<sup>9</sup> It is the government’s responsibility to establish infrastructure, including fiber optics, roads, railway, and electricity; to facilitate investments within the communications and telecommunications sector; and to provide other basic services.

Innovations by both banks and telecoms, whose major costs relate to their initial development and other fixed prices, with very low marginal costs per transaction or per new customer engaged, offer important prospects for expanding access to financial services for those at the bottom of the pyramid. Achieving financial inclusion therefore requires innovative models that dramatically reduce costs for everyone, and thus pave the way to the profitable extension of financial services to the world’s poor.

## **Policy Options**

In Kenya, as in other countries, the continuing push for financial inclusion must rest on three key pillars:

- The safety of any funds held in trust for people and the soundness of the institutions offering them
- The availability of services close to where poor people live
- The relevance, range, and quality of the financial services available to all segments of the population

In order for the financial sector to contribute effectively to growth and stability, complex issues dealing with the functioning of mainstream financial systems as mobilizers of funds, providers of risk mitigation management services, and financers of medium to large-scale enterprises and government must be addressed. While we have identified technological innovations as an important source of innovation, we hasten to underscore the fact that such initiatives do not operate in a vacuum. There are complex legal and institutional frameworks that must also be in place.

Based on the relatively successful uptake of mobile-based payment services, one policy option for Kenya is to be content and carry on with the existing legal, regulatory, and institutional framework.

The second option is for the country to consolidate the current gains due to early adoption of technological solutions, appreciate the limitations of current solutions, identify lessons learned, and commit adequate resources to conduct research and formulate and implement policy and institutional reforms geared toward sustainable financial inclusion.

## Recommendation

In recommending the second option, we recognize that there are emerging challenges that Kenya and other countries will have to address if the full potential of mobile and technology-based solutions will be sustainable. Key among these is the legal and regulatory framework to provide for, among other things, the role of the private-sector banks and telecoms, government and regulatory institutions, and competitive dynamics, especially within the telecom and banking sectors.

## Endnotes

1. Government of the Republic of Kenya, 2007: Ministry of Planning and National Development, National Economic and Social Council (NESC), Office of the President.
2. By banked we refer to provision of financial services through a regulated financial institution, which could include banks and deposit-taking microfinancing institutions such as DTMs and SACCOs.
3. The CPSS is a standard setting body for payment and securities settlement systems. It contributes to strengthening the financial market infrastructure through promoting sound and efficient payment and settlement systems.
4. David Porteous. *Bankable Frontiers*, unpublished manuscript.
5. Michael Tarazi and Paul Breloff. "Regulating Banking Agents." *CGAP* 68, March 2011.
6. This "over the hump" scenario is the subject of the MPayZ scenario in the CGAP/DFID Branchless Banking 2020 Focus Note, 2009.
7. Brazil has 160,000 agents, or 83 per 100,000 inhabitants; but of these, only a quarter are actually handling cash.
8. Patrick Honohan and Thorsten Beck. *Making Finance Work for Africa*. The International Bank for Reconstruction and Development / The World Bank, 2007. p.18
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# CASH-IN AND CASH-OUT AGENTS FOR MOBILE MONEY IN INDONESIA

Siti Hidayati

*Siti Hidayati is Senior Payment System Overseer at Bank Indonesia. This paper reflects the author's view, not those of Bank Indonesia.*

## Problem

The success of mobile money in countries such as the Philippines and Kenya has inspired Mobile Network Operators (MNOs) in Indonesia to provide similar services. T-Cash, the first mobile money scheme in Indonesia, was launched in 2007 by Telkomsel, the country's biggest MNO. As of July 2011, three MNOs in Indonesia have been granted licenses from Bank Indonesia as e-money issuers and mobile money providers: Telkomsel, Indosat, and Exelcom. However, the last two companies are still in the early stages of development.

With regard to financial inclusion, mobile money has played a significant role in other developing countries as a means of making payments and sending (transferring) money, which can serve low-income and unbanked people. It can also reach people in remote areas who have limited access to formal financial services. Though providing access to mobile money does not unilaterally achieve financial inclusion, it can be considered a crucial step leading up to the next level of financial services: savings, credit, and other services.

Four years after Bank Indonesia granted the first mobile money license to an MNO, the level of mobile money usage in Indonesia remains quite low. This policy memo seeks to understand why the number of mobile money users and transactions in Indonesia, as compared to the number of mobile phone subscribers, remains so low. This is probably caused by several factors; this memo will focus on whether the number of mobile money agents is a major constraint to mobile money adoption in Indonesia and how Bank Indonesia's own policies can encourage the growth of the agent network and the greater adoption of mobile money services.

## Background

### Current condition of financial inclusion in Indonesia from demand and supply side aspects

Financial inclusion is now widely recognized as critically important in reducing poverty and income disparities, and increasing economic growth. Financial inclusion is based on the idea of providing the same opportunities to receive financial services for all and inviting every citizen in a nation to engage in economic activities with the help of financial service providers.<sup>1</sup> Through increased access to savings accounts and other financial services, the poor can build financial security, manage risks against adverse shocks such as illness or natural disaster, and even invest in new business opportunities.<sup>2</sup>

Indonesia is a large country in almost every sense. It has a population of 250 million, over 13,000 islands, and about 300 different ethnic groups. Indonesia also has a large number of people who are still financially excluded. A recent World Bank study on financial access in Indonesia estimated that 48 percent of the total households in the country are financially excluded.<sup>3</sup> While 31 percent of households have access to informal financial services, almost 17 percent do not have any financial services, formal or informal.

As the major provider of financial services in Indonesia, the banking sector plays a vital role in improving access to financial services; it controls almost 80 percent of total Indonesian financial

assets. Unfortunately, it serves a relatively small proportion of Indonesian households, and access is highly skewed to urban areas. Only 20–34 percent of rural households have access to banking services.

### Issues of financial inclusion in Indonesia

With Indonesia's wide geographic scope, the main issue is how to reach the unbanked poor in remote areas using cost-efficient means. Conventional, branch-based approaches to expanding financial services would require significant infrastructure and operational expenditures. On the other hand, because of its wide reach, mobile phones offer much promise in providing financial services to the poor in rural regions. According to a report from the Consultative Group to Assist the Poor, there are 172 million active SIM cards in service in Indonesia, but it is estimated that this represents only 90 million customers, many of whom hold multiple accounts.<sup>4</sup> This implies a penetration rate of around 38 percent of the population.

The mobile phone could be a cost-effective medium for enhancing access to financial services in Indonesia for the following reasons:

- The number of mobile phone users in Indonesia is far larger than the number of bank account holders and continues to grow. From out of a total population of 250 million, only 50–60 million Indonesians have bank accounts, while on the other hand, approximately 90 million people are mobile phone subscribers.
- Providing financial services using means that are already familiar (like the mobile phone) can play a significant role in promoting financial inclusion.
- Providing financial services through the mobile phone can save costs, since the infrastructure has already been deployed for telecommunications purposes. In other words, the provider only needs to enhance the system to accommodate financial services, rather than purchasing or building new infrastructure. Additionally, utilizing the current network will substantially reduce the cost of reaching the most remote areas.

### Mobile money in Indonesia compared to other developing countries

Compared to other developing countries, the number of mobile money transactions and users in Indonesia to date has not shown significant growth. The number of users in May 2011 was estimated at 5.4 million, or around 3.8 percent of total mobile phone subscribers; however, not all of these registered users are active customers. Additionally, the number of transactions from January to May 2011 only reached 174,959, about 34,992 transactions per month, with a total value of 6,587 million rupiah (US\$774,941), or 1,317 million rupiah (US\$154,988) per month.<sup>5</sup> This only accounts for 1.19 percent of total e-money transactions in terms of volume, and 2.17 percent in terms of value.<sup>6</sup>

M-PESA in Kenya was launched in the same year as T-Cash in Indonesia, but it now has been adopted by 17 million customers, or 80 percent of Safaricom's subscriber base. The service now reaches 70 percent of Kenyan households and 50 percent of all unbanked households.<sup>7</sup> Meanwhile, in the Philippines at the end of 2007, more than 8 million Filipinos had registered to use two types of mobile money—Smart Money (introduced in 2000) and GCash (introduced in 2004). This was out of 25 million Smart subscribers and 19 million Globe subscribers.<sup>8</sup>

## Analysis

### The importance of cash-in and cash-out agents

Mobile money can be used as an instrument to pay for goods or services, or as a means of sending/transferring money. In other developing countries, the primary use of mobile money is for sending money—that is, person-to-person transfers.

Like other developing countries, Indonesia has many migrant workers, with many people from rural areas working in urban areas. According to the World Bank, the number of Indonesian migrants working overseas is more than 2.5 million.<sup>9</sup> This group regularly sends money home to their families, using informal channels (such as returnees) to send remittances. While many of these households are unbanked, most of them have mobile phones. Accordingly, by using mobile money, this group of households could send money home to their families easily and cheaply.

Since one of mobile money's main functions is as a means of sending money, it is necessary for the provider to ensure that cash-in and cash-out agents can be easily found by its customers. A migrant, for example, will not use mobile money if his or her family in the village cannot easily cash out the money being sent. The migrant will also consider how easy the process is if he or she wants to exchange cash into electronic value (cash in). Therefore, to enable the necessary scale for this low-value, high-transaction business to become sustainable, it is important for the provider to build a large network of cash-in and cash-out agents.

Telkomsel and other MNOs already have a significant number of airtime dealers who also have the potential to become cash-in/cash-out agents for mobile money. Yet there are few agents that can provide cash-out services, in terms of both number and location. For example, Telkomsel now has around 500,000 airtime dealers that are located in almost every province in Indonesia. On the other hand, it has approximately 5,000 outlets for cash out for T-Cash<sup>10</sup>—only 10 percent of its total airtime dealers—most of which are located in big cities. With the number of T-cash users in May 2011 estimated at 5.4 million, it means that there is only one cash-out agent available for every 1,000 T-Cash users.

### **Regulation and its implications for agents**

According to the “Diagnostic Report on the Legal and Regulatory Environment for Branchless Banking in Indonesia” conducted in 2009 by CGAP, IFC, and GTZ, the relatively small number of cash-out point was most likely caused by Bank Indonesia regulations regarding the use of cash-out agents for e-money issuers. Current regulations allow e-money issuers to use agents to upload value to e-money accounts (cash in). However, if an e-money issuer wants to use agents to offer cash-out services, the agent must be licensed as a money remitter by Bank Indonesia. The regulation is based on the principle that cash-out services attach to the person-to-person transfer facility provided by the e-money issuer. Accordingly, there was concern about the implementation of “know your customer” requirements.

