

THE FLETCHER SCHOOL

Leadership Program for
Financial Inclusion

Policy Memoranda

2014

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FOREWORD

A Vision for Financial Inclusion

Influential organizations such as the World Economic Forum, the G20, The World Bank, and agencies within the UN have made financial inclusion a centerpiece of their global agendas. Put forth by the Alliance for Financial Inclusion, the Maya Declaration established the first set of commitments by developing country governments to “unlock the economic and social potential of the 2.5 billion ‘unbanked’ people through greater financial inclusion.” More than 90 countries have supported the Declaration.

A vision of full financial inclusion—one in which all people can avail themselves of a range of useful and affordable financial products—calls on suppliers to meet demand by filling massive gaps in services. It encourages lawmakers and standard-setting bodies to create rules that foster the expansion of these services: savings, credit, transfer, payment, and insurance products, while minimizing risks that such products might pose. Foundations and governments, alongside private investors, are then motivated to disseminate these products to the farthest reaches of domestic and trans-border systems, where markets brim with low-income customers.

That’s the vision. But the actual picture is neither so orderly, nor so bright. Commercial actors, with notable exceptions, build proprietary infrastructure that only their customers can use and are happy to lock out competition and consumer choice at every turn. Many banks still do not view the poor as a viable market of consumers. Informal actors, for their part, are busy offering a range of products, some flexible and convenient, but others inflexible, expensive, and ill-suited to consumer needs.

From Vision to Reality

Who is tasked with crystallizing broad mandates into concrete and actionable rules? Importantly, it’s not elected officials or government appointees. Even if they have instituted the policy, elected officials come and go as the political pendulum swings to and fro. Rather, it is career public servants who embody the long tenures and professional skills necessary to transform sweeping policy ideas into detailed and achievable plans.

Transforming the vision into reality will require the energy and inventiveness of suppliers and the foresight, and often restraint, of regulators. In financial inclusion, regulators play a vital role. The regulator can pull one lever to stimulate innovation, another to drive expansion, and another to educate and protect the customer. Too strong a pull, and the regulator can crush a burgeoning new product or service. Too light a pull, and market forces can wreak havoc on the consumer. In neither case is consumer demand stimulated or served.

Even more vital than balanced regulation is regulation that can be thoroughly implemented. If policymakers create sweeping mandates with little chance of being put into action in meaningful and measureable ways, consumer needs are not met. Perhaps more systemically damaging, consumers may lose trust in policymaking as a vehicle for change, ousting government leaders or retreating into the shadows of potentially ill-suited informal practices.

Our central assumption is simple: good policies need trained champions to guide them to completion. Completion may be the full development of a policy idea to be adopted by multiple stakeholders, or it may be the articulation of strategies that can transform existing mandates into plans of action. The goal of the Fletcher Leadership Program for Financial Inclusion is to identify natural talent and bolster it with a pedagogy grounded in the twin factors of leadership: confidence and competence. We urge you to read, *Rule-Making for Financial Inclusion: from*

Policy Athlete to Policy Champion (pp. 1–6), to gain deeper insight into our program’s pedagogical approach and our results to-date.

Turning broad policy mandates into crisp recommendations is not easy. Yet, the policy memos that follow attempt to do just that. In the following pages, the Fletcher Leadership Program for Financial Inclusion Fellows of 2014 articulate their proposed policy solutions. In our mind, the ideal policy memo presents a clear problem diagnosis (tied to evidence from credible sources); presents clear policy options (and where possible tied to successful policies tried elsewhere); and a clear, persuasive set of implementable recommendations (tied to the problem and the policy options), sprinkled throughout with local wisdom.

Already, Fellows from our first two cohorts (2011 and 2013), have seen their policies implemented, leading to positive change in the lives of people and small businesses. We hope that is true for the policy ideas presented here, from the 2014 cohort of FLPMI Fellows.

We thank a dedicated team of advisors, who have helped to nurture the Fellowship from our own idea to reality. Deep gratitude to our Advisory Committee: Sacha Poverini, Program Officer at the Bill & Melinda Gates Foundation, Michael Tarazi, Senior Associate at CGAP, Ahmed Dermish, Director at Bankable Frontier Associates, and Simone Di Castri, Regulatory Director at the Mobile Money for the Unbanked (GSMA). Thanks to the Alliance for Financial Inclusion.

From execution of our residencies to publication of the following memos, the Fellowship benefited from the diligent work of a team of individuals; we wish to thank Jenny Aker, Yvonne Durbin, Emily Jane Kunz, Ellen McDonald, Benjamin Mazzotta, Jessica Meckler, and Melita Sawyer.

The Fletcher Leadership Program for Financial Inclusion is led by Kim Wilson, Nicholas Sullivan, C. Jamilah Welch, and Carolyn Hall McMahan.

Thank you to the Bill & Melinda Gates Foundation for their financial support and generous counsel.

Kim Wilson, Program Director
Nicholas Sullivan, Program Advisor

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RULE-MAKING FOR FINANCIAL INCLUSION: FROM POLICY ATHLETE TO POLICY CHAMPION

Kim Wilson & Nicholas Sullivan with C. Jamilah Welch & Carolyn Hall McMahon
The Fletcher School, Tufts University

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Our Journey

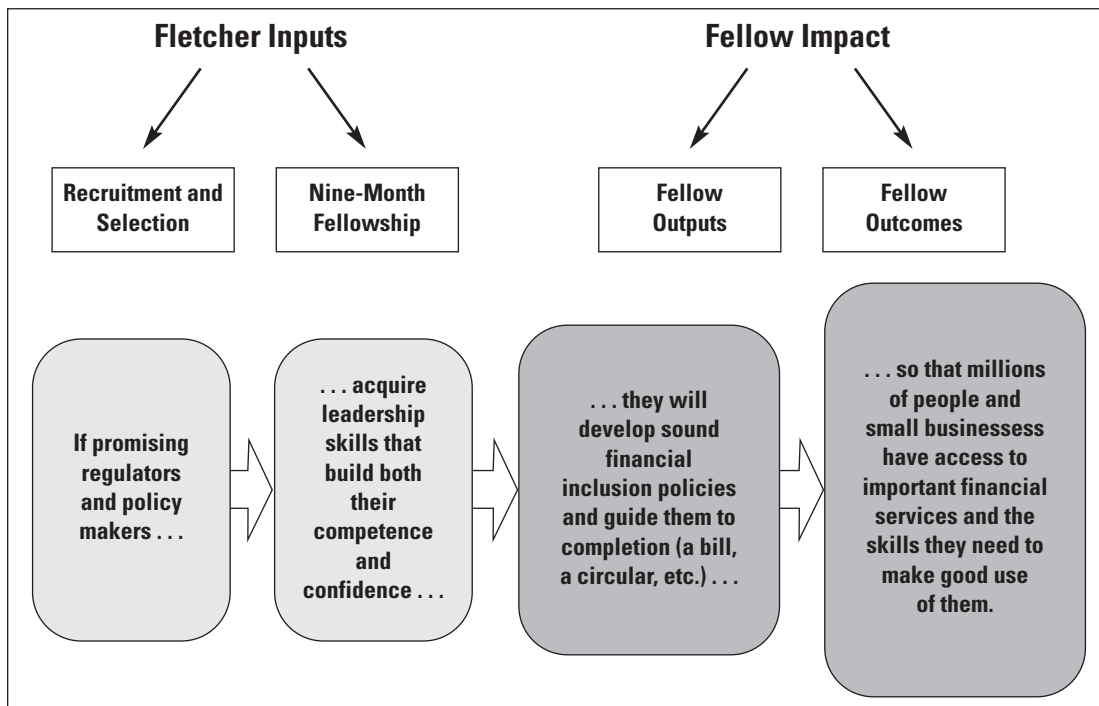
For many, a good idea marks the beginning of a policy journey; positive change in the lives of people marks that journey's end. Since 2011, we at The Fletcher Leadership Program for Financial Inclusion (FLPFI) have spirited the launch of many such journeys, and in the process, learned quite a bit from our Fellows, our Advisors, and their constituents about what a successful end can and will look like in the realm of financial inclusion. This paper documents our journey to-date with forty policy-makers and regulators from around the world, as they work to transform good ideas into actions that will change the lives of people, and ultimately, the state of financial services for the poor. It also documents our steps and missteps, and our first glimpses of a final destination.

In 2010, Ignacio Mas, then with the Bill & Melinda Gates Foundation (BMGF), and David Porteous of Bankable Frontier Associates (BFA) had identified a major gap: many talented regulators with whom they worked had good ideas and were committed to translating larger financial inclusion mandates into meaningful, practical plans of action. What these regulators lacked was the space to produce a strategic plan to convert their ideas into action and the professional skills necessary to “sell” these ideas to stakeholders. We at The Fletcher School at Tufts University had been teaching and conducting research in financial inclusion, but had not developed any practitioner-focused training. Ignacio and David hatched a plan, and thus was born a new Fellowship—the Fletcher Leadership Program in Financial Inclusion.

The Fellowship draws on years of sound academic study and practical field experience in Financial Inclusion. The Fletcher team, with counsel from BMGF and BFA, designed a residency program geared toward public servants. The program is a nine-month fellowship whose mission is to help promising individuals develop and drive sound policy in financial inclusion. Each year the fellowship matriculates 14–16 mid-career regulators from central banks, ministries of finance, and similar departments and agencies.

Our central assumption is simple: good policies need trained champions to guide them to completion. Completion may be the full development of a policy idea to be adopted by multiple stakeholders, or it may be the articulation of strategies that can transform existing mandates into plans of action. The goal of the fellowship is to identify natural talent and enhance it with a pedagogy grounded in the twin factors of leadership: confidence and competence.

Our Theory of Change



While many programs aim to provide technical assistance to policymakers, a few features differentiate FLPFI from other programs in financial inclusion:

- **We focus on competence and confidence.** Leaders need topical knowledge as well as the ability to galvanize support for their ideas. Fellows exit the Fletcher program with new information and practical skills in how to communicate their policy ideas and negotiate with diverse stakeholders.
- **Fellows, not faculty, generate key deliverables.** Most financial-inclusion programs use a variety of lectures, debates, and case studies as their modes of instruction and highlight their faculties. FLPFI does deploy these methods but takes them a step further. Our interactive sessions compel fellows to produce their own case-specific outputs.
- **The program offers a certificate** from a university known for its research, ties in international policy, and expertise in financial inclusion. As a Fletcher “Fellow,” participants are welcomed into a close-knit professional community.
- FLPFI is a nine-month program that **utilizes distance-learning technology** to facilitate assignments, online video instruction, and interaction and post-residency clinics.
- We place the policies our Fellows are developing at the center of the program throughout the entirety of the program. This **high-touch, specialized instruction** allows tailored, real-time learning for Fellows while they work.

Our Method

After admitting Fellows, Fletcher begins coursework with a series of videos and written guidance. We attempt to ground participants with a repertoire of useful tools, emphasizing the art and science of persuasion with a cluster of lectures and activities that comprise negotiation strategy, media management, public speaking and written argument.

The Fellowship is punctuated by two residencies—a two-week residency in April/May at The Fletcher School and a closing four-day residency at The Alliance for Financial Inclusion (AFI) Global Policy Forum in September. At Fletcher, Fellows marry a diagnosis of their current policy needs with expert lectures and clinics. Together with enhanced professional skills, Fellows generate thoughtful, self-authored outputs:

- **A Policy Gap Analysis.** Prior to the residency, Fellows work online with assigned faculty to identify a gap in financial inclusion, which can include a policy idea gap or an implementation gap. Upon arrival at Fletcher, Fellows test assumptions to refine their analyses.
- **A Policy Pitch.** Produced during the residency, the purpose of the four-minute oral policy pitch is both to hone a policy or implementation solution and to improve public speaking and persuasion skills. The residency uses a charette-style format, where Fellows refine concepts through rapid prototyping in small groups with constant iteration and redesign.
- **A Policy Memo.** Generated immediately after the residency and based on the policy pitch plus new research, the memo is a core document that provides the foundation for a new policy or better method of implementation. The most popular subject areas are financial literacy, consumer protection, consumer/SME access, and mobile-money regulation.
- **A Policy Roadmap.** Negotiation and implementation workshops help Fellows to develop a roadmap for change, as well as impact assessments. The Policy Roadmap is revisited during an optional summer clinic and reviewed at AFI's Global Policy Forum.

Many executive education programs cover topics in financial inclusion. None ask participants to produce meaningful outputs. And most are geared to wide-ranging audiences (a mix of academics, practitioners, and policymakers). While such forums are helpful in exposing participants to an array of ideas, they lack the depth and focus needed to address the specific needs of policymakers and policy implementers.

Though narrow in professional scope, the FLPMI cohort represents a wide diversity of country contexts and levels of experience. We have found that variations in seniority and regulatory context generate powerful peer-to-peer learning opportunities.

Where We Are Today

After nearly three cycles of FLPMI, we can begin to discern FLPMI's long-term impact on policy creation and implementation:

A SNAPSHOT OF RESULTS

Policy Achievements

- 13 new financial inclusion policies have been implemented.
- 4 policies are currently being deliberated (e.g., by congressional bodies) and approval is pending.

Professional Development Results

- 14 Fellows have taken on new leadership roles post-graduation.
- 13 have been positively cited by superiors for improved ability to enact change.

*Results reflect responses from 2011 and 2013 cohorts. n=18.

Discerning household-level impact on the consumers of financial services will require more time and study. Still, this strong initial showing invites promising opportunities to observe ramifications at both institutional and household levels. A series of case studies, seeking to answer the former, is currently underway.

What Motivates FLPMI Fellows?

From recruitment, to engendering a collaborative classroom setting, to maintaining ties throughout implementation, understanding the central motivators of FLPMI fellows and candidates is of fundamental importance. Extensive interviews with Fellows have taught us that four primary incentives help them maintain high levels of commitment.

- **Recognition by Superiors and Key Stakeholders.** A prerequisite of admission, all fellow policy priorities must be relevant to a Fellow's country context and have the support of institutional management. Having the Governor or Minister of Finance understand a fellow's work and approve it in advance of FLPMI acceptance is a powerful motivator for fellows to produce high-caliber work throughout their Fellowship. To encourage such recognition and to stimulate this positive feedback loop, Fletcher ensures that superiors receive printed copies of policy memoranda and an invitation to a closing ceremony where Fellows receive their certificates.
- **Opportunities for Career Advancement.** Fellows leverage the FLPMI Certificate and the Fletcher affiliation to describe their outputs to superiors, and the combination often results in a promotion. Some more junior Fellows may use it as a point of departure to discuss career advancement. For others already in line for a promotion, the achievement has hastened the long-awaited reward.
- **Satisfaction in Seeing Their Policies become Approved and Implemented.** Many Fellows are working on new policy ideas. Turning them into specific rules and guidance, while negotiating through a complex system of stakeholders, is no easy feat. Fellows have told us that observing their policies come to fruition is itself hugely satisfying. To catalyze such progress, FLPMI publishes their memos for individual distribution, which places an important seal of approval on their proposed policy and primes stakeholders with evidence and compelling justifications for cooperating toward a shared policy goal.
- **Opportunities to Present.** Fellows are often asked to speak at regional and international forums, opportunities that can bolster confidence and visibility. To boost public speaking confidence, we teach the art of persuasion and communications, and require each Fellow to present his or her policy idea to a panel of judges. This year, Ann Miles, (MasterCard Foundation) Daryl Collins (BFA), and Loretta Michaels (US Treasury and Fletcher CEME Fellow) served as judges, offering detailed commentary on each policy pitch.

The First Three Years: Key Takeaways

Six key lessons are driving changes we plan to make during the 2015 Fellowship.

- **Wisdom Trumps Evidence.** Collecting evidence is a trend in development circles, bordering on obsession. Evidence is clearly important, but we know that data can be chosen to support any argument. To illustrate this, all we need to do is try to reconcile the findings that microfinance seems to be a pretty okay thing in Mexico with findings that microfinance seems to be a pretty horrible thing in Mexico.¹ Both cases are boast lots of evidence, so which is it? "Pretty okay" or "pretty horrible?" Good policies depend on wisdom—the ability to interpret evidence and information, test assumptions, and finally shape an idea into a plan that will make a stark difference in the financial lives of the poor.

In many cases, policy is not the answer to an inclusion problem, even though it may be the knee-jerk impulse of a policy-maker. In others, a policy that works in one setting is disastrous in another. We have seen policies, influenced by Western thinking, that run roughshod over local wisdom. One need look no further than international and bilateral policies promoting microfinance in Nicaragua and Bosnia, and the damage they catalyzed, to see that the evidence at the time was inadequate and deeply biased.

Our Conclusion: To balance the presentation of evidence (often by scholars in academic journals and at times bordering on sophistry), FLPMI 1) includes experienced Fellows in its cohort and 2) teaches complex problem-solving skills. Our tested assumption and experience to date is that experienced Fellows can help mentor junior Fellows in applying reason and research to new ideas. Experienced Fellows offer important counterpoints to conventional wisdom and encourage deep reflection. Teaching problem solving methodologies allows Fellows to put their own wisdom to work on new challenges, tempering data-driven "conclusions" with systematic, holistic reasoning.

- **Crystallizing Policy Recommendations Is Challenging.** Despite being steeped in context expertise, turning broad policy mandates into crisp recommendations is challenging for Fellows. The ideal policy memo presents a clear problem diagnosis (tied to evidence from credible sources), clear policy options (where possible referencing successful policies tried elsewhere), and a clear, persuasive set of implementable recommendations, sprinkled throughout, with local wisdom.

Throughout the memo-writing process, about a third of our fellows find it extremely difficult to list options directly related to policy gaps, fail to cite evidence that justifies the options, are not infused with local wisdom, or fail to make recommendations that are concrete and actionable. They lack a well-defined, feasible implementation strategy with specific measurable outcomes.

Our Conclusion: As educators, we see these results as challenges. In the first two years, Fellows wrote a draft memo before arriving for the residency, but we found that Fellows were hesitant to later make major changes to their thinking. Last year, we asked only that they identify a policy gap, and wait until the residency to develop solutions. This approach yielded deeper thinking about the problem-side of the policy landscape. Going forward, we will tinker with this approach, in order to yield succinct, actionable recommendations.

- **The Implementation Gap Is Big—and Important.** As one Fellow said, “In my country, we have no shortage of great ideas, but a shortage of workable implementation plans.” Policy can create a regulatory space for creative problem-solving or it can tamp down good ideas. Worse, and more worrisome, is that poorly implemented policy can do great damage.

Perhaps one of the biggest policy experiments in financial inclusion is taking place in the United States. The Affordable Care Act (“Obamacare”) has a grand vision—to ensure every American has health insurance, as is the case in most developed countries. But the policy implementation has caused so much frustration and disenfranchisement of potential users that it has negatively affected President Obama’s popularity and perceptions of his policy. The vision is only as good as its implementation.

Our Conclusion: We plan to take policy implementation as seriously as the formulation of policy ideas. Our curriculum will address this head-on in 2015.

- **Rules Often Exist in Administrative Silos.** Financial inclusion has, and needs, multiple stakeholders. Insurance companies are teaming up with telecom operators to offer mobile health insurance, the two stakeholders supervised by different regulators. Telecom operators are teaming up with banks to offer mobile money, the two stakeholders supervised by different regulators. Banks in some instances can offer micro-investment products, with securities and banks reporting to different authorities.

Such combinations of services can be powerful. As a good example of a grand vision, the expansive and beautifully depicted plan for financial inclusion of the Reserve Bank of India² includes other regulators, such as SEBI (securities), PFRDA (pensions), IRDA (insurance) and more. These are the kinds of crosscutting endeavors we hope for, rarely see, and are so difficult to implement from the perspective of a single regulator.

Rule-makers and regulators inside relevant ministries and authorities face two challenges. First, they may lack a mandate from their supervisors to work with other stakeholders. Second, organizational cultures vary widely, each shaped by core strengths and internal logic systems shaped over decades. Despite the challenges, full financial inclusion requires cross-stakeholder policies.

Our Conclusion: We plan to include regulators from diverse stakeholders in 2015 so that Fellows have a chance to observe different organizational cultures at work in different contexts. We also plan to more intentionally workshop policy strategies that involve multiple stakeholders during the residency.

- **Balancing Precision and Flexibility in Rule-Making Is Crucial to Good Policy.** Fletcher faculty and guest lecturers present opposite points of view regarding the importance of clearly drawn, even detailed rules with the advantages of looser, more general guidance, that allows for local interpretation. We give Fellows ample room to find the right balance for their context. We have found some governments to encourage a very strict rules while others exercise a great deal of restraint and prefer very loose rules.

Our Conclusion. We have learned to allow Fellows to reflect the preferences of their own stakeholder context with the hope that Fellows will strike a good balance.

- **Fellows' Policy Ideas Are Often at Different Stages of Development.** Our Fellows hail from countries in the Middle East, Eastern Africa, Western Africa, Southern Africa, Central Asia, South Asia and the Pacific, Eastern Europe, and Central and South America. Beyond this diversity, which serves to enrich classroom discussion, Fellows are at different points in their careers as well as different stages in policy development. This latter point can be tricky. Often, Fellows are uncertain as to the maturity of their own concept and have difficulty communicating where they are in the policy formulation process. The more we know about where they stand, the more we can help to develop the policy idea.

Our Conclusion: To address this challenge, we will ask Fellows to identify the stage and type of policy idea they hope to develop by responding to a few statements in the application process:

Is your policy idea local, regional, national or global? Is the idea yours alone, or already being shaped by your institution? Are you addressing a new policy, or implementing an existing policy? Is it externally or internally focused? What is the general subject area of your idea?

