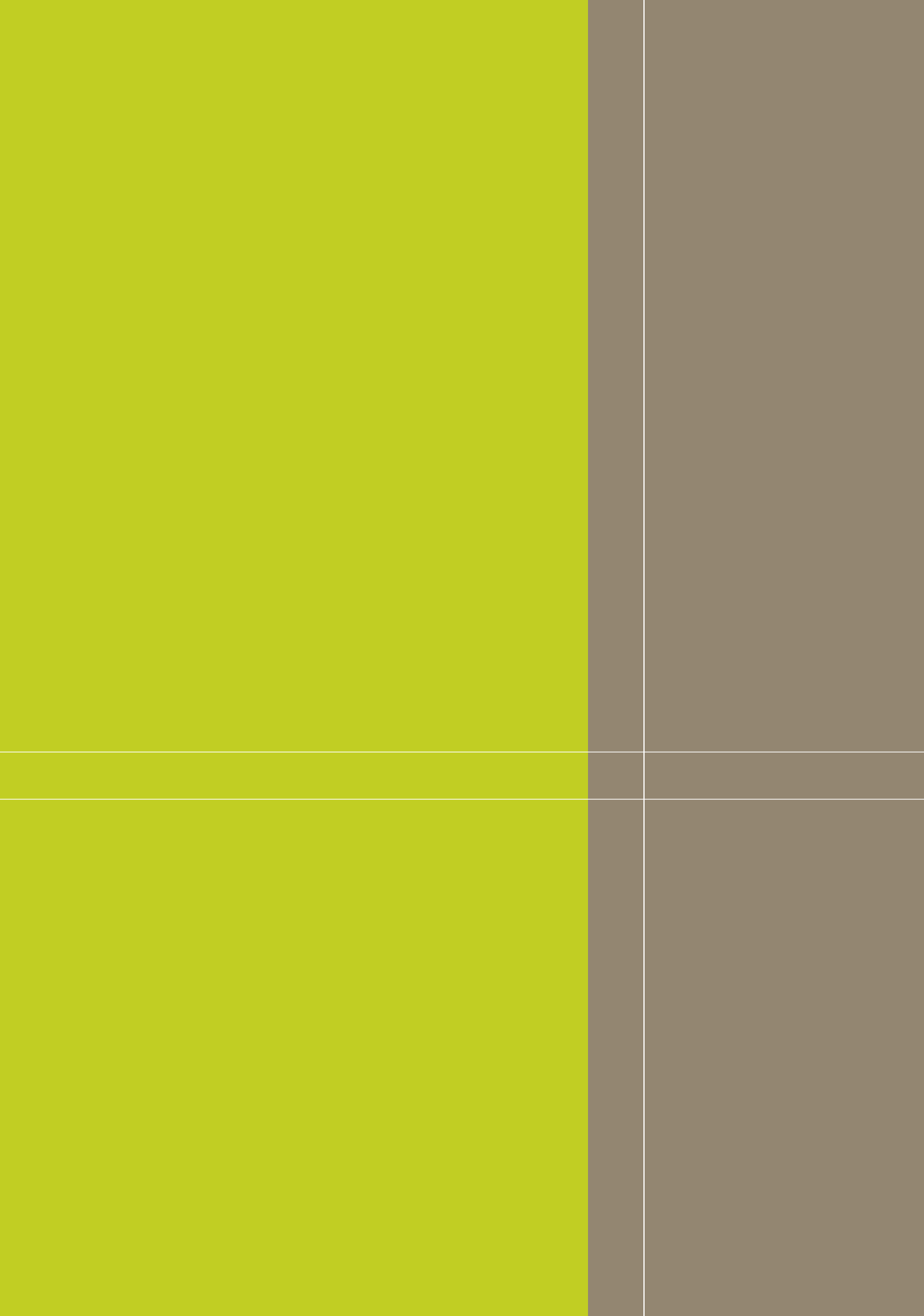


THE FLETCHER SCHOOL

Leadership Program for
Financial Inclusion

Policy Memoranda

2015



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Foreword

This September, we happily complete another year of the Fletcher Leadership Program for Financial Inclusion (FLFPI). Each year the FLFPI team reflects on a key theme that may have surfaced during the Fellowship. This year, a notion continues to tug at us: *how can policy formation be truly evidence-based when so many political forces influence how a policy idea may transform into law, regulation, or organizational strategy, and when uncertainty infuses the evidence.*