Unfortunately, an MNO cannot leverage its usually vast distribution network to serve as a cash-out point, because each of its airtime dealers must apply individually for a remittance license before they are authorized to provide cash-out services, unless the airtime dealer is a “branch office” of the MNO. The relatively extensive licensing requirements imposed by the regulation discourage a significant number of small airtime dealers from applying for the license.

### **Money remitter versus cash-out agent**

Since agents are a necessary condition for the wide use of mobile money, it is important to evaluate the current regulations, especially those related to cash-out agents. We will start with two basic questions: Why are cash-out agents regulated as money remitters? Do they really conduct money remittance activities?

Referring to regulations on money remittance issued in 2006, a money remitter in Indonesia is defined as an individual, legal entity, or non-legal entity that acts as a sending agent and/or a receiving agent of a money remittance. A sending agent is defined as an individual, legal entity, or non-legal entity that receives a sum of money from the originator to be sent to the beneficiary through the receiving agent. A receiving agent is defined as an individual, legal entity, or non-legal entity that receives a sum of money from a sending agent to be delivered to the beneficiary. Since the new Fund Transfer Act was enacted in early 2011, a money remitter must be

a legal entity, and neither an individual nor a non-legal entity is allowed to become a money remitter.

Referring to the definitions above, a money remitter can act as sending agent or receiving agent, where both are involved directly in the process of transferring money. As a sending agent, the money remitter is responsible for sending or transferring money received from the originator to the receiving agent. While acting as a receiving agent, the money remitter is responsible for delivering the money received from the sending agent to the beneficiary.

Now, let's take a look at the activities performed by cash-out agents, which are similar to those performed by cash-in agents. Cash-out agents in the mobile money scheme are not involved in the process of remitting money from one person to another person, but in exchanging electronic value to cash. To understand this, we can look first at the activities that occur during a cash-in transaction:

- The customer gives cash to the agent.
- Using the mobile phone, the agent transfers the electronic value from the agent's mobile money account to the customer's mobile money account in the same amount, with the cash given by the customer.
- The transfer of electronic value is conducted through the MNO's network in real time, meaning that the agent's account will be directly debited and the customer's account will be directly credited before the customer leaves the agent's store.

The opposite flow of activities occurs for a cash-out transaction:

- The agent gives a certain amount of cash to the customer.
- Using the mobile phone, the customer sends the same amount of electronic value from the customer's mobile money account to the agent's mobile money account through the MNO's network, in real time.
- The agent's account is directly credited and customer's account is directly debited before the customer leaves the agent's store.

When a customer wants to send money to his or her family in another location (basically, this is the real case of money remittance), he or she doesn't need to go to an agent. The customer can send money from anywhere at any time by sending the instruction of money transfer via his or her mobile phone—it's as simple as sending a text message. After sending the instruction, the customer's account will be debited and the receiver's account will be credited, in real time. Afterward, if the receiver wants to get cash, he or she can go to an agent to exchange his or her electronic value to cash by using the same cash-out mechanism explained above.

Based on the definition of money remitter and from the analysis above, we can see that cash-out activities should not be considered money remittance activities because they only exchange electronic value to cash, in real time. The case of money-changer activities is quite similar. For that reason, there is a strong case for critically evaluating the current regulations for cash-out agents.

## Options

The experience of other developing countries suggests that agents are a necessity for the success of a mobile money scheme in Indonesia, given that they enable the necessary scale for this low-value, high-transaction business to become sustainable. Accordingly, in order to promote financial inclusion in Indonesia, especially from the payment system aspect, there are strong reasons to review the current regulations related to cash-out agents. In this regard, Bank Indonesia should consider the following options:

- A) Recognizing that cash-out transactions are distinct from remittance activities, it is not necessary to require a remittance license for mobile money cash-out agents. However, considering

agent misconduct as well as concerns about anti-money laundering/combating the financing of terrorism (AML/CFT and consumer protection, the mobile money provider should also set up certain criteria for its prospective agents, including a required education program regarding AML/CFT for its agents. The mobile money provider also has to be responsible for the misconduct of its agents.

B) Bank Indonesia can still require licenses for mobile money agents. As a consequence of this option, in the best case, Bank Indonesia would probably be presented with a flood of applications by small airtime dealers, and also face the task of creating the capacity to supervise a large number of these dealers.

## Recommendations

### Option A

This option is consistent with Bank Indonesia's concern in promoting financial inclusion. As we are aware, financial inclusion covers various activities, including savings, credit, insurance, and payment systems. As a payment instrument and a means of sending money, mobile money does not constitute complete financial inclusion. However, it can be an essential step toward other financial services.

Making cash-in and cash-out points available in many places will make these financial services convenient for potential customers, especially in rural areas. Accordingly, this option will enable mobile money providers to leverage their network of distributors to be cash-in/cash-out agents while still appropriately addressing concerns about AML/CFT and consumer protection.

Jakarta, September 6, 2011

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4. *Diagnostic Report on the Legal and Regulatory Environment for Branchless Banking in Indonesia*, CGAP in cooperation with IFC and GTZ, June 2009.
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# REGULATION OF BANKING AND PAYMENT AGENTS IN KENYA<sup>1</sup>

Matu Mugo

*Matu Mugo is Assistant Director of Bank Supervision at the Central Bank of Kenya.*

## Introduction

Kenya has made significant strides in recent years in extending financial services to its populace. This has been accomplished on the back of the rapid expansion of banks across the country, particularly in rural areas, and the transformational introduction of mobile money transfer services in 2007. However, the battle for financial inclusion remains far from won, and Kenyan policymakers and regulators continue to develop and implement innovative models to expand financial inclusion. To this end, the agent banking model was rolled out in 2010 to enable banks to contract with third-party agents, just as telecommunications companies have been doing since 2007.

This policy memo explores the tensions between the payment agent model run by telecommunication companies and the banking agent model. It starts by outlining the supply and demand sides of Kenya's financial sector. The barriers to financial inclusion, including income, literacy levels, product characteristics, and geographical distance, are articulated. This memo analyzes the geographic distance barrier in special detail. The areas of tension cited by banks include differing requirements for payment and banking agents with respect to business track records, liability, and exclusivity. This memo recommends a review of the requirements for both types of agents to allow for proportional regulation based on risk and types of services provided.

## Problem Statement

Kenya's current development blueprint, Vision 2030, seeks to graduate the country from a low-to medium-income country by 2030 (Government of the Republic of Kenya, 2007). The vision is underpinned by massively upscaling access to formal financial services from current levels of 23 percent to over 60 percent of the bankable (adult) population.<sup>2</sup>

The barriers to financial inclusion identified in national financial access surveys carried out in 2006 and 2009 include costs of financial services (minimum balances and fees), low financial literacy, documentation requirements, distance to financial services locations, and income constraints. Long distances to financial services locations increase the transaction cost to consumers in terms of transport cost and time spent traveling. It is therefore critical that this constraint be addressed in order to expand access to formal financial services.

The rollout of an extensive network of mobile phone payment agents in Kenya since 2007 has, in large part, targeted this challenge. In 2010, with an eye to deepening these initiatives, the Central Bank of Kenya (CBK) issued guidelines to enable banks to offer a broad range of banking services through agents. This framework differs from that for payment agents, which is currently guided by requirements set by telecommunication companies. The Central Bank has also recently issued draft regulations covering payment agents (Central Bank of Kenya, March 2011). Banks have therefore submitted a request to the Central Bank to review the agent banking guidelines in light of the requirements that differ from those of payment agents. An urgent review of this problem by the Central Bank is required to maintain the momentum of the growth of financial inclusion through both payment and banking agents, and to ensure that achieving the Vision 2030 targets is kept on track.



## Background

### Overview of Kenya's financial sector

#### *Financial access landscape (supply)*

Kenya's financial sector comprises both the formal and informal financial sectors. The formal sector is one of the largest and best developed in sub-Saharan Africa. It is comprised of a number of different financial institutions and independent regulators, each charged with the supervision of their particular sub-sectors. As of December 31, 2010, the banking sector included 43 commercial banks, one mortgage finance company, two representative offices of foreign banks, 126 licensed Forex Bureaus, five Deposit-Taking Microfinance Institutions, and one Credit Reference Bureau, all supervised by the Central Bank of Kenya (CBK, June 2011). The National Payment System, which is part of the financial system, is also overseen by the Central Bank. Other players include the capital markets, insurance, pension schemes, and savings and credit co-operatives.

#### *Financial access landscape (demand)*

Kenya's financial access landscape has shown marked improvement over the past few years, as revealed by two national financial access surveys conducted in 2006 and 2009 (FinAccess, 2006, 2009). As indicated in Figure 1, access to formal financial services increased from 18.9 percent of the bankable population in 2006 to 22.6 percent in 2009.<sup>3</sup> The number excluded from any formal or informal financial service decreased from 38.4 percent in 2006 to 32.7 percent in 2009.

### Barriers to financial inclusion

The key challenges and barriers to financial inclusion as revealed in the 2006 and 2009 surveys (FinAccess, 2006, 2009) and various related studies are as follows:

- Low income continues to be the main barrier to expanding access, with 61.8 percent of the unbanked citing income-related barriers as the key reason for exclusion.
- Non-income-related access barriers—such as documentation and qualifications, product characteristics, literacy levels, gender and cultural values, and geographical distance—together constitute the second most important reason for being unbanked.

While all of the above listed barriers are important, this memo will focus primarily on the geographical distance barrier.

### Initiatives to address distance/financial services outlets constraints

#### *Growth in bank branches and ATMs*

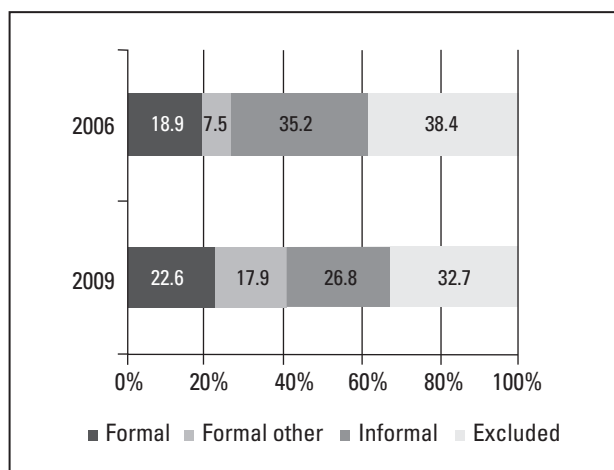
To reduce the distance to financial services, commercial banks have massively expanded their branch and ATM networks in the last five years, as indicated in Table 1.

The number of bank branches expanded from 534 in 2005 to 1,063 at the end of 2010, a 99 percent increase. The ATM network increased from 555 in 2005 to 2,052 in 2010, a 270 percent increase.