First Glimpses of a Final Destination

We began this journey in 2011 with the hope of exposing Fellows to Fletcher's world-class multidisciplinary teaching method and international setting. Thanks to the guidance of BFA's David Porteous, and our donor team, first Ignacio Mas and Claire Alexandre, and now Jason Lamb and Sacha Polverini, at the Bill & Melinda Gates Foundation, along with our own experience coaching three cohorts, we have been able to develop more practical and specific approaches to executive education for policymakers.

Our advisory committee, which includes Sacha Polverini (BMGF), Michael Tarazi (CGAP), Ahmed Dermish (BFA), and Simone di Castri (GSMA), has deftly counseled on all matters from admissions to fellowship structure to country-specific needs. With their support, we are beginning to articulate a clear goal: a talented civil servant in possession of confidence and the right tools can transform himself or herself from policy athlete to policy champion—able to transform an important financial-inclusion idea into an operational reality. Already, our Fellows have seen their policies implemented and beginning to lead to positive change in the lives of people and small businesses. By continuing to imbue dedicated civil servants with the confidence and competence to act as financial inclusion champions, we intend to magnify the effects of our first three years of work.

Endnotes

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2. Nachiket Mor, et al., "Report of the Committee on Comprehensive Financial Services for Small Businesses and Low Income Households," 2014.

Insulating Households from Financial Shocks

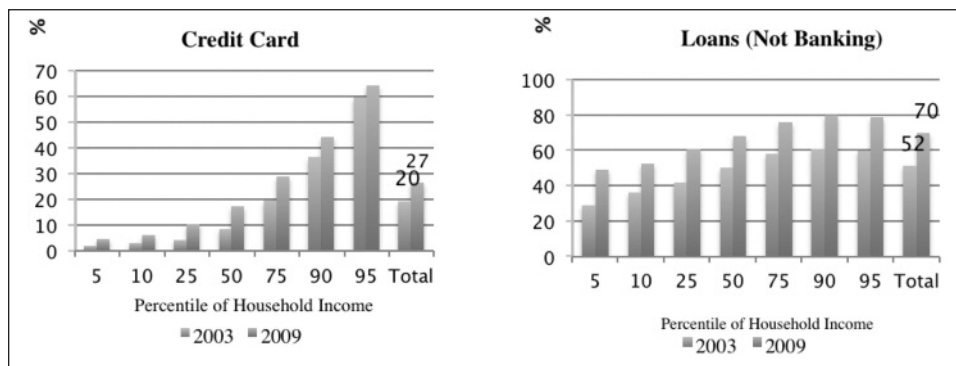
HAVE YOU EVER THOUGHT ABOUT SAVING MONEY BY WATCHING TV? USING SOAP OPERAS TO PROMOTE A SAVINGS CULTURE AMONG LOW-INCOME BRAZILIANS

Mary Cheng, Analyst, Financial Education Department, Central Bank of Brazil

The Problem

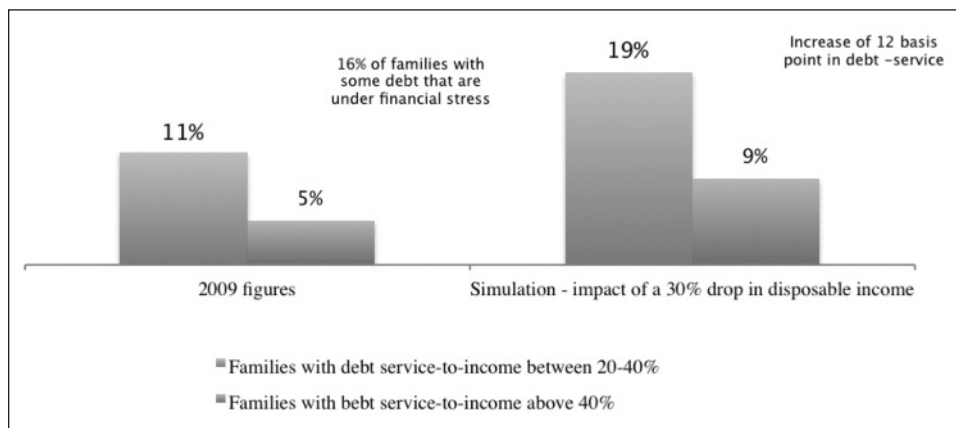
Easy access to credit for consumption, such as credit card and non-banking credit through retailers (Figure 1),¹ is leading to financial stress among middle-income Brazilians. This is the situation faced by Nailda.

Figure 1. Evolution of Credit Card and Loans (Not Banking) Penetration (2003–2009 Figures)



Source: IMF analysis based on POF survey

Figure 2. Debt-Service to Household Disposable Income



Source: IMF analysis based on POF survey

Nailda Santos do Nascimento,² 49, has a formal job as a janitor of a condo and, as a widow, receives a pension to support her three daughters in a São Paulo suburb. Like many Brazilians of the new middle class, with the recent economic upswing, Nailda and her family gained access to new products and services, such as home appliances and private education.

In 2013, her income was not enough to pay for her expenses, which were financed by five credit cards offered by banks and stores without her request. “I have never had a bad credit score because when I had any difficulty in paying I tried to renegotiate, but this time I think I will not succeed. I am depending on credit cards to live and I can’t get out of red,” she explains. Now, Nailda is facing difficulties to pay her R\$ 6,000 credit card debt—a sum three times higher than her monthly income.

IMF analysis reveals that Nailda is not alone: 16% of families are already facing financial stress, spending more than 20% of their income on servicing debt. According to Figure 2, that rate would rise to 28% in case of a 30% drop in income. This is a worrying scenario for low and moderate income populations because they are more affected by unemployment and usually do not have assets to pay-off debt.

Background Context

The unsustainable level of indebtedness of Brazilians—in particular, low-income populations—has roots on both the supply and demand sides.

On the supply side, the financial industry adopts market practices oriented toward short-term profit, such as offering products unsuitable for the customer’s needs or their financial capacity.

Although relevant to explain the indebtedness problem, it will not be discussed in this policy memo, as Central Bank of Brazil has already started the implementation of measures to address this issue.

On the demand side, Brazilians demonstrate a low level of financial literacy, as evidenced by results³ from the Brazilian Market Oversight Committee (Coremec)⁴ survey about financial education. Many Brazilians do not realize the amount of interest “hidden” in prices of products offered by retailers for payment in several installments “with no interest.” Likewise, many consumers are not aware of the process by which money can make more money through investment. This partially explains the reason why Brazil presents one of the lowest levels of savings (around 21%) in Latin America (Global Findex).

The survey reveals that financial woes are not limited to money management. Many low-income customers do not understand functionalities of financial products and services and are afraid of banks, as revealed by survey by the Ministry of Social Development (MDS, 2011). Both surveys concluded that Brazilians are confident about their own knowledge of financial services and their risks, which may suggest the reason why many customers do not seek information or formal advice.

In order to address the lack of financial literacy, the Federal Government formulated the Financial Education National Strategy (ENEF),⁵ aimed at promoting financial education and working in cooperation with representatives of Conef,⁶ which is responsible for plans, programs, and coordinating ENEF’s implementation. For adults, the strategy is to deliver money management content by conventional channels like face-to-face lecturers, through “training the trainers,” and distribution of online content; for children, the content is included in the school curriculum.

Other institutions, such as the Ministry of Social Development, are working in partnership with Central Bank of Brazil to develop a financial education project with beneficiaries of cash-granted programs.

Also, there are private players with commercial interests such as publishing companies and TV programs. Some banks also have financial education initiatives, but they play an ambiguous role because their goal is to sell financial products to consumers.

Policy Options

Option 1: Maintain Status Quo

Maintain the National Strategy of Financial Literacy. Financial literacy is key for sustainable financial inclusion of low-income population. However, the traditional model based on face-to-face and website training models are long-term impact projects, and evidence of their effectiveness is limited (Berg and Zia, 2013). Also, the current strategy success is highly dependent on the capacity to establish partnerships with institutions and monitor trainers who promote financial education to individuals.

Option 2: Launch a National Savings Campaign Focused on Low-Income Population, Using Mass Media

Promoting financial education by changing people’s attitude toward savings can indirectly change their attitude toward money management. Hence, the Central Bank of Brazil should promote a national savings campaign to encourage savings among Brazilians, with the use of mass media, to supplement the activities of the National Strategy of Financial Literacy.

A National Savings Campaign

The main message of the campaign should encourage people to establish a R\$ 1,000 (US\$ 452)⁶ emergency savings fund. With such an amount, one can solve a lot of small routine incidents, such as buying medicine or providing assistance to a son to fix his car—situations that have the potential to become critical and cause financial burden on a family’s budget.

Use an Entertainment Media

In order to increase the chances of success, the campaign should be associated with entertainment media. Besides having a broader outreach, TV shows (as one example) may be used to better communicate messages and influence behavior by establishing a powerful, emotional connection with their audience.

The use of mass media to deliver financial education messages is something new in financial education strategy, but there is some evidence of its effectiveness, according to a World Bank study (Berg and Zia, 2013).

One example is the South African soap opera *Scandal*, which introduced a storyline to positively affect the financial behavior of medium- to low-income population. According to one evaluation, significant improvements were observed in financial knowledge, namely a stronger affinity toward borrowing formally, moving away from hire purchase deals, and less gambling—messages that were conveyed in the soap opera storyline. A similar strategy has been successfully adopted by the financial industry. Standard Bank,⁷ one of South Africa's largest financial services group, effectively used a soap opera to promote basic savings to first-time account holders.

In Brazil, soap operas, which are quite popular among Brazilians across all social classes, already influenced a change in behavior that led to the drop in the fertility rate (La Ferrara, Chong, and Duryea, 2008).

These findings suggest that emotional connections and familiarity with media personalities actually play a role in motivating knowledge and behavior change among viewers and could be used to stimulate a savings behavior.

Policy Recommendation

Information alone is not enough to change behaviors and increase awareness. Advertisers demonstrated that by establishing emotional connections, one could capture buyers' interest. Policy makers effectively could use the same strategy with entertainment media.

Therefore, my recommendation is to promote a national savings campaign using soap operas as the main delivery channel. The idea is to suggest to TV Globo⁸ the introduction of social messages⁹ and characters in a soap opera through the argument of social merchandising, which is part of its social responsibility program.¹⁰ In such cases, TV Globo usually takes responsibility for the entire production, because it sees the opportunity as a means to attract viewers. Some TV Globo screenwriters are well-known for soap operas that have a high content of social themes in their plots, such as Manoel Carlos, with his concern with the elderly and organ donation, and Gloria Perez, who already discussed polemic issues such as human trafficking and drug abuse.

The suggested length of the project is at least three years in order to have a chance to evaluate its results. It includes the production of a soap opera with financial content focused on savings habits, the national savings campaign itself, savings options, consumption, and also debt management. Central Bank of Brazil could be a consultant for financial education content. In addition, a focus group should be established, with the support of experts of financial education and social communicators, to ensure that the financial messages were correctly understood and the audience could identify with the characters and their problems.

Evaluation should be conducted by Central Bank of Brazil with the support of a research team from an academic or international organization for further research and improvements of the project.

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Endnotes

1. In Brazil, it is a common practice that retailers offer the possibility to pay in many installments by credit card (retailer risk) or by credit line.
2. <http://economia.estadao.com.br/noticias/geral,metade-das-familias-de-classe-media-vive-enforcada,185185e>. Accessed on June 10, 2014 (in Portuguese).
3. The first phase was qualitative research, with eight focus groups including children, adults, and the elderly (over 60). The second phase was quantitative research with 1,809 persons between 20 and 70 years-old, divided in four social classes, with monthly income between R\$ 570 (US\$ 258) and R\$ 5,701 (US\$ 2,580), in six cities. 1US\$ = R\$ 2,21 as of June 23, 2014 (Source: Central Bank of Brazil).
4. This committee is composed of regulators of financial markets (banking and non-banking), insurance, securities, and pensions represented by the following institutions: Central Bank of Brasil, Susep (insurance oversight board), CVM (Brazilian Securities and Exchange Commission), and Previc (pension plans regulator).
5. <http://www.bcb.gov.br/?ENEFDOC> It is part of social and macroeconomic policies that contribute to mature Brazil's current development stage. It has been discussed since 2008, when government was planning actions to combat the effects of the global financial crisis, and was formalized in 2010.
6. Conef is composed of representatives of Coremec, four ministries (Education, Justice, Social Security, and Finance), and four representatives of civil society from market association.
6. 1US\$ = R\$ 2,21 as of June 23, 2014 (Source: Central Bank of Brazil).
7. Source: <http://sustainability.standardbank.com/socioeconomic/inclusive-financial-services-in-south-africa/>. Accessed on June 23, 2014.
8. The most important commercial TV station in Brazil.
9. Since 1984, TV Globo has included social messages in its soap operas. The innovative practice of social merchandising earned TV Globo the 2001 Business in the Community Awards for Excellence, the most prestigious social responsibility award in the world in the Global Leadership Award category.
10. http://redeglobo.globo.com/Portal/institucional/folderelectronico/ingles/g_rs_merchandising_social.html. Accessed on June 12, 2014.

POLICY REVIEW TO IMPROVE THE LEVEL OF REMITTANCES TO NIGERIA

Policy Gap Analysis

Fatima Abdullahi Jika, Bank Examiner, Central Bank of Nigeria

Introduction

Background

The rural poor in Nigeria face dwindling resources, irregular income, and inequitable distribution of income, contributing to high poverty in Nigeria. Presently, we surmise that part of this income comes in the form of foreign remittances. Because a substantial number of these transactions are untracked and unmapped, we lack data to monitor any resulting benefits. However, research in other net positive remittance countries indicates that remittances have grown as a percentage of GDP.

The Central Bank of Nigeria (CBN) reports approximately US \$2.26, \$2.66, and \$3.56 billion in remittances for 2004, 2005, and 2006, respectively (DFID, 2006). World Bank data show remittances to Nigeria totaled \$21 billion in 2013, making Nigeria one of largest recipients (after India's \$70 billion, China's \$60 billion, Philippines' \$25 billion, and Mexico's \$22 billion).

Remittances have a propensity to reduce the level, depth, and severity of poverty (Olowa, Awoyemi, & Shittu, 2013). According to Olowa et al., a 10% rise in foreign remittances reduced poverty incidence (PI), poverty gap (PG), and squared poverty gap (SPG) in rural Nigeria by 0.86%, 0.62% and 0.62%, respectively. Consequently, remittances can impact positively on foreign reserves accretion, contribute to balance of payment stabilization, boost national income, increase demands for goods and services, enhance entrepreneurial activities, and ultimately improve the standard of living by reducing poverty (Ratha, 2003).

Problem Statement

Despite the large flow of remittances in Nigeria, the high cost of international transfer precludes many rural poor from accessing these remittance services.

Evidence-Based Impact and Prospects

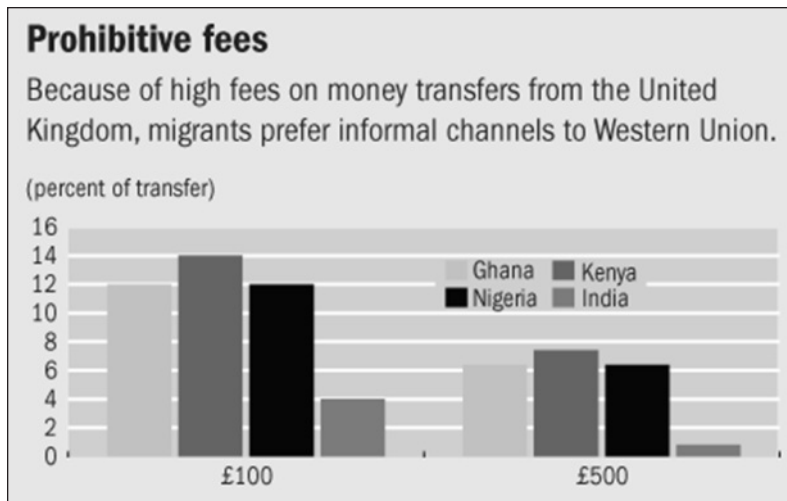
In "Lost in Intermediation," Kevin Watkins and Maria Quattri explained that Africans pay a "remittance super tax" in comparison to residents of other countries (Watkins & Quattri, 2014). Specifically, foreign remittance fees to African markets are double those paid in other international markets. Charges are as high as 10%–12% to send \$200 domestically and between 20% and 40% to transfer money outside the country. The Watkins and Quattri report further estimates that Africa losses between \$1.4 billion and \$2.3 billion annually as a result of high remittance charges, which has the attendant effect of reducing resources that could be utilized in improving education, health care, and promoting investment potentials.

Although at the 2009 G8 Summit, world leaders pledged to reduce the price of remittances to 5% in 5 years, this goal has yet to be realized. Globally, average remittance charges remain at about 7.8%. In Africa, charges are, as explained, far higher.

These exorbitant charges are even more troubling considering that cost-saving technology, such as mobile banking, should be able to reduce costs to senders and receivers.

Reasons for such high charges include imperfect information due to opaqueness on the part of suppliers, resulting from both a lack of the relevant commercial information needed to establish

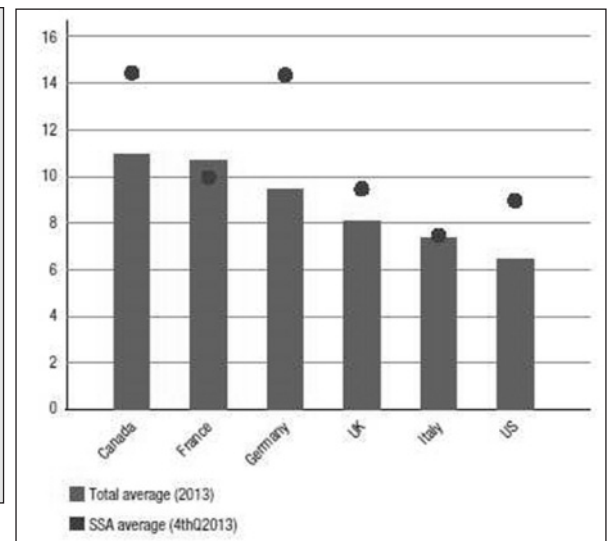
Figure 1.



Source: United Kingdom, Department for International Development (2006).

Note: Fees can change as a result of exchange rate changes, so the numbers should be interpreted as indicative rather than precise.

Figure 2.



Source: Remittance Prices Worldwide database of the World Bank.

detailed market structures, and from the fact that the range of available products are complex and, even with transparent disclosure, difficult to compare with respect to pricing. In Nigeria, several factors prevent the realization of these cost savings some of these factors include the market dominance of two major global money transfer companies, current financial regulation, and low levels of financial inclusion.

Factors Attributable to the High Cost Structure

1. An oligopoly of international money transfer operators (MTOs), namely Western Union and MoneyGram, account for two-thirds of African-bound remittance payments. Consequently, dominance by two players with little other competition means the region suffers from high prices and low efficiency.
2. Existence of “exclusivity clauses,” which restrict market participation among MTOs, banks, and other local payment agents that could stifle the market.
3. Poor regulation and high levels of financial exclusion, which restrict remittance payments primarily through banks as agents of MTO.