Let us back up a bit. Fletcher offers a nine-month Fellowship called the Fletcher Leadership Program for Financial Inclusion. We accept 15 fellows from a large pool of applicants, all of whom are public servants, and most of whom work for central banks, ministries of finance, or public pension and insurance regulatory bodies. Our Fellows hailed from Latin America, Asia, Eastern Europe, and Africa and represented regulatory and supervisory bodies that focused variously on credit, savings, pensions, insurance, and financial literacy.

Fellows begin work in January with a 12-week online curriculum. Each session offers readings, videos, and the opportunity to engage in a vigorous discussion on provocative questions. In May, Fellows convene on the Fletcher campus at Tufts University for two intensive weeks during which we workshop, charette-style, their own policy ideas. Morning sessions feature lectures on topics in financial inclusion and sessions devoted to the science and art of policy articulation and negotiation. Afternoon sessions delve into the specific policy ideas of each Fellow.

Each policy idea begins with the articulation of a clear financial inclusion regulatory gap identified in a Fellow's home country. Our mantra is that each gap must be a *demonstrated* gap and each solution—meaning a proposed policy—must be substantiated with evidence. Still, evidence is a word that is easy to reference but difficult to manifest. In many of the markets in which our Fellows work, evidence for a proposed policy path is tough to find.

Take Liberia for example. Our Fellow, Mussah Kamara, had little trouble referencing the success of a rural banking pilot. But since these pilots are in their early stage, it was difficult to cite specific performance results expected from more mature banks. Ultimately, by skillfully referencing mature rural bank success in other countries, he made a more convincing argument. But to propose scaling up Liberian banks in the face of *emerging* evidence (the pilot areas are extremely difficult to reach making them hugely important but difficult to monitor) requires a leap of faith. Implementation may require iteration: try an idea, test it, keep testing it, perfect it.

This same “best guess” approach might be found also in Bhutan, Brazil, Philippines, Mozambique, Nigeria, South Africa, India, and Indonesia. Our Fellows, we found, try to base their policy ideas on a proven problem, but policy solutions require more than evidence. They require heavy doses of informed imagination. Take Colombia where our Fellow Oscar Martinez labored to meticulously document the challenges of informal sector workers in the wise use of their lump-sum pensions. Many use a one-time pension payout to immediately settle old debts or purchase durables, leaving pensioners with no future prospects for money. His solution is to give pensioners an option of converting their all-in-one-go sums, via a simple financial instrument, into a continuous stream of income. While the benefits of such a product have been documented in other countries, none of these countries is perfectly comparable to Colombia. Again, a leap of faith is required to supplement the evidence. All of which requires an appetite for risk. Shaping a fixed sum into dependable streams of cash could be politically unpopular or practically difficult to implement. But is it worth a try? Our Fellow thinks so and so do we.

Indeed, in the cases of Swaziland and Peru, where Fellows are honing models for mobile financial services, we face an abundance of studies documenting similar cases. Still, no single case links exactly to the timelines and histories of their unique mobile stories. In Zambia, a Fellow

searches for ways to include women—both within current policy efforts as well as prospective ones—and yet scant evidence aligns perfectly with her precise bureaucratic initiatives.

Fellows from Macedonia and Seychelles are taking leaps of faith as they work to pinpoint the best way to engage young people in money management. While they have researched their topics, their best evidence comes from the results of trial, error, and a passion for continuous improvement. Evidence surely is required, but creativity and a continual quest for good policy prototyping rules the day. This is especially true when so many of the good policy ideas we see are pressed through bureaucratic and political sieves that can change even the most substantiated problem into a negotiated solution.