Bank branches have also expanded significantly in rural areas, as depicted in Table 2. The number of rural branches has expanded by 150 percent, from 181 in 2005 to 447 at the end of 2010. Urban branches, on the other hand, have expanded by 75 percent, from 353 in 2005 to 616 at the end of 2010.

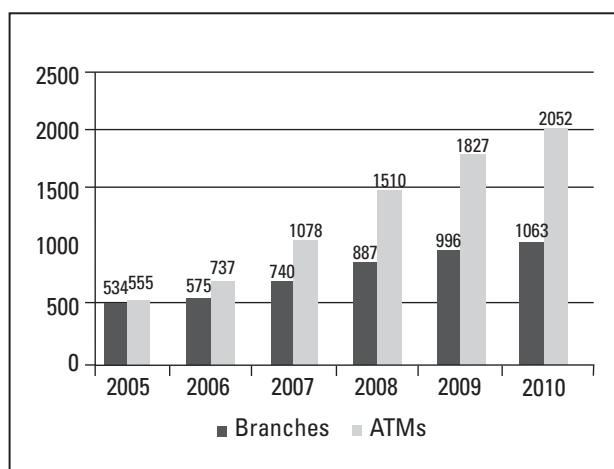
**Figure 1. Financial Access Strand in 2006 and 2009**

Source: FinAccess (2009)



**Table 1. Kenyan Banking Sector: Branches and ATMs, 2005 to 2010**

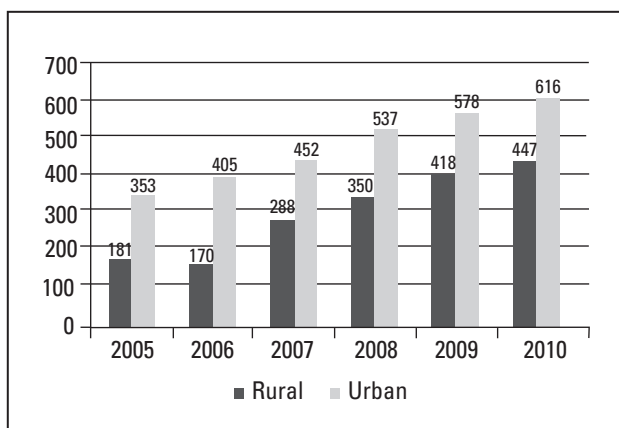
Source: Central Bank of Kenya





**Table 2.** Kenyan Banking Sector: Branches Distribution,<sup>4</sup> 2005 to 2010

Source: Central Bank of Kenya



### *Mobile/payment and banking agents*

One of the most significant initiatives in addressing access to financial services in Kenya has been the development of mobile money transfer services. Safaricom, Kenya's leading mobile operator, launched the M-PESA money transfer service in 2007. M-PESA has experienced viral growth in its first four years, gaining over 15 million subscribers and more than 20,000 agents.<sup>5</sup> The introduction of mobile financial services has helped to more than double the use of non-bank financial institutions, from 7.5 percent of the bankable population in 2006 to 17.9 percent in 2009 (FinAccess, 2009). The attraction of mobile financial services such as M-PESA is their extensive reach all over Kenya, including in villages and slums (Klein, 2011).

The amendment of Kenya's Banking Act through the Finance Act of 2009 permitted banks to use third parties (agent banking) to provide certain banking services on their behalf. The Central

Bank subsequently issued guidelines on agent banking, in May 2010 (CBK, May 2010). The guidelines require banks to seek CBK's approval for the agent network, as well as approval for specific agents, and to clearly specify the services to be provided by the agents. It is the institutions' responsibility to vet the suitability of the agents in keeping with the guidelines. As of December 2010, CBK had granted approval to five institutions to engage agents. Of these, two institutions had appointed a total of 8,809 specific agents, including telecom-related agents and individual specific agents, spread across the country (CBK, June 2011).

### *Representations by banks on a regulatory framework for banking agents*

Following the rollout of agent banking in May 2010, banks have made proposals to the Central Bank on possible areas of revision of the Agent Banking Guidelines. This is based on their experience on the ground, as well as the various frameworks for payment agents contracted by mobile phone operators. The contracting of payment agents is currently guided by the requirements of individual telecommunication companies. However, the Central Bank has recently issued a request for comment on draft regulations on e-money and retail payment systems (CBK, March 2011), which are intended to apply to payment agents.

In summary, the banking sector argues that three issues warrant special examination:

- Payment agents are generally required to have at least a six-month track record in an existing business before being contracted. Conversely, the Agent Banking Guidelines mandate an 18-month track record for banking agents.
- The Agent Banking Guidelines explicitly place liability for the agents' actions on the bank. The liability of telecommunication companies with respect to liability for payment agents is not explicit.
- Banking Agents cannot be exclusive and can serve more than one bank. For payment agents, this is not explicit, and there are payment agents that exclusively serve one telecommunication company.

The banking sector argues that the Agent Banking Guidelines should be amended to allow for a tiered approach in order to create:

- Payment agents whose requirements would be less rigorous and be similar to those of telecommunication agents that offer only cash-in and cash-out services.
- Banking agents whose requirements would remain as per existing agent banking guidelines but would be able to offer a broader range of services beyond payments, including origination of deposit and loan accounts.

## Analysis

### Policy considerations

#### *Vision 2030 financial sector targets*

Under Kenya's current development blueprint, Vision 2030, a more efficient and competitive financial sector is expected to drive savings and investments for sustainable and broad-based economic growth. The central policy objectives of the long-term strategy for the financial sector include improved access and deepening of financial services and products for a much larger proportion of Kenya's populace (Government of the Republic of Kenya, 2007). The goals for the financial sector are to raise savings and investment rates from 14 percent to 25–30 percent of GDP by 2030, and to increase bank deposits from 44 percent to 80 percent of GDP by 2012 (Government of the Republic of Kenya, 2008).

#### *Scaling-up of agent networks*

The ambitious targets under Vision 2030 require massive expansion of access to financial services for Kenyans. Identified constraints to accessing financial services, particularly distance to financial services points, will need to be addressed. The proliferation of mobile money services in Kenya and the demonstrable success in enhancing access to financial services provides key lessons. The success, particularly of the pioneering M-PESA service, has been partly attributable to its wide network of agents (Dittus and Klein, 2011; Klein, 2011; Mas and Radcliffe, 2011).

The effect of a large network of participants, particularly for M-PESA, has contributed to its success. A similar network effect will be critical for banking agents to get to scale and to have a significant impact on access to second-generation financial services for savings mobilization and credit. The current mobile money services offered by mobile operators are largely focused on first-generation payment services, although linkages with commercial banks are increasing.

#### *Proportionate/risk-based regulation*

The Kenyan financial landscape presents a unique ecosystem of both banking and payment agents (Tarazi and Breloff, 2011). The proposals by banks in the earlier part of this memo are to some extent illustrative of the tensions between the two models, particularly given the head start afforded the telecommunications companies with payment agents. This begs the question of whether the regulatory regime for both types of agents should be the same.

To determine the appropriate regulatory framework, financial services that enhance financial inclusion need to be unbundled. The key components could include exchange of different forms of money (virtual money for cash), storage of money for safekeeping (without payment of interest), transfer of money from one person/entity to another, and investment of money (intermediation) (Dittus and Klein, 2011).

The model will then require varying degrees of regulation based on risk, which is lowest with the exchange of different forms of money and highest with intermediation. This suggests differing intensity of regulation with "light touch" regulation at the basic exchange of forms of money to intensive prudent regulation at the intermediation end. Accordingly, it is useful to unbundle the banking and payment agents in Kenya along these lines and recommend proportionate regulation.

## Options

### Policy choices

#### *Retain status quo*

One choice is to maintain the status quo. Doing so would not entail any changes in the existing regulatory framework for banking and payment agents. Rather, it would mean taking a "wait and see" approach, allowing market forces to deal with the unlevel playing field for banking and payment agents. Although this approach represents the easiest course of action, it runs the risk

of slowing Kenya's rapid progress toward financial inclusion. More importantly, it could deter the achievement of the ambitious financial sector targets set out under Vision 2030, especially if banking agents do not scale-up rapidly to benefit from network effects.

#### *Amend regulatory framework for payment and banking agents*

Amending the regulatory framework for both payment and banking agents is another option. This would require more work but would ensure that Kenya's financial inclusion momentum is not only maintained but possibly accelerated. Extensive networks of banking and payment agents would be complementary, with payment agents offering first-generation financial services and the banking agents providing second-generation financial services.

## **Recommendation**

The Central Bank of Kenya should review and amend the regulatory framework for banking and payment agents by unbundling the services offered. A tiered approach should be adopted in the Agent Banking Guidelines to incorporate payment agents ("cash merchants"), as well as full-fledged banking agents. The regulatory regime for "cash merchants" under both regimes (Agent Banking and Draft E-Money Guidelines) should be reviewed to ensure proportionate regulation. The regime for payment agents should be less rigorous than that of banking agents, as they would only provide basic payment services. The key areas to be considered in both guidelines for review should be:

- Harmonization of track record and documentation requirements for both banking and payment agents
- Clarity on the liability of institutions contracting payment and banking agents
- Exclusivity of agents

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## **Endnotes**

1. This policy memo was submitted by Matu Mugo (email:mugom@centralbank.go.ke) in partial fulfillment of the requirements of the Fletcher School Financial Inclusion Leadership Program.
2. "Bankable population" refers to adults over age 18.
3. Formal financial services refer to use of a commercial bank, postal bank, or insurance product. The "formal other" designation refers to use of services from non-bank financial institutions such as Savings and Credit Co-operatives, Microfinance Institutions, and Mobile Financial Services. The informal strand uses informal financial services such as

Accumulating Savings and Credit Association, Rotating Saving and Credit Association, and groups/individuals. The excluded do not use any formal/formal other or informal financial services.

4. Urban Branches are those located in cities and towns that serve as headquarters of provinces/regions.
5. Central Bank of Kenya statistics.

# SETTING THE REGULATORY LANDSCAPE FOR THE PROVISION OF ELECTRONIC MONEY IN PERU

Narda L. Sotomayor

*Narda Sotomayor is Head of the Microfinance Analysis Department at the Superintendency of Banking, Insurance and Pension Funds in Peru.*

## Introduction

Although there is much evidence that access to financial services correlates positively with economic development, basic, convenient transfer and payment services are still unavailable for low-income segments of the Peruvian population. The experience of Kenya, the Philippines, and other countries has shown that e-money products can be effective in extending payment services to them. However, in Peru, the absence of regulation for the provision of schemes based on electronic money (e-money) prevents good investments and at the same time encourages fraudulent activities.