Figure 3. U.K. Outbound Payments by Western Union

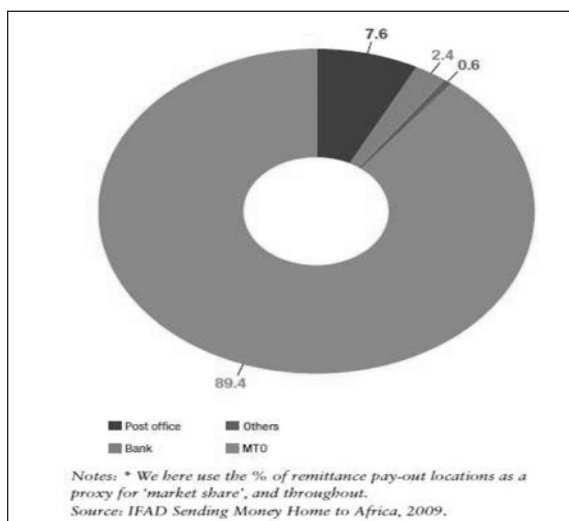


Figure 4. Average Percentage of Cost for Transferring \$200 by Type of Remittance Service Provider

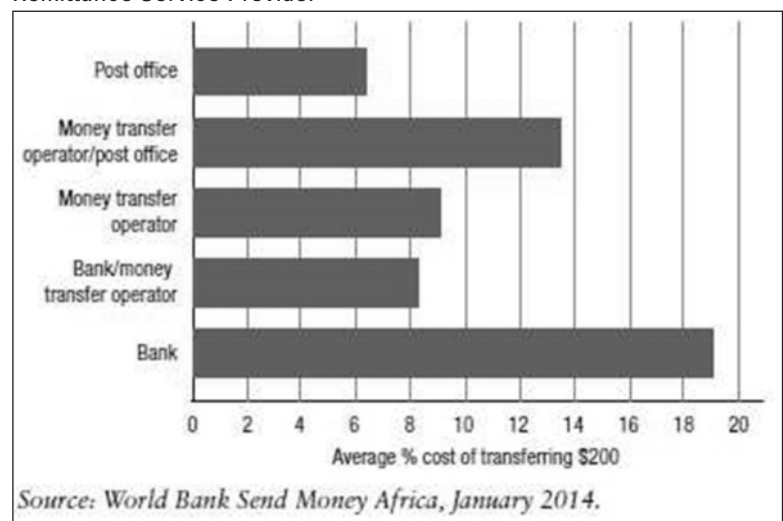
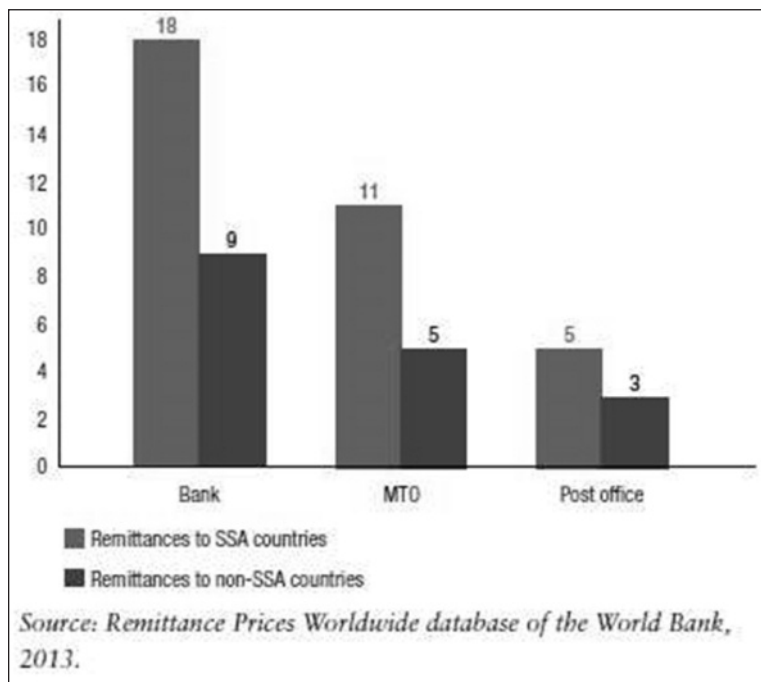


Figure 5. Africa’s Disadvantage: Percentage of Cost for Transferring \$200

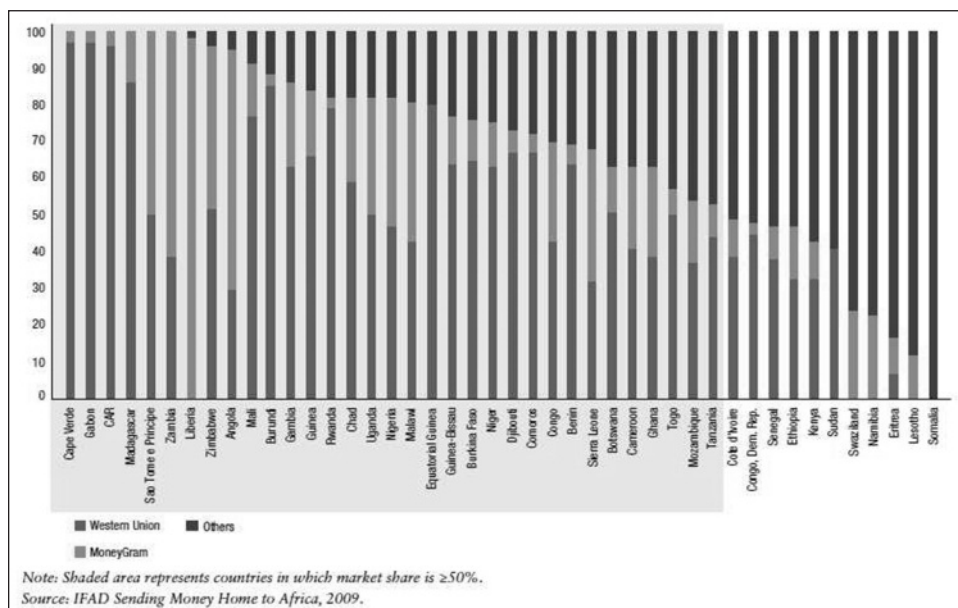


The Remittance Landscape and Cost Structure
MTOs in these markets are very powerful and can impose onerous terms on African banks. The nature of the transparency, regulatory compliance, foreign currency trade, agent fees, and other dealings are anti-competitive, which negatively affects the markets cost structure and prices.

The Nigerian Remittance Environment

In 2008, the Central Bank of Nigeria commissioned a survey to evaluate the challenges and prospects of remittances in Nigeria; the survey revealed that remittance flows were seasonal and that 79.5% of inflows were received through banks, while 20.5% were received through informal channels. The survey also revealed that the agency relationship between Western Union and deposit money banks (DMBs) represented 58.8% of all remittances; Money Gram was 18.0%, and Travelex, Vigo Coin-Star, and Money Exchange SA each accounted for 5.9%. The report also revealed that 55.7% of remitters reside in

Figure 6. Concentration of Market Power: Percentage of Pay-Out Locations by Company, Western Union and Moneygram



the USA, 19.7% in the UK, and 4.6% in Canada.

An analysis of receipts revealed that 36.1% of transactions involved \$200–\$500 while 27.3% involved \$100–\$150. Remittance fees are an important factor affecting amounts sent. Transfer costs involve both direct and indirect costs; the direct costs include transfer fees charged by the sending agent and the foreign currency conversion costs. Indirect costs are born by the recipient and include cost associated with traveling to the point of payment. Data concerning exact costs of remittances to Nigeria is varied; however, the average cost of remitting \$100–\$500 ranges between 10% and 12% of the total transaction, resulting in a “super tax” which is almost double the average world fee of 7.8%.

Table 1. Remittances as a Percentage of GDP

Year	2010	2011	2012	2013
Remittance (Naira)	2,942,551.34	3,144,383.44	3,207,076.94	3,241,781.15
GDP (Naira)	55,061,881.25	63,991,541.17	72,072,229.80	81,139,529.55
% Age	5.34	4.91	4.45	4.00

Access and Usage Relationship to GIS Mapping of Financial Touch Points in Nigeria

In 2013, the Bill & Melinda Gates Foundation in collaboration with Central Bank of Nigeria commissioned Brand Fusion Marketing Ltd. to identify the total number of financial touch points in Nigeria. Brand Fusion pinpointed a total of 16,536 financial touch points across the country. Significantly, bank branches constitute 38% and post offices 10% of all financial touch points paying out remittances, thereby excluding 52%.

It is worth noting that foreign remittances are concentrated in the 5,765 bank branches, which effectively excludes over 8,598 potential touch points.

Policy Recommendations

The CBN needs to pursue a focused policy on foreign inbound and outbound remittances, especially in light of the contribution of remittances to GDP. Such a policy would eliminate bottlenecks in the flow of remittances to rural Nigeria. The obstacles identified earlier in this memo, mainly access and cost, can be tackled to a large extent by increasing the number of payout points both at commercial banks and well beyond them. Payout points might include, for example, microfinance banks, the mobile network, and NIPOST (the Nigerian Postal Service) offices. Good regulation would permit and even encourage other players to enter the payments marketplace, resulting in access to convenient and affordable transfer services.

Existing policy restricts microfinance institutions (MFIs) and microfinance banks from transacting in foreign exchange services. Among other things, the CBN guidelines allow foreign remittance payment to be made in foreign currency, effectively precluding many other potential service providers from offering these services. However, the revised guidelines issued by the Trade and Exchange Department of the CBN in September 26, 2013 states that all “recipients of proceeds of international inward Money transfer via Western Union, Money Gram etc., shall henceforth be paid in Naira only.”¹ This policy allows the market to extend the provision of remittances through alternative means. Players such as licensed mobile money operators, agent banking (e.g., post offices, retail stores), and MFIs may now be enlisted to both deepen and broaden the market.

Regulatory Measures to Improve Remittances

The Central Bank of Nigeria must review anti-competitive terms and onerous contracts that artificially push prices beyond reasonable boundaries. Regulation that promotes a favorable remittance environment and protects customers is necessary to encourage remittances. Next to crude oil proceeds, remittances are the highest foreign exchange earner in the country. The review might recommend the following:

- Eliminate “exclusivity clauses” among MTOs, banks, and agents.
- Improve financial education and also create greater transparency cost and rates charged by service providers.
- Include non-bank institutions (small stores, supermarkets, etc.) as delivery channels.
- Amend regulatory policy to incorporate new financial touch points and such as microfinance banks, bureaux de change, and mobile money agents.
- Institute data capture at payout points to develop strategy that would improve national benefits of remittances.
- Develop appropriate incentives to encourage inflows (e.g., tax weavers).
- Similar to other countries, develop financial products that encourage savings through attractive returns saved inflows.

Conclusions

Expanding access to remittances has the potential of improving the lives of the rural poor in Nigeria. The Central Bank of Nigeria, as the principal regulatory of the financial sector, needs to develop policies that will upscale the benefit of current systems and promote the uptake of new

technologies. Market structures aimed at promoting competitive markets are a major cornerstone to integrating remittances as a strategy for national development.

Thus, the Central Bank of Nigeria needs to amend existing policy by eliminating existing clauses that restrict alternative payment outlets from transacting in foreign exchange and implementing the new regulation stated above that all remittance payments must be in naira. The prospects of incorporating other players into the market place would enable both local and international remittance transfers to become more accessible and affordable to the rural poor in Nigeria.

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Endnote

1. The naira is the currency of Nigeria.

HEATING UP THE LIVES: EXPLORING WAYS TO ACTIVATE “DEAD,” NO FRILLS ACCOUNTS IN BANGLADESH

Asif Iqbal, Deputy Director, Bangladesh Bank (Central Bank of Bangladesh)

Fewer than 4% of NFA holders in Bangladesh make regular transactions in their accounts—behavior that impedes financial inclusion. Before this behavior can be addressed, however, it must be better understood through an in-depth, demand-side survey.

Introduction

A “no frills account” (NFA)¹ is a fundamental and powerful tool to broaden and deepen financial access in any country. NFAs create a pathway for unbanked and underserved populations to avail financial services at an affordable cost.

Problem Statement

Most adult NFA holders in Bangladesh do not keep their accounts active.² In fact, inactivity begins immediately after opening an account. NFA holders visit banks to open accounts but rarely return to make deposits or withdrawals. This lack of account activity hinders financial inclusion, increases the per account maintenance cost incurred by banks, and weakens the banking deposit base.

NFAs in Bangladesh

In January 2010, Bank of Bangladesh (BB) instructed state-owned scheduled banks³ to open NFAs for farmers. Following that, BB gradually issued instructions for banks to open NFAs in the categories outlined in Table 1.

Table 1. Categories of NFAs in Bangladesh

Sl. No.	Category	Target Banks	Concerned Ministries	Year
1	Beneficiaries under National Service Program	State-owned banks	Ministry of Youth and Sports	2010
2	Beneficiaries under Employment for Pro-Poor Program	State-owned banks	Ministry of Food and Disaster Management	2010
3	Freedom Fighters	State-owned banks	Ministry of Freedom Fighters' Welfare	2011
4	Beneficiaries under Social Safety Net Program	State-owned banks	Ministry of Social Welfare	2011
5	Micro Insurance Policy Holders	State-owned banks	Ministry of Commerce	2011
6	Pro-Poor Women under Food and Livelihood Security (FLS) project	State-owned banks	Ministry of Women and Children Affairs	2012
7	Destitute people receiving allowance from Ministry of Religious Affairs	State-owned banks	Ministry of Religious Affairs	2013
8	Cleaning Staffs of Dhaka North and Dhaka South City Corporation	State-owned banks	Ministry of LGRD and Co-operatives	2013
9	Readymade Garments Workers	All banks		2013
10	Workers of Small Footwear & Leather Products' Industries	All banks	Ministry of Commerce	2013

Among the above categories, the BB voluntarily issued instructions for banks to open accounts for farmers and readymade garments workers. Instructions were issued for other categories at the request of concerned ministries.

Features of NFAs:

1. minimum opening deposit-BDT 10/50/100 (USD 0.13/0.65/1.30) and documentation,
2. no service charge and minimum balance maintenance,
3. simplified/exempted KYC,
4. usage of withdrawal voucher in case of non-availability of cheques,
5. introduced automatic deposit of government allowance/wage (except farmers, micro insurance policy holders, and readymade garments workers categories),
6. banks cannot render NFA accounts “dormant,” and
7. no uniform title/name for these accounts from the regulator (usually these are termed as “Tk. 10” accounts).

Recent Policy Initiatives:

- a. In December 2013, BB introduced agent banking as a new distribution channel for financial services which is expected to provide banking services even in remote areas where the establishment of bank branches is not feasible.
- b. In May 2014, BB created a revolving refinance fund for credit facility at affordable interest rate to lower income group who are NFA holders.

Updated Status:

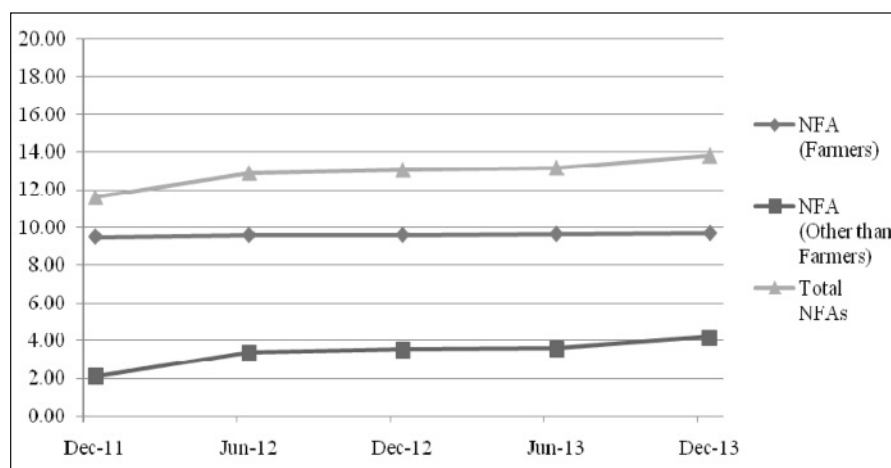
As on December 2013, the number of NFAs and their activation status are shown in Table 2.

Table 2. Activation Status of NFAs

	Number	Percentage
Total	13,845,134	
Regular transaction occurred (except government payment)	422,277	3.05%
Loan Disbursements	231,214	1.67%
Personal Savings	124,606	0.90%
Inward Foreign Remittance	1,385	0.01%
Inward Local Remittance	4,154	0.03%

The numbers demonstrate that the opening of NFAs has experienced a steady growth, as shown in Figure 1.

Figure 1. Growth of NFAs (in million)



Sources/Causes of the Problem

The underlying sources or causes of the policy problem have been viewed from three aspects:

- a. Accountholders:
 1. Because NFA holders are economically poor, they lack financial need or capacity to transact regularly. Moreover, visiting banks takes time and can affect their earnings.
 2. In rural and semi-urban areas, people of lower-income groups deposit their small savings in informal cooperative societies, unregulated (in some cases illegal) intermediaries and lightly regulated NGOs providing doorstep services.
 3. Low levels of education and of financial literacy accompany low levels of income. Often NFA holders are unaware of various banking services.
 4. Weak transportation and communication systems from the residences of NFA holders to bank branches makes accessing bank services difficult and costly.
 5. The conservative behavior of rural society hinders the movement of female NFA holders and makes access to their accounts difficult.
 6. Poor customer service quality discourages people from coming to banks.
- b. Banks:
 1. Banks lack a financial incentive to service NFAs. Although they earn interest, they do not earn a service charge. Therefore, because of the high cost of maintaining these accounts, banks do not put much effort in servicing them,
 2. State-owned banks open the NFAs. These banks suffer from perpetual staff problems.
 3. Because they lack logistic support and technology, these banks cannot provide quality service to the accountholders.
 4. Board and senior management of the banks do not prioritize NFAs in their operations, either for social or financial reasons.
- c. Regulators:
 1. There is no comprehensive policy for NFA opening and servicing by banks. Moreover, instructions for opening NFAs have been issued in an isolated manner and without having background research/study.
 2. Onsite and offsite monitoring have not been strong enough to track the progress of NFA usage.

Potential Solutions

1. A comprehensive Action Research should be conducted that will include a demand-side data survey (for detailed information directly about users of financial services, including users of NFAs) as well as a supply-side data surveys (for information about the banks). This research will help identify the financial needs and behaviors of users and the barriers they encounter while seeking formal financial services as well as geographical access, pricing of different services, and penetration or usage of services. Segmenting user information by socio-economic and demographic characteristics (e.g., degree of financial inclusion by income, occupation, age, or gender groups) will be particularly helpful in understanding which kinds of users might benefit most from different channel or product features.
2. A comprehensive guideline on NFA can be formulated using survey information. This guideline will not only identify the appropriate markets for NFAs but can also offer guidance on developing cost-effective (for both customers and banks) and appropriate products.

Probable Outcomes

A set of probable outcomes from the proposed action research are listed below:

1. BB may advise the banks to cluster their accountholders by region. They can provide banking services weekly/fortnightly/monthly in clustered regions. It will reduce the operating cost of banks on one side and make banking convenient for depositors on other side.
2. BB may advise the board and management of these banks to prioritize NFAs into their business strategy and pursue necessary steps.
3. BB may recommend the government for capacity building of state owned banks.
4. BB may incentivize banks by allowing the “forgone income” for operating NFAs as their CSR expenditure.
5. Recently introduced agent banking should be implemented effectively and efficiently.
6. BB may initiate a countrywide financial education campaign.
7. In formulating NFA guidelines, women should receive special attention because they have better inclination for “savings” than men.
8. Onsite and offsite monitoring of BB for NFAs should be strengthened.
9. NFAs may be considered in regulatory evaluation of banks’ performance, such as the CAMELS rating.⁴
10. BB should strongly monitor the usage of the newly created refinance window.

Recommendations and Conclusions

Bringing the unbanked into banks is only the first step toward financial inclusion. The key challenge is to retain them and to get them using various banking services. Active continuation of NFAs is a key policy priority. In this respect, understanding the demographic features of the unbanked and their financial needs is an important element to advance this priority. Banks should be provided with proper policy support as refinance support is temporary and it may induce inflationary pressure in monetary management. Therefore, conducting action research will ensure the eventual comprehensive policy is effective and results in financial and social stability.

Endnotes

1. “No frills accounts” (NFAs) are the basic savings accounts which require minimum opening deposit, low/no minimum balance maintenance, low/no service charge, simplified know your customer (KYC) profile.

2. NFAs in Bangladesh can be divided with respect to age: minor and adult. This policy memo focuses only on NFAs of adults.

3. Banks in Bangladesh, which are permitted by BB to conduct all types of commercial banking activities, are termed “scheduled banks.” There are three types of banks based on ownership pattern: state owned, domestic private owned, and foreign owned. There are 56 banks: 8 state owned, 39 private owned, and 9 foreign owned. Among them, 9 have been licensed in 2013. In fact, the foreign owned are the branches of foreign banks. State-owned banks are two types: commercial and specialized or development (agricultural and industrial development).

4. The CAMELS rating is a supervisory rating system originally developed in the United States to classify a bank’s overall condition.

BRINGING INSURANCE PRODUCTS INTO THE FINANCIAL INCLUSION STRATEGY

Felipe Lega, Deputy Director for Market Integrity, Financial Regulation Agency, Colombia

Problem Statement

Colombia's low-income population struggles during financial shocks, such as a major disease or a death of one of the members of the household.

Currently, households cope using a range of strategies that could actually worsen their situation in the long-run. For example, the Quality of Life Survey of 2003 shows that more than 20% of low-income households decreased their spending on food and clothing to cover costs generated by situations such as unemployment of the head of the household.¹ Households also use other strategies such as borrowing in the form of informal loans.

Potential Solutions

The first solution usually raised is increased personal savings. Colombia has implemented several successful initiatives aimed at increased access to financial products. In fact, according to Asobancaria,² the bancarization indicator increased from 51.1% in 2006 to 71.5% in 2013.³ This progress is mainly due to personal savings products: out of the 22.6 million persons with at least one financial product, 20.8 million have a savings account.

Another solution is insurance products. Usage of other financial products, such as insurance products, is still very low, and it is even lower within the poorest of the population. According to Fasesolda,⁴ microinsurance makes up only 1% of the total insurance market. This statistic shows that the low-income population is not taking advantage of the benefits of insurance products. The Quality of Life Survey shows that about 25% of the lowest income households had at least one member who suffered from a serious disease, while higher-income households suffered from this calamity to a lesser extent. And this vulnerability is not generated by health problems alone: low-income populations are exposed to many other risks, including those due to economic crises, natural disasters, etc., which affect them more severely.

Insurance products can be presented to the poorest households as a cost-effective alternative to protect them from the above-mentioned risks. These products can be designed to cover the needs of the population, helping them to avoid falling into risky solutions, to cope with financial shocks, and thereby to break the cycle of poverty perpetuation.

However, in order to achieve a higher usage of insurance products, it is necessary to remove the barriers preventing their widespread use by low-income populations. This low usage is due not only the cost of the premium but also to a lack of awareness by the target population and an insufficient supply of products designed for low-income households.

Policy Recommendation

I propose a three-stage solution to increase the penetration of insurance products: enhance the regulatory framework, improve product design and training, and ensure consumer protection.

Regulatory Framework

Insurance products are complex, and this is a barrier given the low financial literacy of the target population.

Decree 457 of February 28, 2014 created a new commission to develop and implement a national strategy of financial literacy. The commission met on April 2014 and established working groups to focus on specific target populations, one of them being the poorest population. Although this will contribute to improved financial literacy, existing insurance products can still be too complex.

Therefore, it is also necessary to work on establishing a regulatory framework for “simple insurance products.” This framework will be developed under a decree issued by the Ministry of Finance,⁵ including a new chapter on Decree 2555 of 2010. It will include minimum requirements for insurance products in order to be considered “simple” (e.g., limitations on the exclusions of the policies). These requirements can be collected into a model policy that will serve as a guideline for insurance companies,⁶ thereby creating the regulatory option for more comprehensible insurance products.