This policy memo discusses the main elements of establishing a regulatory framework for e-money. It recommends that policymakers first define e-money, taking into account the laws and regulations of a particular country. If e-money is not defined as a deposit, then it follows that financial institutions may provide e-money products, as well as telecommunication companies and similar operators. This will provide contestability in the market and more efficiency in the provision of e-money-based products for the benefit of consumers, particularly the poor.

## Problem

Although access to and usage of financial services in Peru has improved, progress has been insufficient. From June 2006 to June 2011, the level of access measured by the total points of service, including branches, ATMs, and retail agents, per 100,000 adults has increased from 23 to 103. More specifically, the share of the number of transactions through retail agents has reached about 12 percent in six years of existence, and it is still increasing. Usage indicators in the same period, such as the number of borrowers per 100 adults, went from 18.2 to 26.1, and the number of individuals with saving accounts per 100 adults went from 61.6 to 83.9.<sup>1</sup>

However, a large percentage of the population still remains underserved or excluded, particularly in most rural areas, where financial institutions do not find it profitable to offer services through the current channels and products available in the market. Relatively low population densities in remote areas and the small average size of transactions hamper the expansion of the financial system's physical network. The population living in the districts with access to financial services delivery channels now includes 82 percent of the adult population. However, the remaining 18 percent of the adult population lives in 66 percent of the isolated districts without any access to the financial system.

The international experience sheds some light on this problem. It shows that alternative access channels and products can be used to expand financial services. In particular, the use of diverse electronic devices, including mobile phones, can significantly reduce operational and transaction costs for both consumers and the financial service providers. In Peru, the fact that penetration of the mobile industry is above 95 percent and that 88 percent of the districts in Peru have mobile phone coverage creates an opportunity for using these devices to increase the scope and the depth of outreach.<sup>2</sup>

In spite of this, the lack of rules and supervision of e-money constrains the development of mobile financial services (MFS) by generating uncertainty and preventing investments in

e-money-based products.<sup>3</sup> On the other hand, this same lack of rules and supervision leaves room for fraudulent activities.

Therefore, it is necessary to define a regulatory framework conducive to the development of e-money-based services so that they can be offered in a secure, reliable, efficient, and transparent way. The proposal of such a regulatory framework is the aim of this memo.

## **Background: Distinguishing Mobile Financial Services**

A regulatory framework may be conceived of as the rules of the game. It conditions entrance into the market, and affects the decisions and hence the outcomes achieved by market participants. For this reason, regulators have a great responsibility and they must be very clear about the vision of the market they want to encourage.

Electronic devices, including mobile phones, may be used in different ways to access financial services. In order to clearly delineate the scope of this policy memo, it is necessary to analyze at least two of these ways:

**1. M-banking services:** The most immediate way to use electronic devices is simply as additional channels to access deposit accounts. In this case, a customer may manage her account using an electronic instrument such as her mobile phone, transferring money among her accounts or to others, or paying bills.<sup>4</sup> This is done by submitting orders to the financial institution (FI) holding her deposit account without her making a trip to the FI's branch. This approach is usually called mobile banking, or m-banking. To sustain these operations, FIs will need to hire the services of a telecommunications company (telecom). Some examples of this approach are Wizzit in South Africa and Nipper in Mexico.

M-banking providers have to be FIs authorized to offer deposit accounts, which are in most cases, as in Peru, prudentially regulated and supervised. From a regulatory perspective, using this relatively new channel to access deposit accounts does not present a particular challenge, other than managing operational risks. In fact, m-banking activities already exist in Peru, although they are oriented to medium- and high-income segments of the population. The extension of m-banking services for the unserved population should follow after deposit accounts become available to them. To encourage this, regulatory changes have already been brought up since February 2011 to reduce the average cost of opening small deposit accounts by lessening the anti-money laundering and counter-terrorism financing (AML/CTF) rules for low-risk products.

**2. E-money services:** The supply of transfer and payment services using electronic devices does not require deposit accounts. These services can also be offered using e-money, which may involve telecoms and other specialized operators, such as service providers. This is the case with Safaricom, a telecom that offers M-PESA products in Kenya, or with GCash in the Philippines. In these cases, the customer buys electronic (virtual) money at the service provider's agent, either with cash or other means of payment, crediting the same value. The value stored is registered by the service provider and can be used by the customer at her convenience by using, for instance, a plastic card or a mobile phone. In the latter case, the product is commonly known as an "electronic wallet," where the mobile phone is used to send orders of transfers or payments to the provider's platform by using an SMS or a specially designed menu.

Until now, e-money activities have not been available in Peru. However, some investors are interested in providing these services; investors vary from little-known operators to telecoms with significant market share.

However, there is a regulatory vacuum. No definition of e-money exists and regulation does not specify who can provide services and under what conditions, thus preventing investments or leaving the door open to any participant, however credible, to enter the market. The current Law of the



Payment System recognizes the existence of possible providers of e-money schemes but does not regulate or supervise them. It indicates that the central bank will supervise them only if providers pose a systemic risk. But if a systemic risk emerges, regulation may come too late. We must fill the regulatory vacuum related to e-money-based services, which is the focus of this policy memo.

## **The Objective of the Regulator**

The main objective of the Peruvian financial regulator is to design an enabling regulatory framework for the development of a sustainable and inclusive financial system. From the regulator's perspective, stability and sustainability are essential to the provision of financial services. However, the regulatory framework should not constrain innovation in order to meet the challenge of financial inclusion. For that purpose, in the arena of mobile financial services, the rules of the game should induce the development of transfer and payment services based on e-money, offered by solid and responsible institutions under conditions of safety, reliability, efficiency, and transparency for the benefit of the population.

### **Analysis: Setting the basis for e-money regulation**

There are two key elements that help define the rules of the game for e-money-based services: a clear definition of e-money, and the decision about the allowed issuers of e-money. In fact, both elements are related, as I will show.

Electronic money is generally understood as a value stored electronically that can be accessed by an electronic device. However, the consideration of e-money as being a deposit or not varies across countries, depending on how deposits are defined in their constitutions, laws, and regulations. In the case of Peru, neither the Political Constitution of Peru nor the General Law of the Financial System defines a deposit. But the latter mandates that the financial regulator supervise depository firms collecting deposits from the public.<sup>5</sup> The Peruvian Civil Code sheds some light on this concept. It indicates that a (regular) voluntary deposit occurs when the depository institution receives a good for custody and later return.<sup>6</sup> On the other hand, an irregular deposit occurs when the depositor allows the depository institution to use the good, acquiring the right to receive (or not) compensation, according to the terms of the contractual agreement.<sup>7</sup>

None of these definitions of deposit tackles the way e-money-based products work in the most successful cases. Those products do not involve just custody and return of the cash handled by the customer, as stated in the general definition of a voluntary deposit in the Peruvian Civil Code. They involve more. For instance, in e-wallet schemes, the customer uses the service of having her cash de-materialized (converted to e-cash) to store value and to carry out transfers and payments in a more convenient and cost-efficient way (Mas and Kumar, 2008). Furthermore, e-money service providers are not allowed to use the value stored for lending or any other purpose that the provider may deem convenient, which differs from the concept of irregular deposits defined in the Peruvian Civil Code. The provider only performs the operations that the customer requests. The cash exchanged for electronic value remains in control of the customer at all times, much like it was interpreted when the Central Bank of Kenya analyzed the case of M-PESA (AFI, 2010).

Thus, under current Peruvian laws and regulations, e-money cannot be considered a deposit. We can define e-money as being a monetary value stored in an electronic device that is presented by a claim on the issuer and that has the following characteristics:

- It is issued upon receipt of funds at an equal value of the monetary value receipt
- It is widely accepted as a means of payment
- It can be converted back into cash
- It is not a deposit

## Analyzing potential e-money service providers

Consistent with the proposed definition, the range of potential e-money service providers and models increases. According to the Peruvian constitution, prudential regulation is required only for depository institutions. Hence, it is possible to allow the entrance of other non-financial service providers without requiring them to be regulated as full intermediaries.

However, the decision of who enters the market should be made only after careful analysis. All of the stakeholders' concerns have to be taken into account—those of the regulator, of the service providers, and of the un-served population. I consider only two general types of potential e-money issuers.

**1. Financial intermediaries:** From the point of view of FIs, the issuance of e-money would just increase the array of products they can offer to consumers. Like their m-banking activities, they would have to use the services of a telecommunications company.

From the point of view of the population, particularly of the poor, the gains are not clear. If FIs were able to reach them through e-money-based products, they could also offer them m-banking services, which would make more sense in that it implies additional services beyond transfers and payment services. However, despite the substantial increase of the retail agent of the financial system in Peru, which reached 9,204 as of December 2010, the impact appears to be limited to the low end of the market. Perhaps the advantage of offering e-money services in relation to m-banking will appear if FIs are able to increase the capillarity of their distribution networks by incorporating the mobile operator's agent network to their distribution networks. Under this option, since deposit-taking FIs are prudentially regulated, the concerns of the regulator relate primarily to transparency issues. The regulator should require FIs to make clear for the customers the characteristics of the product that is being provided, m-banking or e-money (deposit or non-deposit). In addition, FIs should be required to offer e-money-based services using a trust-like scheme, for two basic reasons. First, the regulation must keep consistency with the nature of e-money, whereby the service provider receives the money only to perform transfers and payments at the request of the customer. The constitution of a fund for a specific purpose is the concept intrinsic in a trust. Second, since the e-money issued is not a deposit, it is not protected by the Deposit Insurance Fund. In the event of an FI's bankruptcy, the trust assets will not be liquidated; thus, the customers' money will be safe.

**2. Mobile operators and other specialized service providers:** In this case, mobile operators have the opportunity to go beyond the communication services they provide and offer e-money services. This can be done with the relative advantage of having scope economies, since the systems needed are mostly in place, and they have experience running high-volume, real-time prepaid platforms (Alexandre et al., 2010). From the population perspective, considering the high level of penetration that mobile phones have achieved in Peru even among the poor, the gains are clear. Mobile phone users are already familiar with the mobile service and with their providers, and they can benefit from the expanded functionality of their mobiles. Moreover, the large network of retail airtime resellers may serve them as convenient cash-in/cash-out outlets.

The argument against allowing mobile operators to offer e-money services is that they do not promote full entry into a suite of a financial institution options. Without underscoring the value of providing access to credit and deposit services, for instance, we have to acknowledge that the most basic service that the financial system should provide is transfer and payment facilities. This has not been happening in Peru as in other developing countries. So, poor migrants living in the capital, Lima, often find themselves sending money to their dependents by informal means, such as using bus services to send cash hidden in packages or using informal bus transportation remittance services, in order to avoid the high commissions that a regulated financial entity may charge. Thus, e-money services provided by mobile operators



can make the unserved population better off by offering efficient payment and transfer services. In addition, alliances may take place between mobile operators and full intermediaries to provide a wider set of financial services. In fact, this entry route to financial services may be more effective for consumers, since mobile networks may have a consumer track record in payment and credit worthiness (Williams and Torma, 2007). In particular, this type of information about the poor may help to reduce the barriers to accessing a larger set of financial services, getting closer to reaching full financial inclusion, which is the final objective a country wants to achieve.

From the regulatory perspective, when mobile operators are allowed to offer a financial service (i.e., e-money based) they have to be supervised by a financial regulator. However, since the service is not a deposit, only non-prudential regulation is needed to ensure the safety of the value stored by the customers and to protect consumers from possible mistreatment by the providers. To safeguard the customers' funds, diverse financial regulators from the Philippines, Kenya, and Indonesia, among others, have made the decision to require the e-money issuers to maintain liquid assets equivalent to the total value of the funds collected in a trust account of a prudentially regulated institution. As explained before, if a specialized mobile operator goes bankrupt, customers' funds are safe and they will be able to cash out a value equal to the one they have cashed in. In this sense, there is no solvency risk posed under this approach by the mobile operator (GSMA, 2010).

## The Choice

The most conservative approach would be to allow as e-money issuers only those FIs that are prudentially regulated, which is more than what is needed to monitor e-money services. But this would create a regulatory barrier for market contestability and may hinder potential gains for financial inclusion. On the other hand, the international experience has shown that the participation of mobile operators has been the most effective way to incorporate the underserved population into the payment systems. Their advantage lies in their experience to manage high-volume low-value transactions which allows them to safely offer e-money services with lower cost structures than banks (GSMA, 2010). In addition, mobile operators generally market themselves nationwide, avoiding niche strategies which may be usual for FIs, driven by specific customer and segment profitability within defined geographies (Ivatury and Mas, 2008). Consequently, mobile operators have a larger agent network, which provides more convenience to customers for cash-in and cash-out operations. In the Peruvian case, it is estimated that the telecom with the largest share in the mobile telecommunications market has a network of almost 90,000 airtime resellers, which is about ten times the agent network of financial intermediaries. Hence, mobile operators may be in a better position to achieve mass adoption of their services.

From the regulator's perspective, the concerns involved in allowing mobile operators to offer payment services can be easily addressed. In fact, there is not a tradeoff between the participation of financial intermediaries and mobile operators. Under the two possible scenarios, competition between different types of service providers or alliances among them, the population can be better off. In the end, by allowing all types of participants, the financial regulator leaves the market to figure out what works best, and the customers will benefit from the result.

## Other Regulatory Issues

The fundamental principle that the financial regulator should follow when defining the regulation is to establish a level playing field for all types of service providers. For this purpose, a key approach is to focus the regulation on the service rather than on the service providers (GSMA, 2010). And, to guarantee that all participants will follow the same rules, they should have a common supervisor; in this case, the financial supervisor. During the whole regulatory and

supervisory process, the financial supervisor will need to maintain a continuing dialogue with other supervisors including, in the Peruvian case, the Central Bank that oversees the payment system and the regulator of the telecommunications sector. Thus, mobile operators must obtain a special license from the financial supervisor to provide e-money services only, fulfilling the usual entry requirements to ensure the viability of the project. The financial supervisor should evaluate the suitability of the shareholders, and make sure that directors and management are qualified, fit and proper to manage the operations soundly and prudently. Also, a minimum capital sufficient to support the startup of operations and deter investors who are not serious may be considered.

Once the firms are incorporated into the regulated market regulators should make sure that e-money providers have adequate risk management processes to identify, assess, control and monitor the potential risks arising from their activity, so that the service is provided under conditions of security and reliability. In many countries, including Peru, the existing risk management principles are in general applicable; however, regulators may need to tailor them to the activity of e-money provision. The regulation on operational risk may need to be made more specific, focusing on the information technology risk. In relation to other electronic channels to deliver financial services (internet in personal computers, automatic teller machines), the use of mobile phones and the mobile network in e-money based products are new sources of technological risk. It is recognized the existence of data and network security risks, which may negatively affect the authenticity, confidentiality and integrity of the financial transaction, and also the availability of the service.

In response to these risks, uniform requirements and rigid levels of security may be inconsistent with the objective of incorporating unserved population to the payment system. The level of security functionality of the mobile phone, which is most likely basic among the poor, and the degree of dependence from a particular telcom directly affect the aforementioned risks.<sup>8</sup> In view of that, some countries, such as Pakistan and Mexico, have assumed a tiered approach, requiring data security levels that vary with the data channels used and transaction size (AFI, 2010). Moreover, the standards defined are technology neutral in order not to constrain continuous innovation and efficiency gains observed in the telecommunication sector. In addition, regulators should be very careful in reviewing the providers' risk policies, procedures and tools for managing the risk. For instance, the high risk associated with lower levels of security in basic mobile phones may be mitigated by effective business process and product design controls (Bezuidenhout and Porteous, 2008). In this way, regulators can create a flexible, proportionate regulation to allow a continuous supervision that may eventually help to fine tune the regulation.

On the other hand, liquidity risk is also viewed as relevant to mobile financial services, and in this context it is usually understood as the risk that retail agents may not have enough cash to meet customers request of withdrawals. However, this is not a risk specific to the provision of e-money based products, it is rather related to the use of retail agents to deliver financial services. In the case of Peru, where this scheme is well developed, this risk does not seem to be critical, and may be a consequence of the retail agent model. In order to keep retail agents as low sources of risk, FIs are required to establish operational limits consistent with the business activity of the agent; they may also consider limits per type of transaction and per person. Thus, a customer may be unable to transact in an agent if the limits there are binding. However, she may find it easy, depending on the density of the agent network, to go to another agent nearby to perform the transaction. Even so, the regulator may require to the service provider a contingency plan in case of sudden demand for cash-outs, including information of agreements with liquidity suppliers to cope with this eventuality.

Pertaining to money laundering risk concerns, all type of e-money services providers must comply with already existing regulations on AML/CFT, monitoring and reporting suspicious activity.

And, the involvement of mobile operators may facilitate the identification of suspicious behavior given their more advanced computing power and their ability to handle large amounts of information. In addition, fieldwork revealed that low amounts of money, traceability, and the monitoring features of mobile money can make it far less risky than other means of payment, especially cash (Chatain et al., 2011). Thus, it is possible to introduce some flexibility to the usually rigorous “know your customer” requirements of AML/CTF norms in order to ease the unbanked population’s access to financial services. Moreover, if the regulations are too rigid, people will not move out of the informal sector (Mas, 2010), which is another desirable objective to pursue.

Peru has taken this “proportionate to risk” approach by defining in the AML/CFT regulation along three regimes, recognizing the existence of varying risk levels associated with customers and the services and products provided. The first regime is a general one, where regular measures of know your customer and due diligence apply. The others are special regimes. In the second regime, exemptions from traditional customer due diligence rules aimed at preventing money laundering apply to low-risk products. Under this regime, the regulation defines a general basic deposit account with balance and transaction limits, per month and per day. This product can be contracted with the (widely available) Peruvian National Identification, even at the financial intermediary’s retail agent network. For e-money-based products, the same balance and transaction limits should apply. Finally, in the third regime, firms should apply reinforced measures of due diligence for customers whose transactions are inconsistent with their business profiles and for those highly exposed to the risk of engaging in money laundering activities.

Most of the previous risks trigger consumer protection concerns if the subsequent losses affect consumers, particularly the poor with less lower ability to complain and obtain compensation for damages. The regulatory framework for consumer protection is well developed in Peru, and the responsibility of compliance rests in the service provider independently of the channel used to deliver the service. However, some aspects may need to be tailored to e-money services, addressing the consequences of the new risks derived from the use of the mobile phone and the mobile network. The basic purpose of the consumer protection regulation in Peru is to induce service providers to adopt a conduct of respect with consumers, creating a customer service system with clear policies of consumer protection and mechanisms for complaints and dispute resolution. Transparency in the provision of the services is also a key element in the regulation of consumer protection, since it allows consumers better decision making, which also contributes to the healthy development of service providers. However, some requirements may become cumbersome and costly when dealing with low-risk products. Thus proportionality is also required. In this spirit, a simplified regime is also defined for consumer protection rules as maintaining transparency on the most important elements of information. This framework should also apply to the provision of e-money services with some fine tuning. In this case, basic elements for consumer protection include information on commission charges for each type of transaction, a clear guidance to prevent frauds and identity theft, and information about alternative channels in the event of system failures. As a part of their consumer protection policies, service providers may be required to get involved in programs to increase financial capability and customer awareness with regard to the e-money service being provided.<sup>9</sup>

In regards to factors that affect competition in the market, the role of interoperability is frequently discussed. Interoperability exists when the service is network independent, allowing consumers to transact beyond their service provider’s network. Otherwise, consumers would have to choose their providers by evaluating whose offer is more suitable for them, taking into account, among others, prices and the possibility to transact with a larger group of individuals or with those with whom they interact more. This incentivizes competition, e-money service providers will take actions to add value to their networks and attract customers either by product differentiation or by cutting prices. However, there is a concern that the final outcome may be a reinforcement of

the dominant position of the operator with the largest network. The challenge for regulators is to decide whether or not interoperability should be imposed by regulation and when is the most appropriate timing for doing so. Considering the market dynamics aforementioned, interoperability should not be imposed at an early stage of market development, when e-money services are not developed, to avoid the risk of hampering market development and innovation, which is motivated by competition. At the same time, regulators should make sure that technical interoperability remains feasible at a low cost, whilst reserving a credible option for regulatory intervention to secure interoperability in the future, in the light of market developments (Houpis and Bellis, 2007). In fact, even at an early stage of development it is also likely that interoperability will emerge spontaneously if the leader wants to build up a large customer base, which is a necessary condition for the viability of this low-cost large-volume service. In general, consumers are better off with as much interoperability as feasible, provided that they get value propositions at reasonable prices.

## Conclusion and Recommendations

An enabling environment for the development of sustainable and inclusive mobile financial services requires creating a clear regulatory framework without preventing innovation and competition in the market. Key recommendations for crafting such a regulatory framework for e-money-based services can be summarized as follows:

- A clear definition of e-money must first exist, which takes into account the laws and regulations of a particular country. A key element in that definition is to establish whether or not e-money is a deposit. This defines the array of service providers that may be allowed into the market.
- In order to induce market contestability, it is important to allow all types of e-money issuers, if possible. In particular, the participation of mobile operators may have the potential to accelerate the incorporation of the poor into an efficient payment service system by providing them convenient and affordable products.
- Risk-based approaches deal with money laundering concerns without jeopardizing the objective of financial inclusion. The literature has shown that e-money-based schemes offer less risk than the use of cash, since they are traceable and easy to control.