However, it is also necessary to effectively reach the target population. Low-income households are located not only in main cities but also in the farthest municipalities. And it is very expensive for insurance companies to increase their direct presence in these locations. Drawing upon prior experiences with banks, increased access could be achieved through correspondents. In the bank example, today only two out of more than 1100 municipalities in Colombia have no bank presence via branches or banking correspondents.

The possibility of using correspondents for financial institutions is also part of Decree 2555 and, currently, it is allowed for banks, brokerage firms, pension funds, and trust funds. During 2013, more than 90 million transactions were made through correspondents, mainly payments, withdrawals and deposits.

The modification of Decree 2555 should include an authorization for insurance companies to distribute policies through correspondents. However, as with other financial institutions, this authorization is limited to some products and, in the case of insurance companies, will be only for the products that meet the minimum requirements to be considered “simple.”

The authorization should also allow for the collection of premiums and the payments of claims. This change will facilitate the commercial relationship with the clients and will remove another likely barrier, namely, ease of access.

Product Design and Training

It is important to understand the needs of the target population. Some risks affect the poorest households more often. According to a survey undertaken by Fasesolda in 2008, unemployment, illness, and death of a relative or household member occur with a higher frequency in the lowest strata. And, as mentioned before, in the absence of insurance, these risks can significantly affect the income even as expenses increase.

Thus, insurance companies must engage in a process of designing new policies that meet the minimum requirements to be considered “simple products” and to cover the risks that most often affect the target population.

In addition, the program should be designed to address concerns that premiums are still out of reach for the target population. Insurance companies should consider the option of collective

policies, which would enable lower premiums due to risk-pooling. Also, insurance companies could include existing cooperatives or associations into the process to offer collective policies.

Although, as discussed above, correspondents would only be able to distribute “simple products,” insurance companies must prepare their correspondents on the basics of the products they are distributing. This process will serve a double purpose: consumer protection is conserved because they can address client inquiries and advise them properly; and second, the existing linkage of correspondents with their communities will remove the barrier of lack of confidence in insurance companies because the commercial relationship would occur now in a more personal way.

Insurance companies have shown a lot of interest in using correspondents. Moreover, insurance companies should not have difficulties finding correspondents to represent them. They should be able approach the existing network of correspondents to implement this program. It is important to mention that correspondents are not exclusive to one particular institution.

Consumer Protection

The final stage is consumer protection. Previous sections highlighted some consumer protections, including the definition of “simple products” and the training of correspondents. However, other consumer problems may still arise, and the Superintendency of Finance should be prepared.

Colombia has made great progress on consumer protection. Law 1328 of 2009 established the financial consumer protection regime, including the creation of a new role within every financial institution (including insurance companies) called the “consumer protection defender.” This person is the first line of defense for financial consumers.

The experience from other financial services has shown that using correspondents does not harm consumers; instead, consumers benefit from increased access to financial products and simplified procedures. However, products offered through correspondents must be simple to ensure consumer protection. If a complex product is distributed by a correspondent, he/she may not have sufficient knowledge to explain the risks and benefits of the product to the client. This premise applies equally to insurance products.

To summarize, changes can be made to the regulatory framework (include a framework for “simple” insurance products that allows correspondents to distribute policies and collect premiums) to remove barriers preventing the low-income population from accessing insurance products. Then, these products will help households to avoid falling into dangerous solutions when faced with unexpected events, thereby breaking the cycle of poverty perpetuation.

Endnotes

1. Quality of Life Survey 2003. In Spanish at <http://www.dane.gov.co/index.php/es/estadisticas-sociales/calidad-de-vida-ecv/87-sociales/calidad-de-vida/3884-encuesta-de-calidad-de-vida-2003>

2. Asobancaria is the association of banking and credit Institutions in Colombia. Financial Inclusion Quarterly Report. December 2013. In Spanish at <http://www.asobancaria.com/portal/pls/portal/docs/1/4070047.PDF>

3. The bancarization indicator is measured as the number of adults with at least one financial product, as a percentage of the total adult population.

4. Fasesolda, the Federation of Colombian Insurers, is the Colombian Association of Insurance Companies. Data extracted from the Microinsurance: General Figures Report October 2013. https://www.allianz.com/v_1381221496000/media/responsibility/documents/microinsurance_business_update_2013.pdf

5. Every decree modifying Decree 2555 of 2010 is prepared by the Financial Regulation Agency and presented to the Ministry of Finance for its issuance. This decree contains the regulatory framework for the entire financial system.

6. A decree establishes the general framework and any instructions are included on a Circular issued by the Superintendency.

**Expanding the Reach of Services:
Mobile Solutions and Agent Networks**

BRANCHLESS BANKING AS A FINANCIAL INCLUSION STRATEGY IN GHANA: IMPLEMENTATION CHALLENGES AND THE WAY FORWARD

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With the exception of the policy documents quoted and cited in this memo, the views expressed are those of the author and not of the Bank of Ghana.

Background to the Problem

In 2008, the Bank of Ghana issued Branchless Banking Guidelines that allowed for a bank-based model of branchless banking using nonbank retail agents. The business model differs from similar plans in other countries because it prohibits exclusive partnerships and only permits a many-to-many model. The reasoning was that “this model offers maximum connectivity and hence maximum outreach and is closer to the desired situation where all banks and all telecommunication companies should be able to entertain each other’s customers.”¹ As a result, the Mobile Network Operators (MNOs) with branchless banking services have signed up at least three partner banks.

Problem Statement

The premise behind Ghana’s regulatory framework for mobile money is that mobile money is a banking service and must be led by banks. The current regulation dictates that only Bank of Ghana-supervised entities can offer financial services. This directive is justified from a consumer-protection angle: allowing mobile money accounts to sit solely with an MNO translates into consumers having contractual agreements with institutions with no regulatory oversight by the Central Bank.

However, unlike the success stories in Kenya, Pakistan, and the Philippines, the situation in Ghana is different. Although mobile phones are widely used in Ghana, consumer uptake of associated financial services is very low. Therefore, mobile phones have not impacted financial inclusion.

Background

A study by CGAP points to the fact that there is a low uptake. According to CGAP, the Guidelines have unintentionally distorted incentives for providers and do not match conditions on the ground.² Banks by and large decline to play the roles envisaged by the regulators (holding the float in a pooled account, responsibility for agents and know your customer (KYC) practices, providing support to agents in liquidity management, etc.). However, there is little incentive for banks to make any significant investments due to free rider concerns. In some ways, the Guidelines had the opposite effect as intended: the more banks there are in each partnership, the lower the motivation to invest, and ultimately service to customers suffers. Clients were also not incentivized enough due to non-interest payments on electronic values.

Many-to-Many Model

Under the “many-to-many” model, banks and Telecom operators are expected to work together to offer mobile banking services to the public with central processing of transactions through the Ghana Interbank Payment and Settlement System (GhIPSS) which will:

1. settle all transactions on a real-time basis or through a regulated clearing arrangement,
2. store all proofs of transactions, and
3. provide a day-end reconciliation to all member financial institutions.

In this regard, all bank switches, ATMS, Points of Sale (POS), card, or mobile phone payment products issued or deployed by banks and deposit-taking financial institutions must be interfaced through the national switch.

To date, three telecommunication companies (MTN, Airtel, and Tigo) and two other providers (Africxpress and eTransact) in conjunction with a consortium of twelve banks provide mobile money services in Ghana. The rationale is to offer mobile phone users the opportunity to access banking services without necessarily maintaining bank accounts. The product is earmarked for individuals who own mobile phones. The mobile money service involves the use of mobile phones to effect transactions such as purchase of airtime or phone units, money transfers, and utility bill payments, among other services.

Evidence and Analysis

Ghana is one of the world's fastest growing economies and should be a ripe market for mobile money for the following reasons:

- Less than 20% of the Ghanaian population is banked.
- About 70% of the Ghanaian population uses mobile phones.
- There are fewer KYC requirements for mobile money compared to traditional bank account requirements.
- Mobile phones provide a fast, efficient, convenient, and secure medium for transactions.
- Branchless banking means quick and easy access to money any time and everywhere.
- Payment options are numerous.
- Deposit mobilization means are created for banks.
- The mobile money service creates penetration into inaccessible locations where traditional banking services are virtually non-existent.
- The mobile money service aids the country's quest to become a cashless society.³

However, evidence from the ground suggests that the impact of branchless banking in Ghana has been limited. The table below shows the trend of the volumes and value from 2011 to 2013.

The table shows that there has not been any significant appreciation in terms of volumes and values of the mobile money services since its inception in 2010, and a study by CGAP suggested the following possible reasons for the limited uptake:

- Regulatory rigidity with the many-to-many model⁴
- Lack of clarity around roles and responsibilities of the banks and the mobile network operators and other providers⁵
- Low transaction limits on value of transactions. The user must either be

Items	Dec-13	Dec-12	Dec-11
Number of Agents	18,255.00	18,081.00	18,281.00
Registered Clients	4,674,550.00	4,601,630.00	4,558,759.00
	(GHS)	(GHS)	(GHS)
Float Held	67,044,803.91	56,564,002.58	32,445,529.94
Transfer from Bank Account to M-Wallet	14,096,431.02	12,457,947.14	8,776,758.53
Transfer from M-Wallet to Account Bank	13,735,034.04	5,095,412.83	4,690,348.39
Person to Business	20,700,611.76	41,614,216.88	38,145,985.80
Business to Person	2,465,779.88	45,088,050.34	31,111,920.89
From M-Wallet to M-Wallet	1,277,871.37	35,464,843.47	23,835,079.27
Transfer from Person to Person (Non M-Wallet Holders)	59,819,341.80	29,070,673.10	2,585,725.48
Cash Out	58,740,984.74	31,890,463.19	24,401,550.17
Cash In	57,272,942.78	45,001,669.32	26,757,704.20
Airtime Purchase	19,299,870.72	35,085,288.36	18,438,744.77
Bills Payment	19,249,310.13	17,201,411.31	16,628,701.41

Source: Bank of Ghana

an account holder or must purchase e-money from a financial institution or registered agent which operates a bank account for the purpose of loading e-money. In the case of non-bank account holders or users who have not undergone the rigid KYC requirements, the limit of e-money to be purchased per transaction is GH¢ 50 and a maximum of GH¢ 200 a day⁶

- Banks not stepping up their involvement/support for the product/service⁷
- Partnership challenges due to varying interests of various partners
- Inadequate incomes from the float compared to incomes from the banks' core banking operations, so banks lack motivation to deploy resources or extend the services
- Mobile Network Operators and the other operators have assumed responsibilities which the model assigns to financial institutions (liquidity needs of the agents, acquisition and training of agents, marketing and innovations)⁸
- Lack of public awareness on the benefits of the mobile financial services.

The CGAP report indicated that MNOs and the other providers have by and large been more instrumental in the provision of mobile money services. They are developing the technology platform and front-end products, building the agent networks, and investing in marketing. In effect, they shoulder the vast majority of investment in place of banks.

Finally, the CGAP report noted that the MNOs and the other providers have no direct reporting relationship to the Bank of Ghana and may only approach the Bank of Ghana through indirect channels (partner banks)—which slows down the process for the MNOs and leaves the Bank of Ghana out of touch with the real actors.

Recommendations

The Bank of Ghana recognizes the discrepancy between its original vision and real market developments. The preliminary work of this memo was done after an engagement with the entire range of market players (including MNOs). The private sector in Ghana responded very positively to these overtures and the prospects of a more flexible regulatory environment.

In view of the above, the following policy recommendations are proposed:

1. Amend the current guidelines to ensure that electronic money is provided by financial institutions regulated under the Banking Act as well as duly licensed nonbank entities which are engaged solely in the business of e-money and activities related or incidental to the business of e-money and which are regulated and supervised by the Bank
2. Make adequate provision in the amended guidelines to ensure that that customers of e-money issuers benefit from adequate transparency, fair treatment, and effective recourse. This is to address the problem of consumer protection
3. The agent network is an essential ingredient to the success of the e-money issuing and serves as channel for delivery of financial services. It is therefore proposed that Agent Guidelines be issued as part of Bank of Ghana's broader strategy to create an enabling regulatory environment for convenient, efficient, and safe retail payment and fund transfer mechanisms. The Agent Guideline will promote the use of agents as a channel for delivery of financial services and specify necessary safeguards and controls to mitigate the associated risks and ensure consumer protection safeguards.
4. Ensure exclusivity of agents for a minimum period of three years to enable institutions who initially invested in the agents to recoup their investments.
5. Tiered KYC requirements and tiered transaction limits for individuals, corporations, and government would serve as incentives to clients.
6. Convert all pooled accounts to trust accounts managed by competent trustees for protection of clients, and set a threshold beyond which the excess float should be transferred to other banks to minimize the risk posed to clients

These proposals when implemented should provide enough incentives for all stakeholders in the mobile money space to work toward financial inclusiveness. Coupled with effective monitoring and supervision by the Bank of Ghana, these amendments should lead to increased uptake of mobile financial services.

Resources

Guidelines for Branchless Banking, Bank of Ghana Notice No. BG/GOV/SEC/2008/21

Bank of Ghana Licensing Guidelines for Setting up Payment Services Infrastructure for Branchless Banking, 2008

Ghana's Payment System Scheme Act, 2003 (Act 662)

Mobile Banking, Financial Inclusion and Policy Challenges, Presentation to the 10th IADI (International Agri-Professional Development Institute) Annual Conference, 19 to 20 October, 2011 at Warsaw, Poland, by Pierre-Laurent Chatain

Regulating Transformational Branchless Banking: Mobile Phones and Other Technology to Increase Access to Finance, CGAP Focus Note 43. January 2008

CGAP – Technology Programme Note: Ghana, 2011

Unintentional Consequences, Branchless Banking in Ghana – CGAP, January 2013

Putting the Banking in Branchless Banking: Regulation and the Case for Interest-Bearing and Insured E-Money Savings Accounts (by Tilman Ehrbeck and Michael Tarazi, in "The World Economic Forum 2011 Mobile Financial Services Development" Report)

Endnotes

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4. Guidelines for Branchless Banking, Bank of Ghana Notice No. BG/GOV/SEC/2008/21
5. Unintentional Consequences, Branchless Banking in Ghana – CGAP
6. Bank of Ghana Licensing Guidelines for Setting up Payment Services Infrastructure for Branchless Banking
7. CGAP – Technology Programme Note: Ghana, 2011
8. Unintentional Consequences, Branchless Banking in Ghana – CGAP

EXPANDING BUSINESS OPPORTUNITY FOR DIGITAL FINANCIAL SERVICES AGENTS THROUGH RELAXING THE REGULATION

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Problem Statement

Access to Indonesia's financial system is relatively low compared to other countries in the region. Based on 2011 World Bank data, only 19.6% of people older than 15 had accounts in formal institutions, compared to 26.8% in the East Asia Pacific Region. There are only 8.5 bank branches per 100,000 adults in Indonesia, compared to 10.7 in the region.

Only 3.1% of people older than 15 use electronic payments. According to the latest Bank Indonesia (BI) statistics, in 2013 daily payment transaction averages roughly Rp500 trillion (USD 42 billion). Most transactions involve Bank Indonesia Real Time Gross Settlement (BI-RTGS) and only about 2% involve card instruments or electronic money. Daily electronic money transactions in 2013 average Rp8 billion (USD 700 thousands)—a very low amount compared to other payment instruments.

Currently, only the four biggest banks can offer cooperation with individual digital financial services agents (compared to nine banks permitted to act as electronic money operators) out of 120 total banks in Indonesia. A smaller number of participating banks will limit the choices of individual digital financial services agents to have better business arrangements especially concerning fee sharing. On the other hand, competition will not greatly increase if only four banks participate in this scheme.

Background

Indonesia has more than 250 million people living in more than 17,000 islands. The Indonesian economy grew 5.78% in 2013 (BPS, 2014). It is estimated that Indonesia has 280 million mobile cellular subscribers (number 4 in the world) with more than 200,000 telephone kiosks—many located in remote areas (CIA Factbook, 2014).

To increase financial access, Indonesia signed the Maya Declaration in 2012. In the Declaration, Bank Indonesia committed to expand financial access for unbanked populations. One of the Declaration's initiatives is to encourage sustainable growth of branchless banking in Indonesia through the formulation of a regulatory framework. One recommendation of the regulatory framework assessment was issuance of new regulations for electronic money. Electronic money usage is part of Indonesia's overall strategy for financial inclusion. On April 2014, Bank Indonesia issued a new electronic money regulation (Regulation No. 16/8/PBI/2014, an amendment of Regulation No. 11/12/PBI/2009). This new regulation allows electronic money operators to cooperate with digital financial services agents, especially individual. Although operators can be either banks or non banks, only banks can cooperate with individual financial services agents.

Analysis

The objective of the new electronic money regulation (No. 16/8/PBI/2014) is to expand electronic money coverage to support the national strategy for financial inclusion through digital financial services. Generally, the digital financial service is a payment system with financial services provided

through cooperation between an operator and a third party using mobile and web technology. A digital financial services agent is a third party who cooperates with the electronic money issuer and acts for and on behalf of the issuer to provide digital financial services. Agents play an important role by bridging the gap between operators with customers. Agent involvement is necessary to reduce the cost of financial services (Jansen, 2010).

Article 24D stipulates that only category 4 banks (BUKU 4) can cooperate with individual digital financial services agents. Bank Umum berdasarkan Kegiatan Usaha (BUKU) is a categorization referring to business activities that can be conducted based mainly on the bank's capital. Banks with higher capital can provide more activities under the regulation. There are 4 BUKU (BUKU 1, 2, 3, and 4). The BUKU 4 category comprises the four biggest banks in the country, meaning only these four banks can cooperate with individual agents.

Digital financial services agents can be divided into two categories, namely a legal entity agent and an individual agent. Individual agents are a new introduction into the electronic money market and are intended to increase the channels of electronic money business. Services offered by individual agents include:

1. registration facilitator,
2. top up,
3. bill payment,
4. withdrawals,
5. payment of government assistance to public, and
6. other facilities approved by BI.

Business of Agents and Competition Among Providers

Agents generate money from commissions derived from fee-sharing agreements with parent financial institution. For every transaction processed by the agent, the agent earns a particular percentage of the fees paid by customers. Digital financial services agents generate funds in the same way.

Brazil and Colombia are examples of countries focused on expanding the agents' role in the banking sector. In Brazil and Colombia, payments are the most common agent-assisted service. These include payments of utilities, taxes, bills, and other fees to the agent's parent financial institution, and transfers between individuals. Payments make up more than 75% of the transactions in both countries (AFI, 2012).

A competing view promotes the use of standalone shops and post offices as partners with banks (CGAP, 2010). However, small shops are motivated by the mix of traffic to the shop and revenue. Based on the results of a data survey, small shops and stand alone agents have lower fees (USD 0.22 and 0.28 per transaction) when compared to post offices (USD 0.91). This difference is likely due to post offices having a greater negotiation power with banks than other providers do.

The World Bank reported (cited from Demirguc-Kunt, 2013) that one key to encouraging providers to become involved in financial inclusion is by providing access to technological innovations, including electronic money. To achieve this, regulators should encourage competition among providers and improve the legal, regulatory, and institutional environment. Competition can be increased by increasing market access, thereby allowing more players to join the industry. In addition, the World Bank notes that healthy competition is key to consumer protection because it gives more power to consumers.

The Need to Balance Regulation and Business

Due to the latest branchless banking project in 2013, banks now have more power and are better positioned to dictate terms to prospective agents, including terms relating to fee sharing. Because only the four biggest banks can cooperate with agents, the agents' negotiation power is

fairly limited. Not having the power to negotiate better fee-sharing harms agents' profits and their ability to conduct operational activities. Moreover, restricting cooperation with individual digital financial services agents to a small number of banks also limits competition in the industry. Competition is necessary to achieve better products and ensure consumer protection.

Recommendations

Bank Indonesia needs to expand the number of banks allowed to cooperate with individual digital financial services agents. Increasing the number of banks will also increase opportunities for individual digital financial services agents to negotiate better fee-sharing and commissions and also to increase their business. Individual digital financial services agents will also be able to have more choices on which banks offers better marketing plans, training, and monitoring of the agent's business. If the agent sector grows, it will attract more people to enter the market and more people will be reached with electronic money. Another effect is that more players means increased competition and better consumer protection.

Bank Indonesia needs to amend its regulations, but especially Article 24D of Bank Indonesia Regulation No. 16/8/PBI/2014 concerning Amendment of Regulation No. 11/12/PBI/2009. In the short term, Bank Indonesia should open market access to banks in BUKU 3. With this adjustment, at least 15 banks can partner with individual agents. As a next step, all banks should be allowed to cooperate with individual agents as long as they are licensed by Bank Indonesia as electronic money operators.

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MOBILE MONEY OPERATION AND AGENT NETWORK DEVELOPMENT IN NIGERIA

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Introduction

There is the global recognition that greater financial inclusion is key to developing and sustaining employment, economic growth, and financial stability.

In 2011, Nigeria, through the Central Bank of Nigeria (CBN), committed to reducing the number of bankable Nigerians without access to financial services from 46.3% to 20% by 2020.¹ This declaration became our National Financial Inclusion Strategy, anchored and driven by the CBN.

This policy memo focuses on how financial services can be extended to unbanked Nigerians through mobile money and agent banking. It also reviews how we can include other actors such as telecommunication companies (telcos).

Nigerian Financial Inclusion Strategy

Nigeria has a population of 170 million. More than 120 million Nigerians have access to mobile phones, but only 30 million have bank accounts or other financial services.