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## Endnotes

1. Superintendencia de Banca (2011). Note that the number of depositors may be overestimated, since the information available is the sum of depositors across institutions and one person may have accounts in more than one institution. Still, the trend observed is increasing.
2. Penetration is measured by the number of lines over total population (OSIPTEL, 2010).
3. Bankable Frontiers and Afi (2009) argue that in civil law environments, like those in Latin America, “what is not expressly permitted, is usually not allowed unlike common law countries (such as South Africa and Kenya) where the absence of express laws prohibiting new developments may actually create space for innovations to develop.” Thus, certainty is a relatively stronger prerequisite in Latin America than in common law countries for the development of mobile financial services.
4. From now on, the customer will be referred as “she.” This is to remind us that women typically have less access to financial services than men.
5. Political Constitution of Peru 2003, article 87.
6. Peruvian Civil Code, article 1814.
7. Peruvian Civil Code, article 1829.
8. A complete description of the risks involved and strategies to mitigate them can be found in Bezuidenhoudt and Porteous (2008).
9. A detail analysis of consumer protection issues in branchless banking can be found in Dias and McKee (2010).



### **III. Promoting Savings**





# PROMOTING MICRO-SAVINGS AMONG THE LOWEST END OF THE INCOME SEGMENT: CONDITIONAL CASH TRANSFER PROGRAMS IN MEXICO

Luis Treviño Garza<sup>1</sup>

*Luis Treviño Garza is Director for Access to Financial Services at the Banking and Securities Commission in Mexico (CNBV).*

## Introduction

Governments, multilateral agencies, NGOs, and private organizations are debating whether linking savings products with conditional cash transfer (CCT) programs financially empowers beneficiaries, promotes asset building within their households, and helps them overcome poverty in the long run without weakening the original purpose of the CCTs.

The objective of this document is to advocate promoting savings products and financial literacy programs targeted to the low-income segment of the population through CCT programs. In particular, this memo argues that policymakers from the Oportunidades CCTs Program should develop the necessary regulations and policy mechanisms to deliver savings products and financial literacy programs via CCT programs.

## Background

### What has been done?

The Oportunidades Human Development Program, which includes the Oportunidades CCTs Programs,<sup>2</sup> is among the most successful, well-managed and monitored human development programs using conditional cash transfers in Mexico and abroad. It provides approximately US\$3.2 billion annually in direct transfers to more than six million families in the lowest income brackets, thus help these people secure basic levels of education, nutrition, and health care for their families (about 32 million people). The goal of the programs is to promote human capital investment at the family level.

In 2008, Oportunidades CCTs Programs started a series of pilots to change the distribution strategy of these money transfers in order to provide the beneficiaries with electronic devices—such as debit cards at urban locations and prepaid electronic cards at the rural locations—and to bring at a closer distance from the beneficiaries the delivery of these transfers using the network of community stores DICONSA<sup>3</sup> and Telecomm<sup>4</sup> branches. These pilots had two main objectives: first, to reduce the transactional costs to beneficiaries in terms of distance and time spent receiving the subsidy,<sup>5</sup> and second, to provide an electronic financial mechanism to foster financial inclusion among those beneficiaries who typically are among the most excluded.

Under this new strategy, the CCTs are being developed through three main channels that go more deeply into the small towns that are dispersed beyond the municipality head-towns<sup>6</sup>: through DICONSA communal stores (in rural areas) and Telecomm offices (in urban areas)<sup>7</sup>; through Bansefi's own 492 branch network<sup>8</sup>; and through *L@ Red de la Gente* (cooperatives and microfinance institutions [MFIs] associated with Bansefi), which provides 1,671 points of contact.

By November 2011, Bansefi helped to deliver the Oportunidades CCTs Programs through 3,786,603 prepaid cards, or “e-wallets,” which use a sophisticated biometric identification system (electronic fingerprint recognition) to prevent fraud in rural areas, with an estimated rate of delivery of more than 75,000 new debit cards each month. There are also about 1,147,609 debit cards attached to a deposit account whose beneficiaries access the Oportunidades CCTs Programs in

urban areas. However, it remains a challenge to bring an additional one million Oportunidades beneficiary families a debit or prepaid card, although they may have access to a cardless savings account.<sup>9</sup> This new electronic technology is provided by Bansefi, and the electronic dispersion mechanisms are made through the Mexican National Treasury, both institutions dependent on the Ministry of Finance.

Currently, about 3.7 million beneficiaries receive Oportunidades CCT Programs through direct cash payments, mainly through DICONSA stores and Telecomm offices. Bansefi and Oportunidades have the challenge under a recent government mandate to bring these families into the electronic dispersion transfers schemes within the next two years.<sup>10</sup> By the end of 2012, it is expected that more than six million families will be receiving their conditional<sup>11</sup> transfers electronically. There are still many challenges in achieving this task that go beyond the scope of this document: for example, rising costs on the delivery of direct transfers for DICONSA, due to Oportunidades requirements during this transition period to deliver the full amount of resources in cash to the stores, even though the beneficiaries receive their disbursements and can cash them through electronic devices. Moreover, there is still a need for more training for the DICONSA clerks who perform the electronic point-of-sale (POS) operations. Most importantly, there remains a lack of connectivity to the majority of the DICONSA stores; about 5,300 stores deliver transfers through Bansefi in cash due to this lack of connectivity.

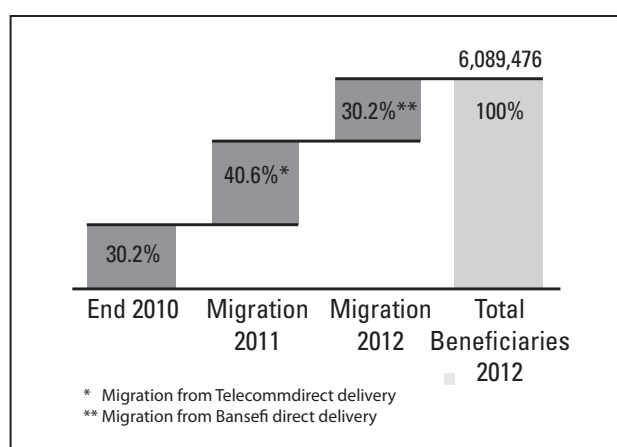
Despite these challenges, families receiving payment electronically are already experiencing reduced transaction costs.<sup>12</sup> And, by taking advantage of these new channels, especially those in rural areas, the federal government now has the opportunity to go a step further in financial inclusion by promoting public policy that will enable savings products and improve financial literacy among this relatively vulnerable segment of people. These two social policy tasks are the focus of this document.

Bansefi offers a range of savings products aimed at 2.5 million families in various income segments of population, but predominantly to those with the lowest income. An estimated 62.2 percent of Bansefi's clients, or about 1.8 million families, are beneficiaries of Oportunidades CCTs Programs; among this group, an estimated 15.2 percent have a savings account with Bansefi, independent of their status as an Oportunidades beneficiary.<sup>13</sup> It is estimated that about 95 percent of the CCT beneficiaries who have a savings account held a positive balance in these accounts, and among them, about 15 percent make deposits from other income sources. Additionally, there are about 134,000 beneficiaries who hold an investment time-deposit account and, although they typically maintain a low balance (\$9.4 million pesos out of 134,000 accounts in 2009), these balances have an average maturity of 12 months.<sup>14</sup>

Other relevant issues revealed in a recent survey among Bansefi's clients, including those who are Oportunidades beneficiaries, include the following:

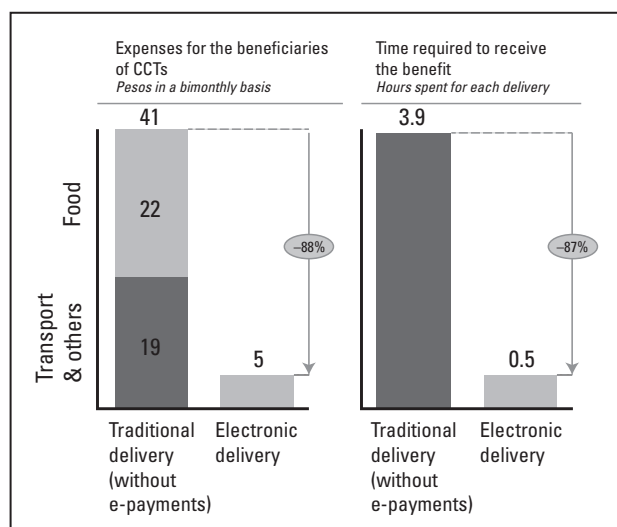
### Number of Beneficiaries through electronic devices

Source: Bansefi, 2011.



### Transactional Costs in terms of time and money saved before and after the Pilot where it was tested the effectiveness of the electronic transfers at DICONSA Stores

Source: Bansefi with research data from CIDE & McKinsey & Co.



- About 79 percent of Bansefi’s clients who are Oportunidades beneficiaries believe that “savings are useful for protecting themselves against unforeseen events.”
- Some 57.2 percent agree that “they prefer not to save within their homes,” although many still fear losing the benefits of institutional saving to high commissions.<sup>15</sup>
- For 44.3 percent of Bansefi’s Oportunidades beneficiaries, one of the main reasons to save is “for frequent and regular expenses as food, and house expenses as water, light, gas, etc.,” whereas 36.5 percent of the same group consider saving a good idea “for unforeseen events/emergencies.”
- As for the means of saving among this group, it depends on their affiliation with another formal institution (such as an MFI or cooperative), even if they are receiving the transfer through Bansefi. About half of the people without affiliation with a formal institution state that they keep cash at home, in *guardadito* as they call it, whereas the 47 percent with an MFIs or cooperative account prefer to use these accounts for their savings rather than Bansefi’s products. This last result can be explained in part by “Oportunidades program conditionality that forces them to withdraw all the cash from their transfers from a specified date if they don’t want to lose it.”<sup>16</sup> Nevertheless, in certain pilots where participants were allowed to keep part of their money in their accounts, many people opted to keep some balances there.

Current Bansefi savings products can help satisfy some of the Oportunidades recipients’ savings needs:

- CUENTAHORRO, a commission-free product targeted to Oportunidades beneficiaries, is the main savings account product, with about 1.5 million accounts
- PREMIAHORRO is a matched savings scheme to incentivize savings among its more than 200,000 clients
- TANDAHORRO is an inflation-indexed saving product with 70,000+ new accounts each year
- DEBICUENTA, with more than 820,000 clients (Oportunidades and non-Oportunidades clients), is present mainly in urban and semi-urban areas

Given this information, there is still the potential to bring well-tailored saving products linked to financial literacy policies and programs to more than five million families through the Oportunidades CCTs Program. These savings products could be delivered both through Bansefi and through well-regulated MFIs and cooperative institutions with products specially tailored for them.