The Central Bank of Nigeria (CBN) launched its Financial Inclusion Strategy (FIS) on October 23, 2012 in Abuja, Nigeria.

The CBN adopted measures to address three major obstacles:

1. **High Cost of Financial Products and Services:** Low-income earners cannot afford financial services offered at commercial banks. The CBN is addressing this obstacle through various cost control/reduction measures. One such measure is the cashless policy, which encourages e-payment options and widespread deployment of e-channels at merchant outlets.
2. **Complicated Requirements for Opening Accounts:** Historically, the documentary requirements for opening bank accounts have been complex. Until 2013, when the CBN introduced the risk-based, three-tiered, know-your-customer requirements, Nigerians could only open bank accounts with a verifiable photo ID. The customer also had to fund the account or keep a minimum balance. Today, Nigerians can open bank accounts with a phone number and with zero balance in the account.
3. **Distance of Financial Service Centers and Touch Points:** Studies revealed that Nigerians in rural areas must take public transportation and spend up to fifteen minutes before they can reach the nearest bank branch or financial service touch points.

The CBN has tackled the first two deterrents through several cost-reducing measures, including the introduction of cashless policy and risk-based, tiered know-your-customer requirements. However, Nigeria still faces proximity challenges.

Mobile Money and Agent Banking Framework in Nigeria

To address the lack of financial services outlets in rural communities, the CBN introduced its Mobile Money Scheme, aimed at delivering financial services through mobile phones. The Mobile Money Framework recognizes two models: bank-led (bank-led and bank-focused) and nonbank-led.

The Bank-Led Model

This model allows banks to lead the consortium of other institutions or to act as a single entity to provide mobile money services. This model requires that banks assume the leading role and own the license.

The Nonbank-Led Model

This model allows nonbank institutions to lead the consortium of other institutions or to act as a single entity to provide mobile money service. This model must have a bank as its clearing institution and all the subscribers' funds are kept in that bank.

The Mobile Money Framework excludes the telecommunication companies from leading any models or obtaining an operating license to issue mobile money or develop an agent network.

Mobile money licenses were first issued to 11 mobile money operators (MMOs) who commenced commercial operations in January 2012. By the end of 2013, 21 MMOs were licensed. As of January 2014, 23 MMOs were licensed to operate a mobile money scheme.

Despite the large number of MMOs, mobile money subscribers remain very low; agent outlets are very scanty and concentrated in cities. The financial inclusion target² set in 2011 desired the number of agent outlets per 100,000 adults to grow from zero to 31 by 2015 and to 62 by 2020. The following table shows the performance of the MMOs since 2012:

Figure 1. Mobile Money Operators' Performance Statistic

Date	Volume	Value (Naira)	Agents	Subscribers
End of 2012	2,297,688	31,509,334,783.20	28,083	3,407,563
End of 2013	18,227,869	174,881,096,018.10	61,641	10,325,892
As of May 2014	27,244,921	289,275,755,112.60	66,387	11,839,680

Source: Central bank of Nigeria

Comparing these targets with Kenya's and Brazil's targets, Nigeria is lagging behind. Kenya targeted 154 agent outlets per 100,000 adults; Brazil targeted 122 agent outlets per 100,000 adults, as shown in Figure 2.

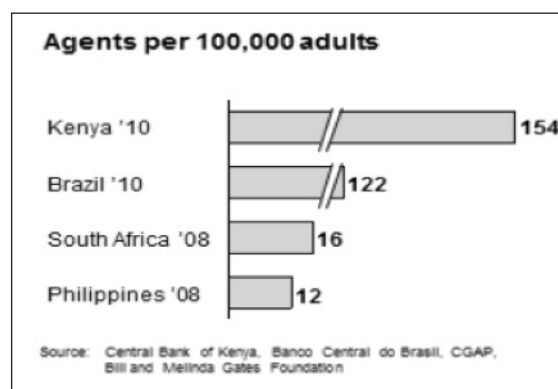
The reports submitted by MMOs to the CBN indicate that only about 20% of agents are in rural areas. This result undermines our quest to provide financial service points closer to the rural communities.

One main reason for the lack of a wide agent network is the high cost of setting up and managing agents. Studies have shown that penetration of financial services into rural communities may not be achieved if left to MMOs. MMOs do not have the financial wherewithal to build the vast agent network needed to drive mobile money services. Accordingly, there is a public agitation for the telcos, who already have the infrastructure, to drive the agent-network management on shared-service basis.

Policy Logjam

The CBN is faced with a difficult situation. Institutions licensed to provide mobile money do not have the financial capacity to build bank branches and agent network in the rural areas. Yet, the telecommunication companies who have the infrastructural and financial capacity are excluded

Figure 2. Agents per 100,000 Adults



from doing so. The current regulatory framework has resulted in a policy logjam hindering the delivery of financial services to rural communities.

The CBN's refusal to grant telcos mobile money licenses is based on the following concerns:

1. **Anti-Competition:** Telcos may have an unfair advantage. First, they might block other players in the industry; second, they might overprice network access to give their own products an undue commercial advantage. This can lead to abuse of dominant position in the industry.
2. **Regulatory Arbitrage:** Telcos are under the supervision of the Nigerian Communication Commission (NCC), not the CBN. Allowing telcos to obtain mobile money licenses might lead to regulatory conflicts between the NCC and the CBN.

The only viable option is for the telcos to separate their mobile money services from their other business sectors and set up subsidiaries to manage the franchise.

3. **Settlement Risks:** All payments system suppliers are expected to put up a certain amount of collateral to address settlement risks. Suppliers must have connectivity to the payments and settlements infrastructure for the finality of settlements (i.e., Nigerian Inter-bank Settlement System (NIBSS) and RTGS). Telcos are traditionally not part of the payments and settlements system and, as such, are excluded.

Although some of these concerns no longer exist, there is still the fear that allowing telcos to join the scheme at this time could prevent smaller companies from entering the market. Many believe the MMOs will compete with their services providers, leading to a dominant advantage for the telcos.

Policy Intervention

Our financial inclusion strategy demands that we increase the number of Nigerians who have access to financial services, from 53.7% of bankable adults to 80%. As of May 2014 (six years to 2020), we have yet to achieve 30% of that growth.

The slow pace of deploying financial services to the rural poor and unbanked is due to a lack of financial touch points.

To resolve this challenge, this policy memo recommends that telcos and other potential mobile money operators have greater participation in the following ways:

1. The mobile money framework and the agent banking regulation must allow telcos to build a shared agent network. They must be permitted to build and manage agent outlets and to co-brand with the mobile money operators.

The agent network should be open to all banks and mobile money operators, but telcos may brand the outlets. By allowing telcos to brand outlets, banks and MMOs can now leverage the shared agent network to provide agent banking and mobile financial services such as cash-in/cash-out (CICO).

Telcos who wish to build agent network must be licensed by the CBN through their subsidiaries as shared agent network companies. This requirement is intended to avoid regulatory arbitrage that may arise because the telcos are not under the supervision of the CBN.

Telcos have always wanted brand penetration and retention of their subscribers. By allowing telcos to brand the agent outlets, they will be motivated to deploy vast network of CICO outlets across the nation.

2. The mobile money framework should allow telcos to offer mobile money services through their subsidiaries or through a special purpose vehicle (SPV) that is setup exclusively for mobile financial services. The CBN will have direct supervisory control over the subsidiaries.

If the telcos are allowed to run the mobile money scheme, they will grow the mobile money subscribership substantially because over 120 million Nigerians own mobile phones. These subscribers can be automatically converted to mobile money subscribers. As of May 2014, only 10 million Nigerians use mobile money.

Recommendations

An immediate implementation of the shared agent network is highly recommended to enable telcos to convert their existing service outlets into cash in/cash out locations. In making this recommendation, we anticipate that the telcos will prefer to brand the outlets. It is therefore advisable to display a CBN-approved signage at these locations to signify that other MMO customers can use the outlet for services especially cash in/cash out.

The CBN should consider introducing the telco-led model, which will enable subsidiaries of the telcos to operate within the mobile money scheme. This is the most viable option to achieve the desired growth of mobile money scheme in Nigeria.

Because the introduction of the telcos into the mobile money scheme will require stakeholder approval for such changes, it is highly recommended that the CBN begins the discussion with other stakeholders and regulators, especially the NCC, as quickly as possible to obtain their buy-in.

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1. This commitment was made at the Alliance for Financial Inclusion Global Forum 2011 in Mexico. It is called the Maya Declaration.
2. Financial Inclusion Target (pg. 23) of the National Financial Inclusion Strategy Report 2012 – Roland Berger.

STRENGTHENING BUSINESS CORRESPONDENTS (AGENTS) OF BANKS TO ENSURE DOORSTEP DELIVERY OF BANKING SERVICES ACROSS INDIA

Ajay Kumar Misra, General Manager, Reserve Bank of India

Problem Statement

The banking footprint in India has undergone a considerable change due to new financial inclusion initiatives. The banking outlets run by business correspondents (BCs) have appeared in over 300,000 villages and 60,000 urban locations in last 3–4 years. Approximately 104 million bank accounts have been opened through these business correspondents.¹ The phenomenal growth in access to formal banks has been acknowledged by all external stakeholders.

However, this phenomenal growth of business correspondents and the large number of bank accounts opened by them has created new problem—namely inadequate usage of bank accounts. The account holders must conduct transactions in order for BCs to earn income. Typically, BCs are paid by banks through a mix of a minimum fixed remuneration component added to a transaction-based variable component. Hence, for BCs to be viable and the BC model to be scalable and sustainable, usage of these services must grow substantially.

Therefore, the problem is that a large number of the bank accounts opened by business correspondents (agents of banks) do not generate sustainable income for the BCs.

Background

The Indian economy was growing at a rapid pace at the beginning of the new millennium; however, the inequitable pattern of the economic growth was becoming a concern for policy-makers.² They realized that for growth to be sustainable, it had to be inclusive. Inclusive growth thus became a national plan priority. Financial inclusion was one of the important tools identified to ensure this inclusive growth. While the term “financial inclusion” was likely used for the first time in financial policy-making, India has been attempting to extend banking services to the large number of excluded vulnerable groups for almost 60 years. The focus of these earlier efforts was on channeling credit to priority sectors and vulnerable groups mostly through a fiat from either the government or the Reserve Bank of India.

The strategy of promoting financial inclusion as a deliberate policy option started in 2005. The central piece of this policy has been to pursue financial inclusion as part of a viable business strategy of banks. It was realized that to provide banking services in over 600,000 far-flung villages in the country, India needed to find economical and scalable models of delivering banking services. The brick and mortar outlets alone could not provide these services to excluded sections due to their high cost structure. It was, therefore, decided to allow banks to extend banking services through information and communications technology-enabled agents called business correspondents. These business correspondents³ could typically be individuals such as retired bankers, owners of grocery/medical shops, or public call office operators, or NGOs/Microfinance institutions, non-banking finance companies, cooperative societies, post offices, or certain registered companies which include telcos.

Analysis

As previously stated, the immediate cause for this problem of profitability is an inadequate number of transactions in the new accounts. However, there are quite a few causes underlying the lack of transactions. One cited macro-economic cause is that account holders do not have regular sources of income and thus cannot transact in mostly zero-balance accounts.

The more proximate cause is that BCs are not yet accepted by bank staff as their extension and, hence, operational difficulties result in sub-optimal performance of BCs. For example, many banks ask BCs to provide 100% security deposits for undertaking banking business as an agent on behalf of the bank. This requirement is understandable while a BC's operation is new and the business relationship is not established, but as a BC's operations stabilize and business grows, the BC should not be expected to maintain a 100% security deposit. Business correspondents' operations will never scale up if the requirement of security does not come down as business grows.

Another issue that continues to hamper BCs' operations is non-payment of adequate and timely remuneration to BCs by banks or to BC agents by a BC's company. Similarly, the cash held by BCs to conduct banking business on behalf of the bank is not treated by banks as the banks' own cash. As a result, banks do not monitor whether a BC has sufficient cash to serve customers, whether the cash is insured by the BC, and (if insured) at what cost.

Yet another reason for lack of transactions in these accounts is that the large number of state and central government payments, including old age pensions, social employment wages, subsidies, etc., are still not flowing to beneficiaries through the bank accounts of beneficiaries. Apart from increasing the stake of beneficiaries into their bank accounts, this would also encourage savings habits among these people.

Another important reason for a low number of transactions taking place in these accounts is that, despite no regulatory restrictions, BCs are mostly allowed by banks to only do transactions of receipts and payments in deposit accounts.

Recommendations

In light of the above, Reserve Bank needs to impress upon banks through meetings with the banks' top management, formal communication, off-site review, and follow-up of compliance/returns submitted by banks in this regard. Banks need to review BCs' operations at the highest levels to ensure that the operational difficulties relating to security deposits, remuneration, etc. are resolved, and ensure that banks increasingly treat BCs as their extended arms to reach nooks and corners of the country.

The grievances of BCs against the local bank functionaries relating to cash management could also be resolved by ensuring that banks treat BCs' cash as their own cash. Banks functionaries need to internalize the fact that customers at BCs' outlets are customers of the bank, and BCs are banks' extended counter service.

Reserve Bank should also liaise with departments and ministries of both union and state governments to ensure that all social security, pension, employment, and subsidy payments are routed through bank accounts. If all these benefits, including social security payments, are routed through the bank accounts, then the issue of a lack of regular income of account holders could also be solved.

Further, this is a win-win proposal for government departments, banks, and customers. The government saves on costs of administrative machinery, banks get more transactions in the bank accounts, and customers can get doorstep delivery of banking services.

We also propose to encourage banks through regular consultations in the matter to allow BCs to transact in a bouquet of banking products and services. It is imperative that BCs be allowed to transact on other banking products. For example, banks should allow BCs to disburse loans and collect repayments thereof. Similarly, they should be allowed to collect and disburse remittances.

It is hoped that the above measures will make BCs more viable and the BC model both scalable and sustainable.

Endnotes

1. Financial Inclusion data as reported by banks.
2. Inclusive Growth - Role of Financial Sector speech given by Dr. K. C. Chakrabarty, Deputy Governor of Reserve Bank of India in 2010.
3. Financial inclusion by extension of banking services. Use of BCs - Circular Issued by Department of Banking Operations and Development, Reserve Bank of India, September 28, 2010.

INCREASING ACCESS TO FINANCIAL SERVICES IN RURAL AREAS THROUGH THE IMPROVEMENT OF BANKING AGENTS' EFFICIENCY

Laura Karina Ramos Torres, Director for Access to Financial Services, Comisión Nacional Bancaria y de Valores (CNBV), México

Introduction

Identifying public policies that promote greater financial inclusion,¹ especially in poor, rural areas, is a challenge for many countries. Mexico is no exception. Our main strategy for developing financial access in rural areas is mobilization of banking agents.²

Since this strategy began, the number of banking agents operating in rural areas has grown considerably. However, many people living in rural communities have not made use of them. Reasons for lack of use vary from one place to another, but a common cause for low adoption is a consumer lack of awareness about which transactions can take place through agent channels.

This paper proposes several options for fostering use of the banking agent model and concludes that, at its core, participating small businesses acting as agents must be profitable. A key strategy to developing profitable banking agents is the formation of distribution networks that can manage the cash needs of agents.

Background

In recent years, several Latin American countries have adopted a banking agent model. The success of this model varies greatly by country. In 2011, Brazil was generally known as the global pioneer in this area and had developed a mature network of agents covering more than 99% of the municipalities in the country (CNBV, 2011b). In Peru, the number of agents per every 10,000 adults is higher than the number of agents in Colombia and Mexico.

Nonetheless, Mexico has made progress in implementing a banking agent model, thanks to amendments to banking regulation³ in 2009. In just five years, the number of banking agents in Mexico has reached 23,626 (CONAIF, 2013). However, this number could grow to 100,000 if agents were to become interoperable.⁴

Table 1. Permitted Transactions for Banking Agents

Transactions Debited from the Agent	Transactions Credited to the Agent	Other Transactions
Payment of utilities using cash, credit cards or checks of the institution	Cash withdrawal	Inquiry on balances and transactions
Deposits using cash or checks of the institution		Opening accounts
Payment of loans using cash, credit cards or checks of any institution	Check collection of the same bank	Transfer of funds for payment at branches of the institutions themselves or at banking agents (Remittances)
Circulation of payment means (Prepaid cards)		

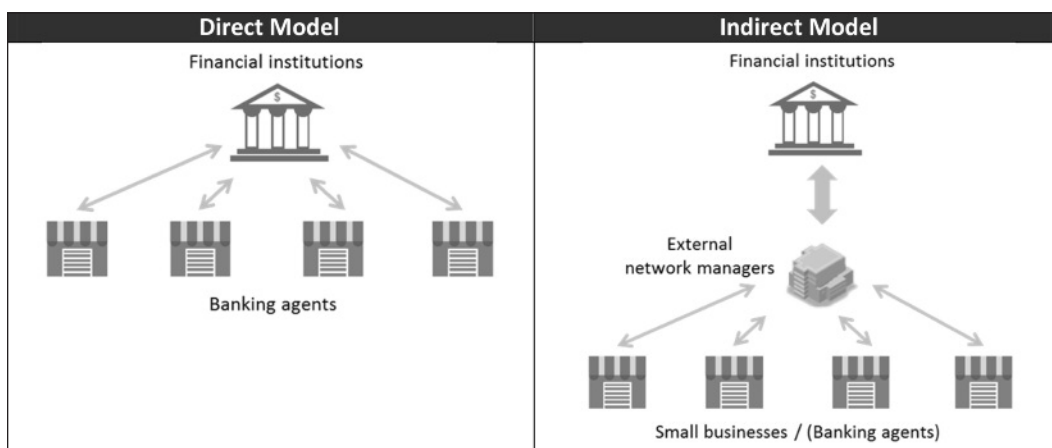
Source: CNBV.

According to the banking agent operating model, the permitted activities are shown in Table 1.

In Mexico, banking agents can be divided into two large groups: (1) large commercial chains; and (2) small businesses, such as grocery stores, stationery stores, pharmacies, etc. Most banks focus on leveraging existing large retail chains (mentioned as group 1). A bank will evolve its model according to

its existing interaction with a chain. In some cases the bank will carry out its business directly—namely, bank staff perform identification and assessment activities of potential banking agents and, afterwards, contract and manage agents (commonly used with large commercial chains). In

Figure 1. Operating Models for Banking Agents



Source: CNBV.

other cases, the bank carries out its business indirectly, hiring an external management firm to handle the whole process (commonly used with small business agents).

In cases where a bank hires an external management firm, that firm facilitates the growth of the agent network and reduces per agent operating costs. The firm also carries out activities that guarantee the sustainability of the small business agents, such as solving technical problems, managing and controlling business risks, providing liquidity needs, creating incentive schemes, and offering counseling in sales and marketing.

Whether banks work directly or indirectly, the advantages of banking agents is clear:

- Patrons may feel more comfortable visiting a store than a bank branch.
- Banking agents provide an appealing channel for people who do not yet have a formal bank account.
- Agents reduce the cost of extending banking infrastructure to areas located well beyond the reach of a bricks-and-mortar branch.

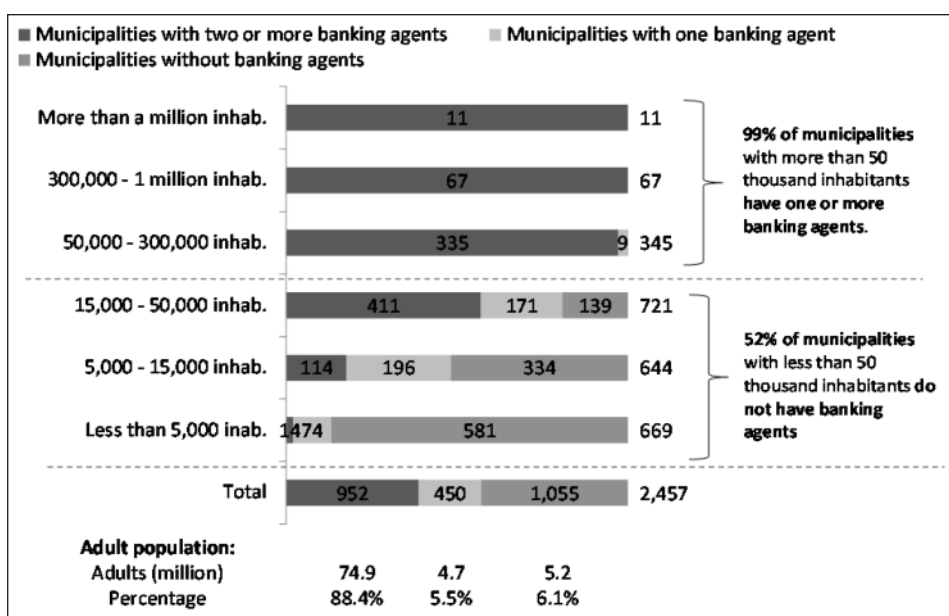
Analysis

Even though wide coverage has been achieved at a municipal level, many localities still lack financial service infrastructure. Currently, banking agents have a presence in regions with high a population density; thus, Mexico has an opportunity to increase agent presence in rural areas.