## Analysis

### Challenges

Despite the potential gains to be made by linking CCTs with savings products, the concept has its share of detractors. The main arguments against linking CCTs to savings products include:

#### **Pairing savings schemes with CCT programs could undermine the strengths of CCTs.**

1. Resources originally intended to be used completely for investment in human capital would be diverted to savings, and thus erode family spending on health and education.
2. Electronic dispersion of conditional transfers might negatively affect the direct contact Oportunidades dispersion staff has with the beneficiaries.

#### **The sustainability of savings mechanisms remains suspect.**

1. The intermediation of geographically dispersed, small, and irregular amounts of savings targeted for lower income people may not be commercially profitable.
2. The financial soundness and prudential supervision of savings products offered by different financial intermediaries may come into question, since beneficiaries of CCTs are particularly vulnerable to unethical practices due to their financial illiteracy.

## Opportunities

Nevertheless, there are compelling reasons to question these criticisms of the joint delivery of CCTs, financial literacy programs, and savings schemes.

### **Savings linked to CCTs might divert the original purpose of investing total resources in human capital.**

Although CCTs are 100 percent directed into spending on human capital, the families benefiting from these programs must have additional sources of income, part of which could be directed into some small, short-term savings that could actually let them build some assets in the medium term.

### **Electronic dispersion of conditional transfers might erode the direct contact Oportunidades staff has with the beneficiaries at delivery of cash dispersion.**

There are other mechanisms to ensure the soundness of contact between beneficiaries and the supervision of Oportunidades staff—school committees, health clinics, etc. Meanwhile, there are actual gains for more transparent and clear management of the economic resources, whereas it diminishes any political influence on delivering the direct transfers to the beneficiaries.

### **The intermediation of geographically dispersed, small, and irregular amounts of savings aimed at lower income clients may not be commercially profitable.**

On the one hand, CCT programs are in fact reducing transaction costs for both beneficiary families and financial intermediaries, in the sense that the program has already made a considerable investment in selecting people from the lowest income segment of the population, a group that has the potential to grow economically and be good financial clients in the longer run.

On the other hand, both technological improvements and recent new financial inclusion regulatory policies offer the opportunity to reduce intermediation costs through electronic financial products and services (debit or prepaid cards and mobile payments schemes), and through more convenient financial business models such as banking agents, mobile banking, and simplified accounts. These two issues might have a direct and positive influence on the reduction of costs and the profitability of business models, which could enable the offering of savings products.

### **The financial soundness and prudential supervision of savings products offered by multiple providers may come into question.**

Since these new and adequately tailored saving products would be a part of the public policy, side by side with the CCTs other policies, and since there will be only sound regulated financial institutions from different sectors, including development banks and popular savings and loan entities, as cooperatives, there should be no more risk than people already take by using any other formal, regulated financial institution.

Furthermore, this is precisely why part of the proposed policy includes financial literacy and financial capabilities programs that could strengthen and empower these people to use this and other financial services safely and effectively by providing information on how to keep track of their income and expenditures; on the different mechanisms available to face financially expected and unexpected events; on the various ways to increase step-by-step savings to improve income; and on the purposes and uses of different financial services and how to select the best of them, taking into account their income condition and the key features that can help them smooth consumption, income and risk effectively. Finally, this type of instruction should help clients be aware of their rights as customers of a financial institution and help them prevent and solve any abuse or conflict they encounter with a financial institution.

## The Role of Technology in Savings Linked to CCTs

Technological innovation through an electronic payments infrastructure must be used to reduce transaction costs for delivering financial products, both for financial providers and for customers:

- For banks, using technological innovation has the potential to reduce transaction costs by delivering and managing financial products such as savings and insurance remotely, thereby avoiding the cash management costs.
- For customers, the availability of these services near the place they usually live may reduce the transaction costs of time and money spent commuting to other places, and may help them learn about the use of additional financial services.
- Technological innovation gives financial intermediaries the opportunity to take advantage of cross-subsidies, enabling them to offer additional services, such as microsavings, micro-insurance, POS online payments for services, etc.

## The Role of Regulation

Regulatory improvements also have the potential to promote products through low regulatory requirements and sound prudential supervision (e.g., through a simplified accounts regime), and through low transaction costs (e.g., through banking agents and mobile payments schemes), both targeted to the circumstances of low-income people.

These improvements would both enable the design of more appealing and suitable products for low-income people and help reduce costs for financial institutions, thereby contributing to financial soundness and prudential compliance through bank supervision.

The connection between low-cost channels for financial access with Oportunidades CCTs Programs also has the potential, given the investment already made by Oportunidades to identify beneficiaries, to attract the most suitable financial intermediaries for this market niche, such as state-owned savings banks and popular financial regulated companies (well-regulated MFIs and cooperatives). This would enable these intermediaries to offer well-suited financial products and services to these potential markets.

This connection also could help provide cross-subsidies among different financial providers and more financial services. For example, if a DICONSA store has POS devices and an online connection, they could not only deliver Oportunidades transfers but also offer additional products at relatively low costs, like micro-insurance or service payments.

## The Role of Policy

### Innovative savings product design policies

The main characteristics and features of an appealing microsavings product for low-income families must include a great deal of research in order to bring trust, convenience, and attractiveness to the product, as well as sustainability. In many countries, including Mexico, there are relatively new studies, such as the Portfolios for the Poor, that are conducting formal research to develop suitable financial products for low-income people.<sup>17</sup>

Another challenge is to build a business case for a microsavings product that could prove sustainable, reliable, and profitable. Annex B provides some initial suggestions for the features that such a product could have in order to be sustainable, attractive, and practical.

### Financial literacy programs and financial consumer protection schemes

Two crucial policy components that must be included in linking savings to CCTs are financial literacy and consumer empowerment, such as financial consumer protection and recourse



mechanisms, which are sine qua non for the longer term sustainability of these savings incentive policies and asset-building schemes.

In recent years, the federal government, through various public institutions, including Bansefi, as well as private institutions, such as commercial banks and MFIs, have been developing financial education programs. In recent months, the federal government has made an effort to build a national strategy of financial education among both public and private sector stakeholders; this fundamental policy would be part of the national strategy, a component of financial literacy and financial capabilities aimed at savings linked to CCT programs. The design of these programs should be carefully developed and must include an impact measurement component, as every Oportunidades policy does.

The particular importance of this type of policy is that it could have a direct impact on the demand side, helping to bring not only financial inclusion but social inclusion to an important segment of the population.

## Recommendations

The goal of this set of proposed policies (promoting savings products and financial literacy) linked to a previous successful CCT social program is to enable, in a relatively short period of time, a large group of families at the lowest-end of the income distribution in Mexico to have access to both financial empowerment and awareness, and convenient financial savings mechanisms at relatively low costs.

On one hand, there is always the option to do things as they have been done in the past, without changing anything. In this scenario, the public policy for promoting financial inclusion would continue at its own pace, promoting more financial access through banking agents and new technology devices for transferring funds and deposit schemes electronically, such as the mobile-payments model, and even to continue with the existing national financial literacy strategy.

The existing financial inclusion policies are set from both a regulatory and a business model perspective, and the chances that they will soon be available for the poorest of the poor are rather low, given the lack of financial literacy among this segment of the population.

On the other hand, establishing a coordinated approach on policy, regulation, and business research between the different stakeholders (mainly from the federal government), given the relatively good outcomes some related policies have demonstrated in the recent past (e.g., e-transfers), could advance the financial inclusion agenda by delivering financial literacy awareness and empowerment, as well as quality financial services, to a significant group of people.

Given this analysis of the risks and opportunities inherent in these policies, it is clear that the benefits outweigh the costs, provided that some key principles are adhered to:

- New policies must guarantee the original objectives of CCT programs in building human capital and helping people find their way out of poverty, and at the same time must allow for the introduction of financial capabilities and awareness of the advantages of using savings and other financial services for their own benefit.
- In order to lower costs and make feasible the link with other policies, policymakers must use the technological and regulatory innovations, such as electronic dispersion and POS technology, as well as banking agents and mobile payment schemes to effectively reduce the cost of financial services and create products suited to the requirements, aspirations, and transaction costs for the beneficiaries of CCTs, for the financial service providers, and for the social programs themselves to allow for expansion and encourage these innovations.
- Finally, there must be careful research to offer proper financial products and savings mechanisms through financial intermediaries specially targeted to these people.

## **ANNEX A**

### **International Experience in Linking Savings to Conditional Cash Transfer Programs**

The policy of promoting savings by linking them to CCT programs is the subject of intense interest among different multilateral institutions, NGOs, governments, and private institutions due to the success of the CCT programs in alleviating poverty levels in many countries. CCT programs are particularly respected for developing over the years a sound and clear capacity to measure results.

The Ford Foundation recently developed with other organizations and federal governments in Latin America the “Project Capital” to deliver pilot projects for evaluating the prospective results of linking savings to CCT programs in six countries: Bolivia, Colombia, Chile, Dominican Republic, Ecuador, and Peru.

The results of this pilot project have been positive in many countries such as Colombia and Peru:

By 2007, Colombia’s expansive nationwide CCT Program, Familias en Acción, had reached more than 1.5 million households. Beginning in March 2009, payments were distributed through affiliated banks (Bancafé, Banco Popular, and Banagrario) in 700 municipalities. Although nearly 350 other municipalities have no formal banking presence, this new linkage between Familias payments and the formal banking system was a first step toward broader financial inclusion of the poor in Colombia. Program administrators could formally link debit cards to bank accounts, as well as incorporate a savings option into their new CCT distribution model.

Similarly, in 2003, Peru developed the Personal Capitalization Account (PCA) pilot to improve individual access of poor people, especially women, to deposit services in formal institutions and was promoted in small, financial education workshops in which participating women received intensive training in the management of their personal financial resources and money management in general. Results in PCA pilot projects in Peru are encouraging. One pilot revealed that 10,000 very poor rural women have accumulated more than \$2 million in just 2 to 3 years of savings.