The results of the National Survey for Financial Inclusion (ENIF, 2013) suggest that consumers who live in rural areas invest considerably more time and money in getting to a branch or ATM than those in urban areas. Data also show that the most common transactions conducted at branches and ATMs

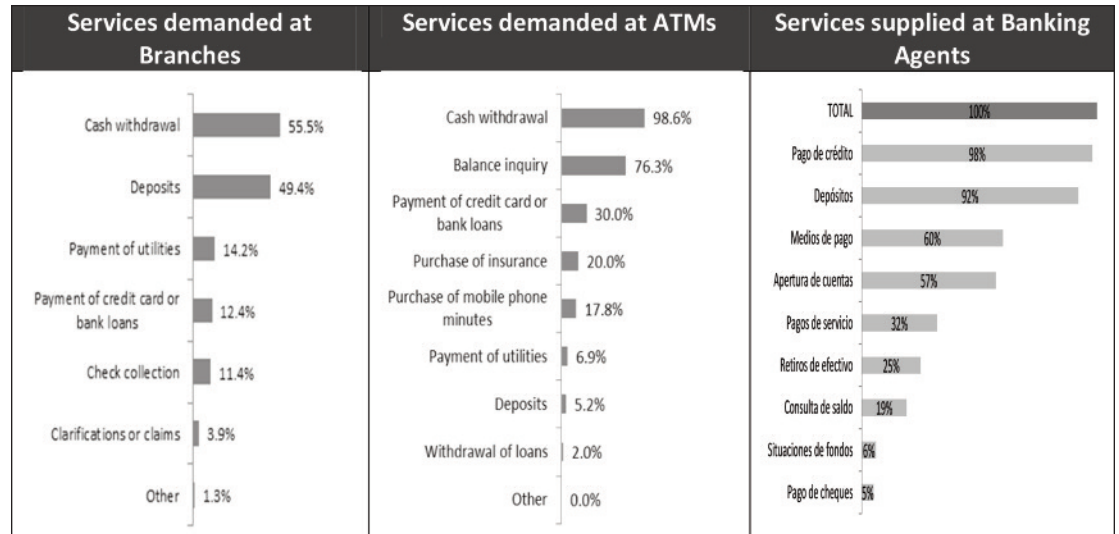
are cash withdrawals, deposits, payments, and requests for statements of accounts.

Figure 2. Presence of Branches and Banking Agents per Type of Municipality



Source: (CNBV, 2014).

Figure 3. Products Supplied and Demanded



Source: (ENIF, 2013); (CNBV, 2014).

However, banks report that the main transactions⁵ carried out through banking agents are loan payments (60% of transactions), deposits (25%), and cash withdrawals (11%). This is directly related to the fact that the supply of services at banking agents is focused on processing loan repayments and taking deposits.

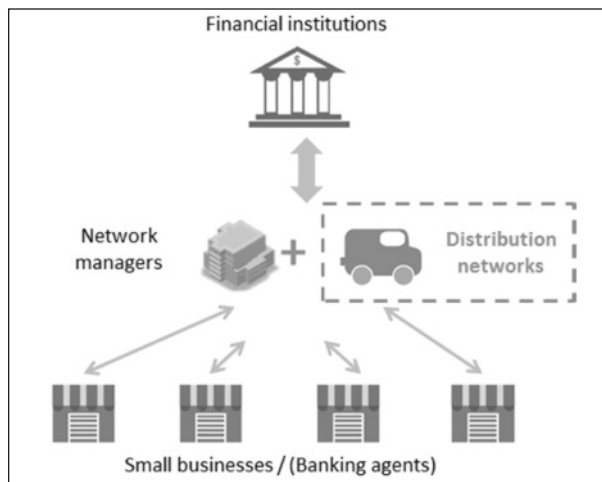
Thus, there is no correlation between services supplied at banking agents and those demanded at branches and ATMs.

Options

Given that banking agents are points of sale with a very high frequency of visits, they have the potential to actively participate as promoters of financial services, which could be reinforced with an acquisition scheme (“member get member”⁶) to increase the trust in, and familiarity with, formal financial services.

In rural municipalities, the major challenges include the expense and time to identify small businesses as potential banking agents and the lack of branches, which makes it difficult to monitor and handle cash and thus increases the costs for both businesses and the banks.

Figure 4. Incorporation of Distribution Networks



An alternative is to incorporate distribution networks into the cash management and distribution process. Distribution networks refer to companies that organize and manage their own transportation network to deliver the products they sell, from the manufacturing facility to each point of sale.

Distribution networks would be in charge of balancing the cash flow among the different small businesses they provide services to, causing the cash transfer between the bank and the banking agents to be considerably cheaper. In turn, distribution networks could be benefited by reducing cash obtained for the sales of its products and, therefore, reduce the risk of being robbed.

The benefits of the distribution network model are that, in addition to obtaining profits from commissions charged, banking agents in a network may capitalize on other benefits. For example,

they can share a brand (the brand of the network) which would help network members differentiate their activities from those of competitors.

Pursuant to the regulations, the bank is the entity that enters into the agreement with the banking agent and, therefore, is responsible to the CNBV for the agent's operations. In this sense, banks may benefit from the increased volume of transactions and, consequently, from the related gains, the increase of penetration of their products, a greater geographical coverage, the opening of new market segments, and, in the long term, a greater financial inclusion.

Recommendations

The first recommendation is to conduct a wide and comprehensive study on the current banking agent market to identify market issues—e.g., asymmetric information, costs inequity, or disloyal competition. The study should include an analysis on international experiences to explore the feasibility of incorporating distribution networks as a relevant actor providing sustainability or to incorporate some other championship model applied in another country with major success.

From the CNBV perspective, and with the intention of making the correspondent model profitable, it is further proposed to amend the regulatory framework to establish the distribution network model as an additional relevant actor into the operational process thereof. Changes in the Bank and Credit Institutions Law⁷ shall define the roles and operations allowed for this purpose and must be sufficiently flexible so this figure may celebrate commercial agreements with either the bank or with administrator networks or banking agents.

The recent Financial Reform promotes greater financial inclusion: allowing the correspondent figure for popular savings and loan institutions is one of the most important strategies that will make a direct impact on low income population. Making such changes into the law could also encourage greater efficiency and competition among correspondent agents into this sector.

The problem of achieving greater financial inclusion must be addressed from several directions and requires interrelated solutions. The suggestion to promote distribution networks is only one possible step toward achieving greater access to financial services with proper regulation.

It is essential that small businesses become profitable and sustainable in their cash flow operation. As such, they can properly bring financial services to rural communities while also promoting other more innovative products, such as using mobile phones to carry out transfers or to promote, sell, and distribute more sophisticated products, such as micro insurance.

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Endnotes

1. In Mexico, financial inclusion is defined as the access and usage of formal financial services under a proper regulation that guarantees consumer protection schemes and promotes financial education.
2. Banking agents are correspondents that supply financial services to banking clients, operating as a counter between the bank and the client.
3. Credit Institutions Law.
4. The same banking agent may supply services for more than one bank because there are no exclusivity agreements to provide financial services through banking agents.
5. Banking regulatory reports.
6. This term refers to the concept of fidelity and affiliation growth, using members already registered—i.e., campaigns that offer incentives for inviting a family member or a friend to use the service or product.
7. General Provisions Applicable to Credit Institutions, Chapter IX.

ENHANCING ACCESS TO FINANCIAL SERVICES IN UGANDA THROUGH REGULATORY AND LEGAL REVIEW

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Bank of Uganda

Introduction and Context

The rural poor in Uganda are unable to access financial services because most financial services are concentrated in urban areas along urban “Main Streets.” Convenient financial services would offer important assistance to the rural poor, enabling them to limit financial shocks; allow for investment in health, education, and income-generating activities; and open up growth opportunities. Together, these benefits can enable the poor to escape a vicious cycle of poverty.

This memo proposes to amend the Financial Institutions Act 2004¹ (FIA) to enable regulated financial institutions to offer financial services through banking agents and to open up micro branches. By allowing the use of banking agents or micro branches, financial institutions will be able to offer financial services, at a lower cost over a wider geographical area, than through their current model of establishing brick and mortar branches.

Problem Statement

The rural poor in Uganda are unable to access financial services because financial services are concentrated in urban areas (and, in particular, along the “Main Streets” of urban areas), and the costs to access them are high.

Accessing financial services such as savings or credit products can allow households to accumulate the money they need to invest in productive assets. Productive assets can result in increased income which in turn can aid in smoothing consumption and further increasing the ability to make agricultural investment, which again can translate into more income.

Accordingly, access to financial services can turn around the lives of the rural poor.

Analysis of Root Causes of the Problem

The following factors have caused the above-mentioned problem in Uganda:

1. **The Current Legal Framework.** The FIA requires that regulated financial institutions shall offer financial services in a defined place of business, which shall be a bank branch. A regulated financial institution must seek approval from the central bank before opening a new place of business/branch or changing the location of an existing place of business/branch. Before approval is granted, the central bank first assesses the financial strength of the financial institution to ensure that it is adequately capitalised to take on an expansion strategy. In addition, the central bank carries out an inspection of the proposed new branch premises to ensure, among other things, that:
 - the banking hall is secure,
 - tellers working space is secured,
 - there is a functional back office,
 - the strong room is adequately secured,
 - the server rooms are secure and functional business resumption infrastructure is in place, and
 - general security (sensors, CCTV, panic buttons, fire extinguishers, etc.) is in place.

All these requirements, coupled with administrative costs such as wages and salaries, security, utilities, etc., mean that the cost of opening and maintaining a brick and mortar branch is high, impeding regulated financial institutions' ability to establish new places of business in rural areas.

2. **The Livelihoods of Rural Households.** A majority of people in rural areas earn low incomes because they are primarily involved in small-scale farming. Given this low level of economic activity, banks have little incentive to extend banking services to rural areas. A significant number of people in Sub-Saharan Africa live in rural areas, where they typically own a small plot of land and farm subsistence crops. According to the Uganda Household Survey 2009/2010,² Uganda's population was estimated at 30.7 million, with half the population being less than 15 years old. The population is predominantly rural, with about 85 percent living in rural areas. The average monthly income derived from all sources was UGX 303,700—the equivalent of about USD 150 (official mid-rate average). The main income source was subsistence farming, with 42% of households deriving their livelihoods from this activity. All these statistics indicate that households in Uganda have fairly low incomes, implying that their ability to save is greatly curtailed and they are not well-positioned to make deposits. Rural households also have difficulty borrowing because banks are reluctant to accept clients in rural areas: households usually cannot meet the requirements for collateral or minimum balances. In addition, besides being inconveniently located, rural residents often find banks intimidating and expensive.
3. **Lack of Supporting Infrastructure.** Most rural areas do not have the basic infrastructure (such as power, roads, and telecommunication coverage) required to operate bank branches and ATMs. According to an African Development Bank economic brief,³ infrastructure investments in Africa have not kept pace with growth in demand, creating a huge deficit. Less than 40% of the continent's population has access to electricity; about one-third of the rural population has access to roads. On the other hand, the information and communications technology (ICT) sub-sector is characterized by huge differences across specific services. In 2008, four out of ten Africans had access to mobile phones, with penetration rates growing fastest compared to the rest of the world. However, internet density is just above 80 persons per thousand (less than one in ten), while the figure for fixed telephones are even lower.

Proposed Policy Intervention

The proposed policy intervention is to amend the Financial Institutions Act of 2004, to allow regulated financial institutions to conduct business in places outside bank branches. By amending the law, financial institutions will be able to contract agents, who may offer financial services in rural areas at a much lower cost.

Why This Policy Intervention

The Central Bank is mandated by law to regulate and supervise financial institutions; as such, it has the power to amend the FIA. Strengthening financial inclusion is also one of the initiatives in the Central Bank's strategic plan 2012 to 2017. The Bank of Uganda is in the process of implementing various initiatives to improve financial inclusion in Uganda as a response to financial innovations, gaps in financial education, financial consumer protection issues, opportunities in the context of financial innovations, financial deepening issues, as well as issues of access and quality of financial services. Finally, by allowing financial institutions to use agents to offer financial services or to open micro branches, the other two root causes of the problem will also be addressed. This model has minimal infrastructure requirements as compared to operating a fully-fledged branch and has the ability to deliver appropriate financial services to the rural poor at a very low cost.

Process of Policy Implementation

- Central Bank amends FIA and submits the amendment to Ministry of Finance.
- Ministry of Finance approves and submits proposed amendment to Cabinet.
- Cabinet passes the proposed amendment; the Minister of Finance presents the amendment to Parliament.
- Parliament discusses the amendments and passes them into law.
- The Central Bank issues implementing regulations to financial institutions on how to engage banking agents and operate micro branches.
- Financial institutions are able to offer financial services outside designated bank branches.

Assumptions

- Poverty alleviation is a top priority for the Government of Uganda, and financial inclusion is an essential component of the country's poverty-alleviation strategy. Given that access to financial services to the rural poor has the potential to ultimately reduce poverty and inequality, it is expected that the Ministry of Finance will buy in and strongly advocate for the speedy passing of the amendments by the Cabinet and enactment by Parliament.
- Ugandan financial institutions will be willing and ready to adopt this new model of offering financial services through agents or micro branches. The model offers financial institutions the opportunity to increase its customer base at a much lower cost, which should translate into increased returns.
- People in the rural areas will be willing and ready to take up this new mode of receiving financial services because the services will be offered within their reach and at a much lower cost.

For the policy intervention to succeed, the Central Bank will have to actively engage various stakeholders, such as the Ministry of Finance, regulated financial institutions, development partners, other regulatory institutions, telecommunication companies,⁴ and the public, at all levels during implementation to ensure that they buy into the process. This process will require an elaborate awareness campaign using workshops, meetings, and print and electronic media to sell the merits of the policy to the various stakeholders.

Expected Benefits from the Policy Intervention

When the policy is fully operational, it is expected that stakeholders will benefit in the following ways:

- The rural poor will be able to access appropriate financial services at a low cost and within close geographical reach. This access is expected to increase incomes or smooth cash flow, enabling them to deal with financial shocks, increase investments, and ultimately improve their social and economic well-being.
- The Central Bank will have achieved its strategic initiative on increasing financial inclusion in Uganda.
- The financial institutions will be able to make low-cost extensions via agents to leverage current infrastructure, thereby reaching new clients and increasing earnings.
- Increased economic empowerment of the rural poor will lead to increased tax earning to government.

Endnotes

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3. The African Development Bank Group Chief Economist Complex: Infrastructure Deficit and Opportunities in Africa. Economic Brief, Volume 1, September 2010. Prepared by Albert Mafusire, John Anyanwu, and Maurice Mubila. Available online at: http://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/ECON%20Brief_Infrastructure%20Deficit%20and%20Opportunities%20in%20Africa_Vol%201%20Issue%202.pdf

4. Telecommunication companies have the necessary data, knowledge and relationship with majority of the unbanked population; financial institutions can tap into these existing opportunities when offering financial services through banking agents or when they operate micro branches.

FACILITATING BANK CREDIT FOR INDIAN POOR

Sushma Vij, Deputy General Manager for Financial Inclusion and Financial Literacy,
Reserve Bank of India

The Problem

A large number of Indian poor continue to depend on informal sources to meet their credit requirements. As per the World Bank-NCAER 2013 Survey “Rural Access to Finance,” 70% of the rural poor do not have a bank account and 87% have no access to credit from a formal source. The Technical Group to Review Legislation on Money Lending (RBI, 2006) further confirmed the continued presence of money lenders. The Report of the Task Force on Credit Related Issues of Farmers (GOI, 2010) found that about 36% of farmers’ debt is from informal sources with interest rates ranging from 20% to 25%. Another 38% of loans had an even higher rate of 30% or more, indicating the excessive interest burden such debt generates on small-scale and marginal farmers.

Background

Increasing the poor’s access to formal credit remains a core concern for India’s planning architecture. The first impetus for regulatory intervention arose out of the findings of the All India Rural Credit Survey, which indicated that informal sources accounted for 93% of the total credit requirements in 1951–52,¹ while institutional finance accounted for only 7%.² To address this concern, India nationalized the Imperial Bank into the State Bank of India in 1955, nationalized 14 commercial banks in 1969, introduced priority sector lending norms in 1972, established regional rural banks in 1975, nationalized 6 more commercial banks in 1980, formed NABARD as a specialized institution for rural development providing credit facilities to agriculture and allied activities in 1982, and introduced the SHG-bank-linked micro credit program in 1992.

Each of these policy measures improved the territorial spread of banking throughout the country, particularly in rural areas and under-banked regions. With institutional agencies making steady inroads into the rural scene, informal credit gradually declined to 43% in 2002 while the share of institutional credit agencies of the rural households increased to 57% at the all-India level.³ The number of bank branches increased from a base of 8000 branches in 1969 to 100,000 branches in 2013. Rural branches increased from 1822 in year 1969 to 38,451 in 2013.

Analysis

Despite these changes, the poorest still prefer moneylenders who charge exorbitant interest rates and impose unfavourable terms and conditions, to formal services. The poor’s continued reliance on informal rural credit markets is largely due to easy accessibility and flexibility: a willingness to lend on personal security, no insistence on punctual repayment, and unrestricted lending for consumption purposes. Despite the impressive banking network growth, only about 7% of the country’s 600,000 villages have a bank branch, meaning that people residing in 93% of the villages must walk to a distant location to get bank credit. Other noteworthy reasons for a continued reliance on moneylenders include a general lack of awareness among poor people about banks products and services, and the procedural and documentation requirements they demand.

Recent Policy Measures

Recently, India has undertaken concerted efforts to link poor people with the formal financial system. To reach unbanked remote areas, in January 2006, Reserve Bank permitted banks to engage business facilitators and business correspondents (BC).⁴ Furthermore, Reserve Bank considerably relaxed branch opening norms for banks in 2007; it mandated that banks open at least 25% of their branches in unbanked rural centres in 2011, and it advised banks to open low-cost ultra-small branches in 2012.

Reserve Bank advised banks to offer “overdraft” as a built-in product in basic savings accounts for consumption credit to meet short-term emergent consumption needs such as illness and household expenses during the lean season. Innovative products in the form of Kisan Credit Cards⁵ and General Credit Cards⁶ were designed as hassle-free credit products for lending by banks for farm-based and non-farm-based business activities. Banks have also been launching suitably customised basic products as per the needs of specific target segments. Additionally, banks have made stand-alone efforts to create awareness about products and their advantages. This strategy worked well, resulting in the opening of about 12,000 rural branches in unbanked rural centres during the last 4 years and additional availability of banking outlets through BCs in about 200,000 villages. Still, about 350,000 villages remain unbanked, and awareness remains a major challenge.

Policy Recommendations

Increased penetration of the banking network, simplification of procedures, and the availability of hassle-free loan products have still not displaced the informal credit market.

Although both access and awareness are integral to financial inclusion, they are currently being addressed separately. However, in either scenario—providing access without creating awareness, or creating awareness without providing access—the poor will remain outside the banking system. Therefore, to address the informal credit problem, it is essential to synchronise access (supply side) with awareness (demand side).

The banks have prepared a roadmap for opening a banking outlet in all unbanked villages within next three years. This plan must be synchronised with a companion program to create demand through increased awareness and education. Such a program would educate the poor about how hassle-free basic loan products meet their requirements and would describe the advantages of using these products.

Reserve Bank is to issue guidelines to banks to organise Financial Literacy Camps to ensure that people use these services when BC outlets open. This program should not take the form of a one-time awareness camp, similar to those already provided by banks in some places. Rather, these camps should be conducted in three phases, and be organised by the banks sponsoring the BC outlets, in partnership with Local Government authorities, NGOs, and other key actors. The first phase will introduce basic financial concepts, starting with personal financial management, the importance of savings, and responsible borrowing practices. In the second phase, only after being taught these basic principles, the poor will be introduced to basic bank products, and their accounts will be opened through the local BCs. The third phase will focus on sorting out difficulties in usage, followed by monitoring of usage on continual basis.

A quick assessment of the pilot program reveals linkage of about 95% of participants to the banking system. In addition, the poor understand simplified procedures and the advantages of availing loans from banks. They are in a position to avail themselves of business and consumption loans from banks at lower costs with greater ease, to engage in income-generating activities,

to make regular repayments to banks, and to reserve surplus income for growth. For banks, the program results in the opportunity to serve the excluded segment of the country and to earn more interest to make up for the costs of setting up BC outlets. Additionally, BCs get higher commissions due to the increased number of transactions. Therefore, this program will effectively alleviate poverty and rescue the rural poor from moneylenders.

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Endnotes

1. Informal finance includes micro finance institutions, professional money lenders, agriculturist money lenders, traders, landlords, relatives and friends, etc.

2. Institutional finance includes commercial banks, regional rural banks, cooperative banks, and lending under the SHG bank linkage program.

3. The data on Informal Sources has been taken from the various issues of All-India Debt and Investment Survey, latest being AIDIS 2002, which was carried out in 2003 and published in December 2005. In the absence of survey data beyond AIDIS 2002, references to informal credit have been drawn from recent reports published by Reserve Bank of India and Government of India to substantiate the problem.

4. BCs work as intermediaries, providing banking services and using information and communication technology for last-mile delivery in a user-friendly manner. This allows banks to provide doorstep delivery of services—especially “cash in–cash out” transactions at a location much closer to the rural population in remote areas, where it is not economical and practical for banks to serve through brick and mortar branches.

5. Kisan Credit Cards scheme is an innovative credit delivery mechanism to provide adequate and timely credit support from the banking system to farmers for their production and other needs under a single window.

6. General Credit Cards is a kind of revolving credit based on the assessment of cash flow, where the objective of the scheme is to provide hassle-free credit for non-farm-sector-based activities.

Supporting the Needs of SMEs & MFIs

A GUARANTEE SCHEME TO SUPPORT SME CREDIT PRACTICES

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Problem Statement

In Egypt, small and medium enterprises (SMEs) are not getting sufficient bank finance, thereby restricting a sector with huge potential for growth. Banks' culture and policies are still targeting only large corporates because they perceive financing of SMEs as high risk with low profitability.

Background

Recently, Egypt has witnessed two massive revolutions and an ongoing political turmoil which negatively affected its economic scene. Indeed, it has been a very interesting yet very challenging time, with public trust in banks growing as the financial sector became the only engine keeping the economy afloat.