## ANNEX B

### Proposed Characteristics for a Microsavings Product Linked to CCTs for the Poor

Here we propose some characteristics that might be suitable for such micro-savings products:

1. **Safe.** It must be guaranteed by the federal government and driven to the beneficiary.
2. **Formal financial product.** It must be issued through a formal financial service (regardless if it is a financial state-owned or financial private institution).
3. **Trust.** It must give people confidence and trust in the savings product.
4. **Profitable.** It must give recipients a certain guaranteed return (as a treasury bond)
5. **Optional.** People must have the option to save through this mechanism in a relatively easy way so as to deposit it at a fixed time and in relatively easy amounts.
6. **Flexible.** It must let them save in small increments. CETESDIRECTO can be held from \$100 pesos (less than US\$9).
7. **Convenient.** There must be access to purchase it and cash it back (until its redemption) from the location where people receive their payment electronically.
8. **Lasting.** People should have the option to save on a longer run basis if they wish so: 1 month, 3 months, 6 months or longer.
9. **Purpose.** It should be tagged by people to strengthen them to continue to be safe.
10. **Cumulative.** Micro-savings must let people add into their previous savings in a transparent way.
11. **Intuitive.** The procedures for managing savings must be very intuitive and as flexible as possible for users, just as depositing money from one account into another.
12. **Education.** It must be introduced through an educational campaign, which describes how to operate it and the underlying advantages that can be achieved.
13. **Empowerment.** The product must be introduced in such a way that provides them pride of saving for some purpose.
14. **Demonstrative effect.** It must provide a kind of model for other potential savers.



## ANNEX C

### Financial Literacy and Financial Capabilities: Recent Initiatives

- In recent years there has been an increasing interest in promoting financial education, financial literacy, and financial capabilities programs to improve from a demand side perspective the comprehension, attitudes and behavior of people towards financial products, services, and institutions.
- Given the rapid technological pace at which communications and financial transactions take place nowadays, and the increasing change in the conditions of financial markets, there is an increasing interest from a public policy perspective to have more informed, capable, and empowered citizens in financial products and services usage.
- There have been several international efforts to bring this topic for discussions and measurement from multilateral organizations such as OECD and the World Bank.
- Recently in Mexico, from the mid-2000s on, there have been increasing efforts to develop financial education programs from both public and private institutions, with different aims, different audiences, and different outcomes.
- Recently, the Federal Government decided to start a National Financial Education Strategy, building a National Education Committee composed of the main financial regulatory government organizations such as the Ministry of Finance, the Central Bank, the different National Financial Commissions (Banking & Securities, Insurance, Financial Consumer Defense, Pension funds) and the Banking Savings Fund Institute.
- Mexico is starting to set different national measurement indicators of financial capabilities and financial literacy.
- Financial capabilities is a rather new concept in the developing economies, that started at the UK in the beginning of the 2000s for measuring and improving public policies on the comprehension, attitudes, and behaviors towards personal finance from the individuals and families. This approach has demonstrated improvements in financial education programs and policies in countries such as UK, Australia, New Zealand, and the USA.
- Mexico is developing a first national measurement baseline for financial capabilities.

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## Endnotes

1. The author assumes the responsibility of the content of this publication, which might not necessarily reflect the position of any of the institutions mentioned or represented here.

2. Oportunidades CCTs Program sponsored by the Mexican Ministry of Social Development includes three different social and human development programs:

- Oportunidades brings direct transfers to women for the family income, scholarships for kids and youngsters (to keep them in school), and health care.
- Food Support Program provides money for a better diet, food supplements for babies (0–2 years old), etc.
- 70 & more offers support for elderly people living in rural locations (<= 30,000 inhabitants).

Each program includes technical assistance at health care clinics and at public schools.

3. DICONSA is a majority government-owned company that belongs to the Social Development Sector. Its purpose is to contribute in overcoming food poverty through the supply of basic and supplement products to rural localities with a high and very high deprivation, based on the community organization and participation. This government distribution network has more than 23,000 stores throughout Mexico, mainly at rural areas. The stores are owned by the community and operated through a "rural supply committee" formed by the most outstanding members of the community. In order to fulfill its purpose It also manages 300 rural and central warehouses. The DICONSA stores constitute the sole source of food & groceries supply in over 4,000 localities. Currently, 559,124 beneficiaries of the Oportunidades program receive the payment of such program transfers through DICONSA, which represent almost one billion pesos dispersed through 5,280 stores located throughout the country. Since 2008, following an alliance with the Banco Nacional de Servicios Financieros, Bansefi, and with the contribution of the Bill & Melinda Gates foundation DICONSA was incorporated to the new task of serving as a distribution channel for government grants and for the provision of financial services addressed to the low-income population at the most deprived regions of the country.

4. Telecom or Telecomunicaciones de México is the government-owned telegraph company. Through the 2008–2012 Telecom Institutional Program there were defined the basic strategies to promote the institution's restructuring turning it into a modern, flexible and innovative entity. As part of such restructure, the supply of basic

financial services was included among its duties. Currently, Telecom has 1,598 points of contact fully on-line connected that supply telegraph, communication and financial services, thus turning it into the main participant among Government Networks acting as banking agents. Six commercial banks and Bansefi have banking agent contracts with Telecom, allowing Telecom to provide basic financial services in behalf of them. The main services provided are deposits, withdrawals, payment of services, payment of loans, and balance inquiries.

5. The general procedure for delivering the CCTs for many years had been to deliver them up to the municipality head-town from each region, so on many occasions the beneficiaries had to spend on average as much as 4 hours and 20–25 percent or US\$5+ on transportation costs.

6. Head-towns or *cabeceras municipales*, formerly were the towns used as points of money dispersion without going further into the communities' locations.

7. Both DICONSA and Telecom recently signed contracts with Bansefi as banking agents under the CNBV/SHCP banking regulation.

8. Bansefi, Banco del Ahorro Nacional y Servicios Financieros, is the state-owned savings bank that has its own network of 492 branches in the lowest income municipalities of Mexico. It supports the development of a network of more than 400 associated popular financial providers as cajas and cooperatives, with 1,671 branches and more than 4,000 point-of-sale terminals at DICONSA stores.

9. SEDESOL-Oportunidades, *Los Programas de Transferencias Condicionadas en tiempos de Crisis – Bancarización. Experiencias en el Programa de Desarrollo Humano-Oportunidades*, presentation in Santiago, Chile, November 6, 2009.

10. After the successful pilots, the Mexican government, through the Ministry of Finance, made a series of commitments between the different government stakeholders to guarantee to the public an electronic dispersion mechanism for delivering these resources.

11. Oportunidades Conditional cash transfers are conditional because people have to periodically proof that their children are attending school, and beneficiaries and their children are attending medical check-ups, and vaccination campaigns for children as well as informative sessions on different aspects such as nutritional, prevention of diseases, etc., at Social Security Clinics.

12. The reduction in transaction costs can be proven in a reduction of the time of transportation from an average of 2.5 hours to 30 minutes, and the time for receiving the subsidy from an average of 5 hours, 9 minutes to 16 minutes; Oportunidades through the 2008 DICONSA pilot.

13. Bansefi, Bansefi-DAI, *Encuesta sobre preferencias y necesidades de usuarios de productos y servicios financieros del Sector de Ahorro y Crédito Popular*, Informe de Análisis de Resultados, September 2010.

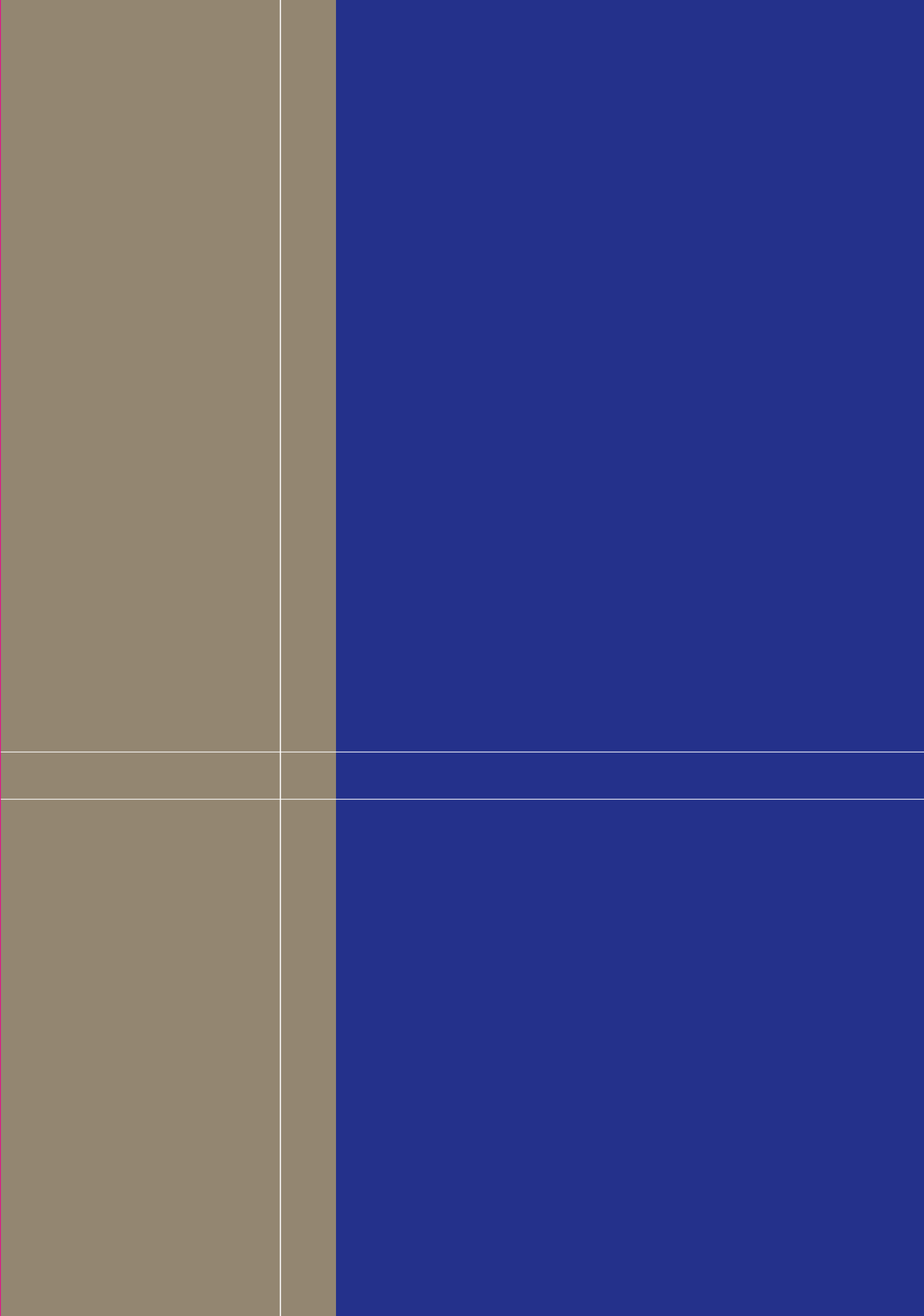
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15. Ibid.; Bansefi, 2010, pp. 18, 21.

16. Ibid., pp. 26, 27.

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