Banks have always dominated the Egyptian financial sector. There are 40 banks operating in Egypt. For years, they have exploited large corporates with competition, resulting in diminishing profit margins and leading to the point of saturation. Recently, banks targeted retail business as a means of seeking new opportunities for growth.

Unfortunately, banks have not yet targeted SMEs—even though they account for an estimated 80% of the total number of businesses operating in Egypt (bearing in mind the lack of data available on this sector). Recently, other players such as non-governmental organizations (NGOs) and microfinance institutions (MFIs) have shown interest in offering SMEs alternative, yet more expensive, funding. Still, when compared to the banks' portfolio size, these institutions are negligible.

Problem Analysis

In analyzing the previously mentioned problem statement, two main causes are clearly identified:

1. A large number of unregistered companies and businesses are currently being operated in the informal economy. The main reasons for this informal economy are tax evasion coupled with financial illiteracy. Moreover, to move to the formal sector, owners must deal with complicated administrative and bureaucratic procedures as well as high costs and fees (e.g., the high cost of accountants). These costs hinder registration and thus formalization. As a result, SMEs are generally unable to present the proper official documents needed to obtain bank financing.
2. Banks are reluctant to finance SMEs for the following reasons:
 - a. Banks perceive SME lending as high risk. This perception is largely due to weak or non-existent financial documentation which in turn leads to weak credit scoring. Most small businesses do not have financial statements and are unable to prepare them, and medium size companies' financial statements are often doubtful and of poor quality.

Furthermore, Egyptian banks focus on traditional bank practices in performing their credit analysis techniques, scoring, and types of lending and services offered. Bank employees lack specialization in the SME field; therefore, they view all clients in a traditional lending manner and fail to properly identify profitability versus risk.

In many instances, SMEs lack sufficient guarantees and collaterals to cover the risks identified by banks. In addition, the inability of banks to accept movable assets (e.g., inventory,

- moving vehicles) as collateral further restricts the process. It is also hurt by weak foreclosure laws and lengthy and complex legal procedures to liquidate collaterals.
- b. SME loan amounts are small in comparison to much larger corporate loan, therefore banks perceive SME financing as unprofitable due to the associated high operating costs which include:
 - Fixed infrastructure costs, including huge branch networks for better outreach, systems, staff salaries and training.
 - High administrative costs for a proper system of internal control on credit initiation, monitoring and follow up of loan repayment.
 - Cost of credit analysis and asset valuation.

Possible Solutions

The solutions to this problem are multi-layered and require a complete framework to incentivize both the companies (to register) and banks (to finance). This framework should include:

1. Offering long-term tax exemptions as an incentive for companies to register and have proper documentation. This solution lies mainly with the Ministry of Finance, tax authority, and the Ministry of Investment. It is to a great extent outside the scope of the Central Bank.
2. Initiating a comprehensive financial literacy program to educate:
 - a. Business owners about the advantages of registration, the benefits of financial services to boost companies' growth, and the steps to become more bankable.
 - b. Banks about how to properly analyze, rate, and finance SMEs as well as how to identify a good risk/return deal focusing not only on lending but also on product- and service-bundling relationships and diversification of risk in the portfolio.

Such a solution requires collaboration of many stakeholders and huge funding, and results are slow because the approach targets a change of culture for both banks and companies.

3. Improving asset foreclosure laws and enacting the legal framework to accept movable assets as collateral. This approach is currently a work in progress under the auspices of the Ministry of Investment.
4. Offering a Central Bank-backed credit guarantee scheme:

Currently, only one credit guarantee company (CGC) operates in Egypt. It is owned mainly by thirteen banks and operates on a very small scale, being restricted in offering guarantees to the size of its own capital and trust funds offered by international institutions such as the World Bank, EU, and other funding/donor agencies. The CGC offers guarantees to SMEs by leveraging off their available funds against a calculated risk weighted portfolio of guarantees. Its operations could be tremendously boosted if the Central Bank of Egypt (CBE) offers a large fund (triple the amount of its current funds size) against which it offers banks a sovereign-backed guarantee to cover the credit risks that banks fear when considering SME finance.

Recommendations

In weighing the feasibility of these options, it is clear that the first three solutions are outside the scope of the CBE. The last option would fall under the sole control of the CBE to adopt and implement; therefore, it is the most preferred option. Moreover, all stakeholders involved in implementing this solution have a vested interest in its success—a win-win situation, as described below:

1. **The CBE:** SME finance has been one of its announced priority objectives since 2008, as evidenced by several initiatives issued to promote access to SME finance. In terms of fund size, the amount required to triple the existing CGC is equivalent to about \$700 million, which is small and easily approved by the BOD considering the recent low-income mortgage initiative issued early this year in the amount of \$1.4 billion.

Moreover, the original funds will remain intact as the guarantee liquidation for non-performing loans should not exceed the interest return on the original fund; thus, no loss is incurred.

2. **The CGC:** The CGC will likely welcome the opportunity to triple its operations, to collaborate with the CBE, and to announce to the market that its guarantee is backed by the banks' regulator. The CGC already submitted a request to the CBE to approve it as an eligible guarantor.
3. **The Banks:** The banks get a sovereign-backed credit guarantee as a credit risk mitigation technique. In addition, under the current regulations, a sovereign guarantee is eligible for two incentives:
 - a. A capital relief in calculating its regulatory capital adequacy ratio as sovereign exposures are zero risk weighted and diversified small portfolios are eligible for a reduced 75% risk weight.
 - b. Provisions relieve in calculating regulatory provisions.
4. **The SMEs:** The SMEs will receive the necessary finance against an acceptable commission as opposed to not obtaining any funding from banks or obtaining expensive funding from the other market players. However, if SMEs choose not to take advantage of guarantee scheme and better access to bank loans, no money will be lost.

Critical Success Factor

The successful execution and implementation of the proposed policy recommendation is subject to a very diligent preparation phase between CBE, CGC, and banks to set up the modus operandus for the guarantee scheme, including proper governance structure, eligibility criteria of SMEs, policies and procedures, follow up, internal control, and oversight mechanisms.

Conclusion

Bearing in mind the current political and economic circumstances, Egypt cannot rely on external aid and must enhance growth from within. SMEs offer an attractive field with great growth and impact potential. Recently, many stakeholders (such as NGOs, MFIs, and nonbank financial service providers) have recognized SMEs are the only solution for Egypt and focused on them as their sole target. As this realization grows, one can only anticipate success of the proposed policy solution to remedy the problem.

THE CHALLENGE OF LOWERING THE COST OF CREDIT AND ENSURING VIABILITY OF MICROFINANCE INSTITUTIONS FOR FINANCIAL INCLUSION IN SENEGAL

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Objectives

In light of the recent usury law enacted by the WAEMU council of ministers reducing the interest rate cap from 27% to 24%, Senegalese microfinance institutions (MFIs) need to better control their costs to be competitive and to ensure their continued viability. Therefore, Senegal should conduct a new study to (1) analyze the costs and expenses incurred by Senegalese microfinance institutions, (2) compare the effective interest rate applied to the cost of services, and (3) issue recommendations to reduce and control operating and management expenses to broaden access to financial services.

Background

The West African Economic & Monetary Union (WAEMU) is a unified monetary region and includes a customs union and currency union between the members. The member states (Senegal, Mali, Ivory Coast, Benin, Togo, Burkina Faso, Niger, and Guinea Bissau) share the West African Franc (CFA) as common currency.

After a series of successive adjustments starting in 1989, the monetary system of the WAEMU now has three essential components: the monetary program, the policy rate interest in its component “open market policy” and “interventions on permanent branches,” and the minimum reserve system. These instruments are complimented by a system of quality control for distributed loans.

The interest rate is the main instrument for ensuring liquidity management and monetary policy implementation.

Problem Statement

The microfinance sector is thriving throughout the WAEMU Member States. According to the Ministry of Finance (DRS-SFD: Direction de la Réglementation et de la Supervision des Systèmes Financiers Décentralisés), at the end of December 2013, the sector comprised 378 MFIs with 938 points of service, serving 1,789,032 customers. The transactions completed by these institutions reached F CFA 177 billion in terms of savings collected and F CFA 229 billion in terms of outstanding loan portfolio. Twenty years earlier, the sector counted 107 MFIs, with a loan portfolio of F CFA 18 billion and F CFA 13 billion of deposit mobilized.

Notwithstanding these encouraging results, financial exclusion remains prevalent in the Union. Indeed, less than 10% of the total Senegalese population has access to services from formal financial institutions (banks or MFIs). The relatively high cost of services offered by these institutions is perceived as one of the major obstacles to building an inclusive financial sector in WAEMU. As recently as April 19, 2014, consumers protested in Dakar about the lack of access and high costs of financial services.

However, by controlling cost drivers, MFI managers should be able to practice appropriate pricing to broaden financial access and increase the viability of MFIs. In May 2013, Yale University's Innovations for Poverty Action released a study of Banco Compartamos noting that it could easily lower prices and increase volume. Moreover, both theory and evidence suggest that microcredit does more harm than good, particularly when offered at high interest rates.

Analysis

Methodological Approach

A study undertaken by the Central Bank of West African States (BCEAO) focuses on a representative sample of diverse microfinance actors. The sample included fourteen MFIs and represented 56% of customers, 82% of deposits collected, and 97% of the value of loan disbursed.

Calculating the Effective Interest Rate (EIR)

To calculate the effective interest rate charged by MFIs, the following two approaches were used:

1. The approach prescribed by the implementing decree of the law defining and repressing usury in WAEMU: This approach does not take into account security deposits. The elements entering into the calculation include the interest rate applied to loans, loan terms, the periodicity of repayments, and any commissions or application fees that may be charged.
2. The conventional approach includes all credit costs, notably interest, fees and commissions, as well as security deposits.

Cost Analysis Method

Due to constraints linked to the current status of MFIs' management and information systems, the full cost method is used in the study. Since the profitability of savings has not been adjusted, its level might have been underestimated, leading to an overestimation of the profitability of loan. The costs of community-based financial institutions were considered as direct costs to the extent that, in these institutions, all expenses are directly linked to credits, both in terms of personnel and supplies.

Findings

Components of MFIs Cost Structure

Generally speaking, the costs and expenses incurred by MFIs included the following elements.

The Cost of Funds

This is the cost of deposits collected from customers and funds borrowed from banks or other financial institutions. These funds may be invested in banks or other financial institutions in order to generate incomes that allow MFIs to reduce the real cost of these funds. Costs of funds represented 5.78% of total costs incurred by MFIs.

Operating Expenses

Operating expenses consisted of personnel expenses, supplies, and services required to mobilize resources, cost of loan portfolio management, and other administrative expenses. The level of operating expenses of MFIs seems to be relatively high. Operating expenses represented 72.3% of costs incurred by MFIs and are more difficult to control.

Cost of Risk

The cost of risk represents the loss incurred by MFIs due to occurrence of the counterparty risk or risks of defaulting on loan repayments (loan losses). The cost of risk was evaluated at 14.6% of all costs incurred by MFIs.

Cost of Capital

These costs are linked to the capital used to finance investments and start operations. Capital is provided by members (credit unions), partners (associations and private companies), loans, or grants. In Senegal, the cost of capital represented 7.3% of all costs.

Determinants of Cost of Product in Microfinance

The factors determining the cost structures observed in different MFIs are identified. To understand the financial driver cost within microfinance institutions, there is a focus on a certain number of financial indicators, including:

- Personnel expenses: the factor with the greatest impact on the cost of products due to its preponderance in total cost.
- Yield on loan portfolio: the second most influential factor. This factor is mainly responsible for variations in the cost of credit. Thus, MFIs that draw more income from loan transactions make less effort to reduce their set-up cost.
- Portfolio at risk: due to the fact that the portfolio quality may significantly increase the cost of credit, in conjunction with the high cost of managing defaulted loans.
- Number of borrowers per employee.

Determinants of Interest Rates Applied by MFIs

Criteria such as target clientele, area of operation, number of products offered, legal status of MFIs (credit unions, solidarity group, village bank, private companies, etc.), and amount of individual loans disbursed influenced the effective interest rates on loans. The amount of individual loan disbursed is a decisive element in the costs incurred by microfinance institutions.

Interest Rates Disclosed by MFIs Compared to Their Cost Structure

Currently, if MFIs offered an effective interest rate lower than 36.6%, they would go bankrupt. Indeed, the cost structure (i.e., a business model with a minimum operating cost ratio of 36.6%) imposes a minimum effective interest rate of 36.6%, which allows only their short-term viability. To ensure their long-term viability, MFIs would have to offer an effective interest rate of 53.5% on all their products. If all MFIs were applying the usury rate (24%), it would mean that most would have to go bankrupt.

Each business model (traditional MFIs with branches, savings and credit village banks) presents both advantages and disadvantages. In addition to the cost of funds, the analysis should focus on viability, customer needs, and the ability of the institution to satisfy a large number of beneficiaries. The real challenge would be to define the optimum combination of these models to better serve clients. Competition seems to be one of the best ways of reducing interest rates.

Recommendations

In conclusion, the primary recommendations for developing an inclusive financial sector in WAEMU are the following.

MFIs Should Emphasize:

- controlling operating expenses,
- improving portfolio quality,
- adopting strict lending policies,
- adopting tools to calculate the effective interest rate,
- reinforcing communication strategy on interest rates,
- modernizing management and information systems and setting up management control functions,

- using new technologies and pooling (outsource) non-core activities,
- regrouping small institutions and strengthen their capacity, and
- setting up financial entities for larger MFIs to access funds at lower cost.

Microfinance Professional Associations Should:

- pool costs linked to technological innovations, market studies, and training activities for staff and managers, and
- reinforce communication strategy on rights and obligations in a credit agreement.

The Public Authorities Should:

- revise tax exemption measures for MFIs, particularly those targeting poor people;
- reinforce existing guarantee funds and funds for interest rebate and facilitate the creation of new special mechanisms for loan security;
- set up systems to categorize MFIs;
- promote public awareness of the legal limitation on interest rates and other costs;
- implement the central credit bureaus; and
- encourage diversification of the financial sector through the creation of a multiple companies for facilities leasing, factoring, investment funds and mutual guarantee.

Technical and Financial Partners Should: continue supporting the supervisory authorities, MFIs, and microfinance associations with a view to increase professionalism of the sector in the following areas:

- capacity building;
- guarantee fund;
- provision of long-term resources;
- effectiveness of information exchange platform, and especially central credit bureaus for MFIs; and
- support to regroup small institutions.

In addition, partners should better coordinate their interventions and actions, and target their support to MFIs.

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THE E-CLAIMS SYSTEM

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Small and Medium Enterprises (SMEs) play important roles in developed and developing economies. SMEs are also a key driver to Thailand's economic growth. Between 2008 and 2012, SMEs' production volume experienced an average annual growth rate of 2.9%—the same rate as real GDP growth. In 2012, SME real output growth registered at 6.6%, slightly above Thailand's 6.5% real GDP growth. The 2012 SMEs' output valued 136 billion USD which accounted for 37% of 366 billion USD GDP. However, this figure is relatively low when compared to other countries. For example, SMEs' contributions to GDPs were 58.1% of EU-27 countries (Wymenga et al., 2012), 54% of both G-7 and OECD countries, and 49% of the world (ACCA, 2010). This data indicates that Thai policymakers must work to build up an SME backbone as part of a national strategy for inclusive growth.

Small Enterprises (SEs) are also important to Thai economy. They contributed an average of 25% of national output between 2008 and 2012. The Office of Small and Medium Enterprise Promotion (OSMEP) reported that in 2012, there were 2.8 million SMEs creating jobs for 11.8 million workers (98.5% and 80.4% of all enterprises, respectively). These 2.72 million small businesses employed 10.2 million jobs, accounting for 98% and 71.8% of all enterprises.

Lack of financing limits the potential of Thai SMEs. Banks financed only 1.1 million SMEs, or about one-third of Thailand's SMEs. According to a recent survey (OSMEP, 2013), only 35.7% of Thai small enterprises were able to borrow from financial institutions and 37.4% had never received bank credit. The survey goes on to suggest that medium enterprises can more easily obtain financing than smaller enterprises. Micro and small enterprises whose assets are less than 0.6 million USD still struggle to access financing from commercial banks.

Thailand is not alone in its SME financing gap. Literature indicates (Ayyagari, Demiguc-Kunt, and Maksimovic, 2006) that root causes for limited SME financing include lack of reliable accounting systems, business experience, and adequate collateral. These problems become more pronounced as the size of an enterprise decreases. Banks lack the information they need to analyze SME loan requests (Wesaratchakit et al., 2010). Insufficient data, including SME profiles and payment histories, make it difficult for credit analysts to make good decisions (Cainey, 2014).

The Bank of Thailand (BOT) is one of several public and private agencies promoting SME development. The BOT has launched programs to help SMEs gain access to commercial bank funding in three priority areas: financial literacy, credit guarantee schemes, and data and information infrastructure. First, the BOT conducts training on hedging and currency management for the SME sector. Second, the BOT facilitates credit guarantees between commercial banks and the SME Bank. Third, the BOT is developing an SME database to help banks create segmentation strategies for different SME categories.

The Thai Financial Sector Master Plan II (2010–2014) recommends that the Ministry of Finance and the Ministry of Justice propose legislations to increase SME financial access. The business collateral act will allow broader types of assets such as leasehold and mortgage servicing rights. The foreclosure law will lessen inefficiency in terms of financial and litigation costs and timeliness associated with non-performing assets.

This paper proposes to advance the Financial Sector Master Plan by promoting the use of an electronic platform. The platform would help SMEs, including micro-businesses, register trade

claims, financial transactions, and tax payments. This data will help banks develop workable substitutes for traditional credit histories, which rely on credit payment data. Transparent posting and tracking of data will allow banks to analyze client capacity and willingness to pay. Moreover, in this E-Claims System, a micro- or small business can declare accounts receivable as collateral because receivables will be electronically tracked.

In traditional business practice, an enterprise purchases goods or services with notes (accounts payable); suppliers record for the amount owed as an asset (accounts receivable). Taxes are included in such purchases. Business-to-business transactions involve payment between payers and payees as part of the clearing and settlement process. Businesses may use banking services for their transactions rather than cash, which, with good information and communications technology (ICT), can facilitate electronic records. Virtual transactions can be recorded in a registry that safely stores data accessible by all parties, thus reducing costs associated with physical record-keeping and collateral verification.

The E-Claims System ideally integrates commercial transactions, banking, clearing, and payment. The E-Claims System must be institutionalized by cooperating stakeholders including regulatory authorities and private sector businesses. The buyer and seller act as an obligor and obligee who accrue and assign records of claim into the system. In some cases, the latter can assign other claims on a new obligee who also transmits the records to store in the system, which is able to electronically clear the balance between the former and new obligee. All obligations will require guarantors to secure payments within the registry. If banking services are engaged, financial institutions pay obligees by recording entries into the system. Therefore, the system not only functions as an electronic clearing of monetary claims but also compiles electronic data records that the stakeholders can use. For instance, a large amount accrued by an obligor can be paid and settled in a lump sum to multiple smaller amounts assigned by obligees. Authorities can utilize the electronic records for policy analyses in trade and investment and banking.

Through the E-Claims System micro- and small enterprises will be able to create credit trails. An individual enterprise can declare its electronically recorded accounts receivable as collateral to facilitate accessing bank credit. With client consent, a bank can trace past transactions and pinpoint assets and liabilities and thus have reliable financial information to analyze credit risk. The E-Claims policy helps reduce information asymmetry between commercial banks and SME customers.

The proposition of an E-Claims System will be a part of financial access development in the next financial sector development plan, which is now in the planning stages. The strategy will evolve in three phases. First, all parties coordinate the implementation of an in-depth study to further diagnose gaps in service. Second, involved regulatory bodies will provide a draft of an E-Claims Act and accompanying guidance for a legislative process. Third, the public and private sectors will prepare the establishment of the E-Claims registry.

In the first stage, the in-depth study will provide details of the scale and scope of the registry. Authorities must design the main architecture of a regulatory and supervisory body to control for potential risks. All document claims must be formalized in standard (physical) formats to be transformed later into electronic formats. In parallel, authorities will draft the E-Claims Act comprised of institutionalization of a registry, the membership contract, scope of business, risk management, and the assignment of a regulator and supervisor. The draft Act must be proposed to the cabinet and parliament through a normal legislation process. Finally, all stakeholders must set up the organizing body of the registry and be prepared to allocate appropriate resources such as human capital, ICT systems, and physical offices. The implementation calls for a working group of the Ministry of Finance, Ministry of Industry, Ministry of Commerce, Ministry of Justice, the Bank of Thailand, the Commercial Bank Association, and the Chamber of Commerce

all under the Steering Committee of the next financial sector development plan chaired by the Minister of Finance.

In conclusion, the E-Claims policy will allow SMEs to track financial information which banks can then use to develop alternative credit histories and analyze their suitability as clients. The E-Claims System helps reduce information asymmetry in that SMEs will have more opportunity to access financing from commercial banks.

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**Consumer Experience:
Tailoring Education and Consumer Protection**

DELIVERING FINANCIAL LITERACY WHERE IT MATTERS: A NATIONAL FINANCIAL LITERACY STRATEGY THAT ADJUSTS TO DEMOGRAPHICS

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Policy Problem

Recent studies show that financial products and services suffer from limited use in the Philippines. Financial literacy can be used to achieve a more inclusive financial system. However, implementation of this intervention is complicated by country's archipelagic economy whose physical fragmentation is exacerbated by a significant degree of socio-economic segmentation.

Background

The Philippines has 80 provinces and 17 regions spread over 7,107 islands and three island groups. More than the sheer distance between islands and island groups, the fragmentation of the economy is further evidenced by the 170 spoken dialects and at least 6 main religions practiced.

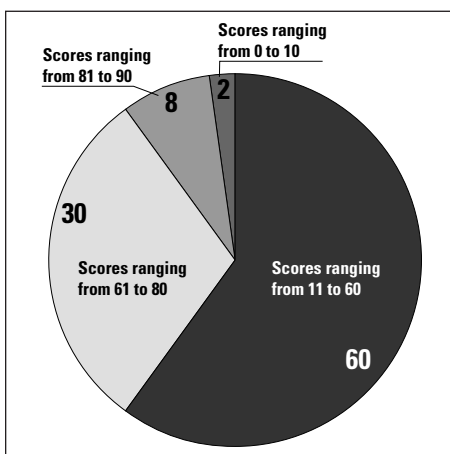
The economic distinctions across families are stark. The latest Family and Income Expenditure Survey indicates that the lowest 10% of families cannot save (i.e., expenses regularly outstripping revenues) and the next 40% of families can hardly save, with 81% of saving generated by the top 30% of families. It is therefore not surprising that the latest Consumer Finance Survey reports that only 2 out of every 10 households have deposit accounts. In another survey conducted by a private financial institution, 92% of respondents scored worse than 80% in a financial literacy exam despite the fact that 20% of the same respondents consider themselves "experts."

The above data validates the need for a heightened financial literacy campaign. In the absence of a designated lead agency, however, various parties from the private and public sector have undertaken their own financial literacy initiatives. The result, unfortunately, is a range of initiatives that remain uncoordinated.

Figure 1. Current Level of Usage and Access of Products and Services



Chart 1. Current Level of Financial Literacy



Lifted from: SOLAR FLARe Financial Literacy Advocacy Report

Analysis

Two insights emerge from the above: (1) a concerted financial literacy campaign should make a real difference in uplifting the financial well-being of Filipinos; (2) such a campaign must specifically account for socio-economic differences.

The first point simply follows from the fact that a significant portion of Filipino individuals/families are currently "financially excluded." Families with the capacity to save will benefit from a financial literacy campaign either by identifying various options for mobilizing saving or being better able to safeguard their savings.

The financial literacy campaign should also cover borrowing opportunities for those with entrepreneurial initiatives. Even those with personal financing needs are likely to be better off with micro-finance personal loans than informal market alternatives.

The second insight is necessary so that the messaging is not “lost” upon the intended recipients. Demographic factors are material because they define the starting point for each constituent’s financial awareness journey—even though a common “destination” (i.e., the measure of “success” for the literacy campaign) may be set by public policy.

In effect, we expect financial literacy to address the personal finance needs of individuals and their families. Yet, those needs are highly variable across individuals/families and one can argue that “personal finance” must be more specifically personal than generic finance if it is to be effective as a platform for a financial literacy campaign.

Moving forward, two issues need to be addressed. First, what are the key messages that Philippine authorities wish to convey to the general public in a financial literacy campaign? Second, what demographic factors must be considered in order for these key messages to be calibrated for delivery to differentiated constituents?

The first issue is simply a matter of policy choice. Upfront, four themes present themselves are natural choices:

1. Saving for the future
2. Saving for unexpected funding needs
3. Avoid over-indebtedness
4. Avoid scams and fraudulent activities

On demographics, the relevant issue is to identify specific indicators that would materially affect both the delivery of the key messages and potentially the content of the message itself. One can consider, for example, the following.

Age Profile

Economic opportunities and ability to generate income may be related to the age profile. For example, a constituency of fresh college graduates is more likely to be cautioned against principal risk even though they may have a longer investment horizon. Saving will remain to be a key message but the deployment of such saving will have to be calibrated to their likely profile (i.e., single individuals with modest earnings, still establishing themselves professionally, and thus cannot afford to take significant investment risks).

Chart 2 validates a young Philippine population where 52.9% of population is below 25 years old and only 4.3% is above 64 years old.

Chart 2. Philippine Population Based on Actual May 2010 Status

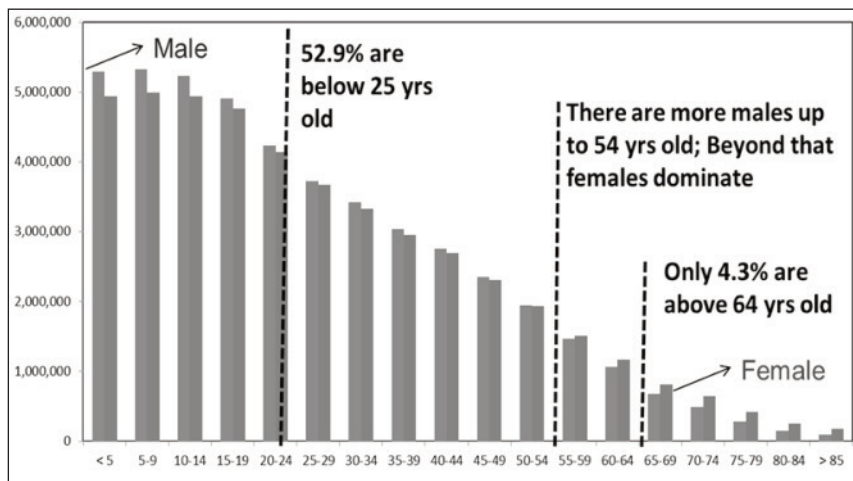
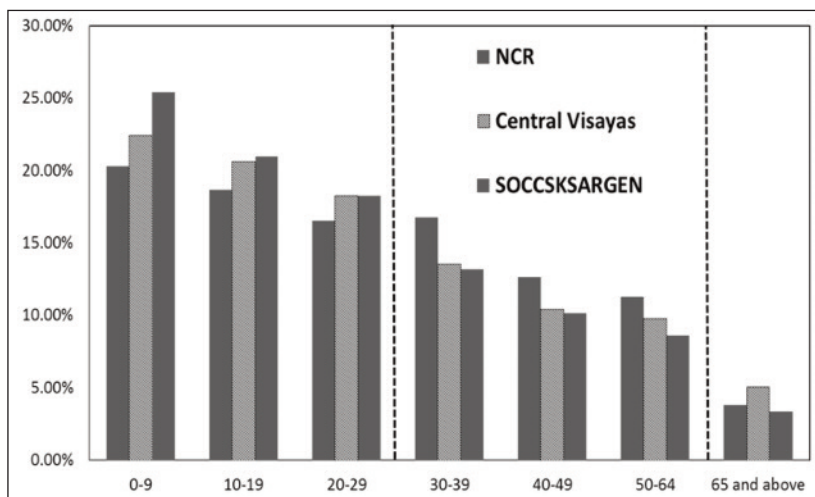


Chart 3. Age Profile by Sample Region



There will be differences across regions, however. Chart 3 shows SOCCSKSARGEN region having a higher younger population than NCR but NCR’s working group population is higher compared with SOCCSKSARGEN.

Chart 4. Total Family Saving by Income Range

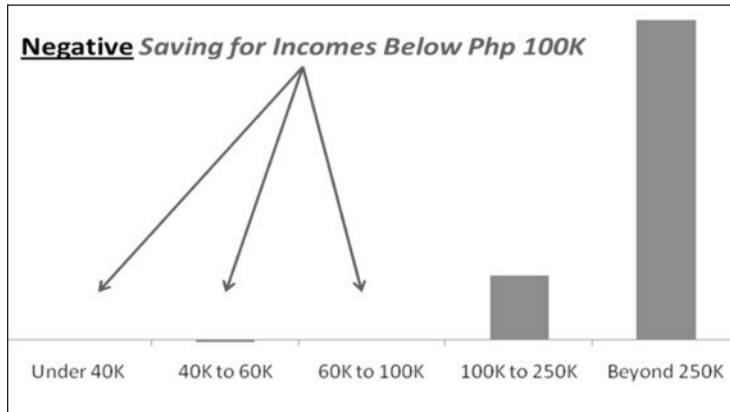


Chart 5. Savings of Families by Decile

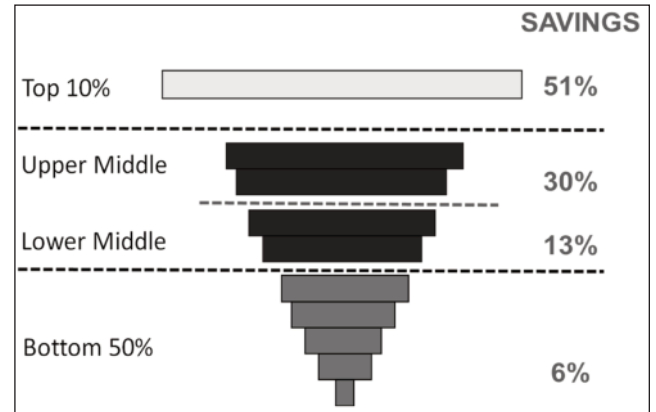


Chart 6. Distribution of Savings by per Capita Income Decile

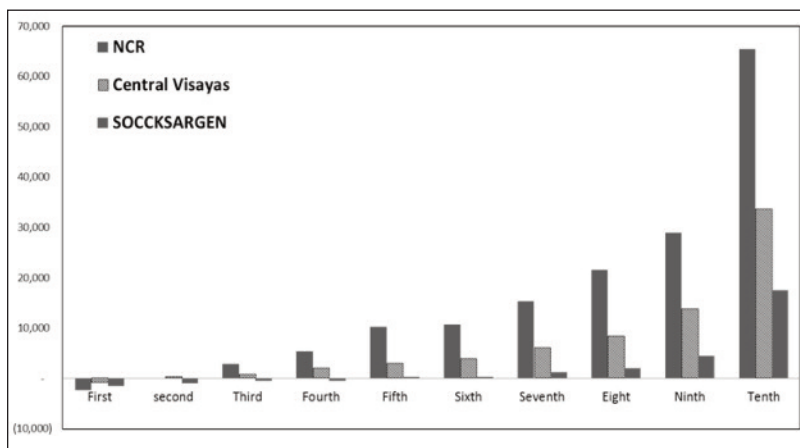
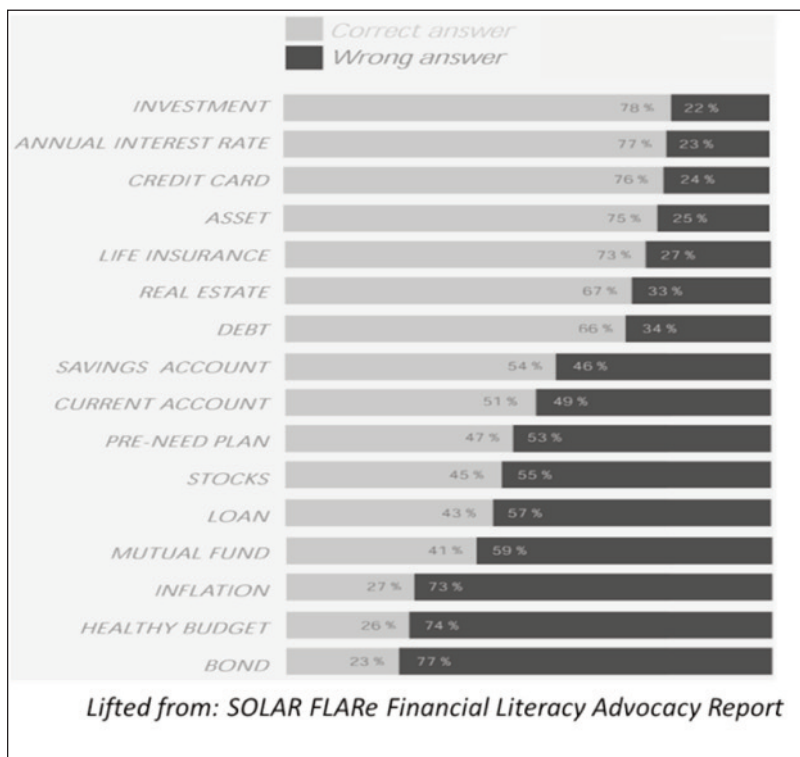


Chart 7. Score per Financial Concept



Income Profile

The ability of families to save as a collective unit will certainly depend on how much income they generate. Income rather than expense is to be treated as more variable since there is a limit for the latter (i.e., there is a minimum threshold for the cost to living below which general welfare is compromised).

It should be highlighted, nonetheless, that income is not necessarily proportional to either financial literacy or even to the generation of saving. Evidence in Chart 4 suggests that there is an “income floor” below which families cannot save. In this case, one cannot preach “saving” when a more appropriate intervention is on employment.

The same caveat holds for income and financial literacy. If Filipino families are divided into income deciles, one can readily validate that saving is rather disproportionate and in fact concentrated toward the most affluent 20% of families.

Chart 6, however, shows different regions will save at a different pace across the family decile.

Furthermore, even those who are familiar with financial concepts, products, and services (and indirectly, have more means to participate in the financial market) do not necessarily show strong evidence of a capacity to operate and understand financial markets. In this case, saving per se would not be the appropriate message but rather the management of risks in deploying the mobilized saving.

Options

The above considerations invariably lead to two obvious choices:

1. **Maintain the status quo**

Under this option, different institutions who have an interest with financial literacy continue to pursue their initiatives. There is no coordination needed as these initiatives are “stand-alone” and may target different constituents. The resources needed for such efforts are then the concern of the specific institutions. However, the very lack of coordination is itself a concern. There is no party tasked with overseeing the contents of the various initiatives. Furthermore, it will not be obvious whether the insights shared by the various literacy initiatives are themselves addressing the issues needed by the targeted constituents.

2. **Develop an integrated yet calibrated financial literacy intervention that is composed of two parts:**

- a. A baseline national financial literacy program that espouses core messages applicable to all constituents.
- b. A financial literacy program per region/province that takes off from the national program and calibrates both the content and delivery to best respond to the local community's requirements/demographics.

Recommendations

It should be evident that a national strategy will be a major initiative but it is unlikely to fully address the policy objective of making financial consumers well-informed in a manner that positively influences their financial well-being. What instead may be more appropriate is a baseline national financial literacy program which is further calibrated to account for the nuances of demographic conditions across regions. The regional distinctions institutionalize the need to “tailor-fit” both delivery and content of the literacy campaign and, when appropriate can be further “granularized” into the provincial level within each region. Toward this end, the following implementation strategy shall be proposed.

1. **Drafting of the Baseline National Financial Literacy Program**

A **draft** baseline strategy can be generated for stakeholders to review and discuss. Given current initiatives, the BSP may initiate crafting this draft. We note that the same procedure was done for the National Financial Inclusion Strategy.

2. **Convene Strategic Partners**

The draft should be disseminated to strategic partners. Said partners can include the government agencies for education, regional development, trade and industry, overseas Filipinos, and financial regulators, among others, while private sector representatives from the banking, securities, and insurance organizations may likewise be invited. These stakeholders should establish a coordinating body or committee and identify a national leader responsible to provide focus and effective coordination to ensure that the strategy is implemented, reviewed, and modified accordingly. The stakeholders should be able to commit resources and should establish accountabilities, measurable plans, and targets.

3. **Conduct Pilot Calibrated Regional Financial Literacy Programs**

Two to three regions may be identified as pilot areas. The strategic partners may create a council, and accountabilities may be delegated to generate the pilot programs.

4. **Perform Continuing Monitoring and Evaluation**

To determine the degree to which the national program has been effective and identify areas for improvement, a framework for rigorous monitoring and evaluating the effectiveness and impact will be established.

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FINANCIAL CUSTOMERS FACE CHALLENGES TO REACH OTHER STAKEHOLDERS IN THE FINANCIAL MARKET

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Financial markets are changing in an effort to reach more customers with services that better meet customer needs. Despite technological innovations, potential and existing customers are not able to change their behavior and preferences fast enough to keep pace with these changes in the financial system. A 2012 World Bank study noted that before the recent crisis, 150 million new consumers of services entered the financial system each year. Although the rate of joining the financial system decreased during the crisis, the number of financial system consumers kept increasing. The financial market of Tajikistan has made efforts in recent years to improve outreach, but rates of adoption are disappointing. Low levels of financial intermediation and limited outreach of service providers combine with financial illiteracy and a lack of information and communication among stakeholders to produce a poor financial inclusion track record in Tajikistan.

In its Banking Sector Development Strategy for 2010–2015, the National Bank of Tajikistan reports a lackluster intermediation rate of 15% in 2013 due, in part, to low levels of public confidence in Tajikistan's formal financial services. A massive collapse of the banking sector in the early 1990s created a general mistrust still felt by the population today. A recent World Bank (2013) study confirms a lack of public confidence. This study also indicates that only 2.5% of the population older than 15 years has an account with a formal institution. This figure lags behind an average account penetration of 30.3% level in developing countries and 87.1% in developed countries (Demirguc-Kunt, 2013).

The same study indicates low levels of financial literacy. The majority of the population does not know basic financial concepts such as calculating interest rates or inflation, and only half are aware of the services provided by banks and microfinance organizations. The report also states that 53% of the population in Tajikistan does not use any kind of formal financial service and that 35% uses only one kind of financial service. Money remittance services are the most widely used financial services. Currently, Tajikistan has the highest remittance to GDP ratio of any country in the world. Remittance inflows account for almost half of Tajikistan's GDP. Transforming these remittances, by financial intermediaries, to savings would help both customers and financial organizations. Moreover, according to Global Financial Development Report (CGAP, 2014), there are 6.7 bank branches per 100,000 people—a very low penetration compared to 18.3 in Turkey and 3.3 in Poland.

Also, despite the fact that 13.8% of adults have savings, only 0.3% of them save in the formal institutions (World Bank, 2013). However, in their research, Pytkowska and Kory ski (2010) state that 84% of households have savings as cash.

The above-mentioned shortcomings are due to three main stakeholders in the financial market: customers, financial institutions, and regulators. This memo proposes three policy options to address these issues: (1) introduce new financial services; (2) help credit organizations reach remote areas; and (3) most importantly, create a consumer protection mechanism.

The first policy option is introduction and implementation of new financial services to broaden the outreach of financial institutions. Islamic banking is currently being introduced: the law was adopted, and some credit organizations are acting as pilot offices on Islamic banking. Furthermore, mobile banking is being introduced to reach a broader clientele base for the system. These services will positively impact many because most of Tajikistan is Muslim and many people live

in remote areas. However, the question remains whether these services will be enough to create more inclusive environment.

The second policy option is helping credit organizations reach remote areas. Because opening and running a branch has high costs and efficiency concerns, permitting credit organizations to serve clients through sub-branches and mobile agents would decrease the networking gap. Also, new types of organizations like credit unions could narrow this gap. The entrance of microfinance organizations to the market and recent developments of this sector demonstrate this point. Microfinancing has changed from donor-funded initiatives to self-funded businesses. They reach rural populations and currently serve more clients than banks do. Loan portfolio of microfinance organizations has increased approximately 9 times in 5 years, from USD 32 million in 2007 to USD 265 million in 2013 (National Bank of Tajikistan, 2013).

However, as was noted by AFI Policy Note (2010), “without adequate consumer protection, the benefits of financial inclusion can be lost.” Therefore, the third and most important policy option is to create an effective consumer protection mechanism. According to best practices, there should be set rules and regulations for financial consumer protection. These rules allow consumers to make informed decisions, abolish unfair conduct with consumers, and resolve disputes (World Bank, 2012a). Regarding the importance of this policy option, OECD (2009) stated that there is a need to improve consumer protection and financial literacy because consumers are in greater financial insecurity due to complex financial services and the lack of knowledge about them. CGAP (2010) addresses the issue of information asymmetries and indicates that consumer protection increases transparency and fair treatment and leads customers to gain confidence for the formal financial institutions. It can also promote fairness in the markets and leads to their efficiency.

Armenia, Peru, and Uganda are examples of the countries that are implementing consumer protection of financial services. Transparency and fair treatment are two pillars for Peruvian regulators and supervisors (CGAP and SBS, 2010). By implementing consumer protection mechanisms, Peru reduced complaints about financial system by 35% since 2004 (AFI, 2010). In Armenia, the Financial System Mediator is responsible to protect financial consumer’s rights and solve disputes between consumers and financial system out of the court (World Bank, 2012b). Finally, in order to promote fairness in the financial market and increase confidence in the financial sector, Bank of Uganda (2011) set consumer protection guidelines that are applied by all financial service providers.

In Tajikistan, from the regulator’s perspective, the absence of institutional mechanism with “clear responsibility and capacity to deal with financial consumer protection” (World Bank, 2013) is one of the most important challenges. Recent amendments to the legislation giving National Bank of Tajikistan the mandate “to create necessary conditions to protection the rights of banking system consumers” is just the beginning of the job.

In this regard, based on the importance of the consumer protection issue, the experience of the other countries, the absence of the mechanism in Tajikistan, and the recent mandate, the National Bank of Tajikistan should create a separate financial consumer protection unit within the National Bank of Tajikistan. The responsibilities of this unit must be clearly identified in order to avoid duplication of duties. The unit must be empowered to analyze the market to see the problems facing financial consumers. The unit should prepare consumer protection guidelines to accommodate the needs of both consumers and financial organizations. These guidelines should be simple and understandable for consumers and should be applicable to all the financial service providers. In addition, the unit should address the process of information disclosure and fair treatment of the financial organizations. Moreover, the unit should oversee a hotline and manage a complaint process. Proper handling of complaints would positively affect both

financial sector regulators and financial institutions. The information gained would also give regulators knowledge about the market and what consumers need. Moreover, complaints and comments about financial institutions would be a good source of evaluation for the performance of their employees.

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