Despite these challenges, our Fellows are unstoppable. We applaud this year's cohort for its unyielding commitment to form policy made up of equal parts evidence, wisdom, ingenuity, and skilled negotiation. May they continue to pilot, document, refine, expand, and try their ideas in a friendly environment.

Kim Wilson
Director, Fletcher Leadership Program for Financial Inclusion

Contents

Bringing Better Access to Rural Areas

Addressing Unmet Needs of Rural Liberia through the Establishment of Rural Community Finance Institutions 3
Mussah Alemame Kamara, Director, Regulation and Supervision Department, Central Bank of Liberia

Bank More with Fewer Branches: A Conducive Branchless Banking Policy to Advance Financial Inclusion in Bhutan 9
Eden Dema, Deputy Governor, Royal Monetary Authority of Bhutan

Promoting Usage of Branchless Banking to Increase Access to Formal Financial Services in Rural Areas 15
Aurora da Gloria Vaz Bila, Director, Banco de Moçambique

Enhancing the Mobile Experience

From Cash to E-Cash: The Implementation of Digital Financial Services in Peru 21
Juan Carlos Chong Chong, Head, Education and Financial Inclusion Department, Superintendence of Banking, Insurance and Private Pension Funds (SBS) – Perú

Enhancing the Ecosystem of Digital Financial Services 27
Ricky Satria, Deputy Director, Bank Indonesia

Mobile Money as an Enabler for Improved Financial Inclusion in the Kingdom of Swaziland 33
Nomcebo Sherron Hadebe, Principal Finance Officer, Fiscal and Monetary Affairs Department, Ministry of Finance, Swaziland

Improving upon Institutional Mandates

Integrating Gender Mainstreaming in Financial Inclusion Strategy 39
Kabinda Kakoma Kawesha, Executive Assistant to the Deputy Governor – Administration, and Specialist – Financial Sector Development Unit, Bank of Zambia

Beyond Boundaries of Financial Access: Trigger the Transactions for Meaningful Financial Inclusion 45
Talapala Venkateswara Rao, General Manager, Financial Inclusion and Development Department, Reserve Bank of India

Promoting Sound Practice through Transparency & Proportionality

Bringing Light to the Shadows: Regulating and Supervising Remittances in the Philippines, an Attempt to Address Shadow Banking Activities for Low Value Accounts 51
Gerardo Abulencia Butardo, Director, Integrated Supervision Department I, Bangko Sentral Ng Pilipinas

Enhancing Formal Credit Adoption among Adult Nigerians through Transparent Screening and Monitoring	57
<i>Temitope Akin-Fadeyi, Head, Financial Inclusion Secretariat, Central Bank of Nigeria</i>	
Informal and Unlicensed Providers of Funeral Insurance Pose a Risk to Low-Income Households	63
<i>Mamoraka Jacobeth Huma, Head of Department, Microinsurance Supervision, Financial Services Board, South Africa</i>	
Financial Inclusion for the Lifecycle: Tailoring to the Needs of the Young and the Old	
Enhancing Financial Education in Seychelles.	69
<i>Nicholas Julian Cetoupe, Financial Services Analyst, Central Bank of Seychelles (CBS)</i>	
Financial Education in Republic of Macedonia—Need or a Must?	77
<i>Kristina Nikolovska, Assistant to the Governor, Central Bank of Macedonia</i>	
Bringing Responsible Lending to the Payroll-Credit Market: Protecting Pensioners from Aggressive Lending.	83
<i>Stanislaw Zmitrowicz, Coordinator, Central Bank of Brazil</i>	
Bringing Income Options to Non-Pensioners in Colombia	87
<i>Oscar Martinez, Deputy Director of Prudential Regulation, Financial Regulation Agency – Colombia</i>	

Bringing Better Access to Rural Areas

Addressing Unmet Needs of Rural Liberia through the Establishment of Rural Community Finance Institutions

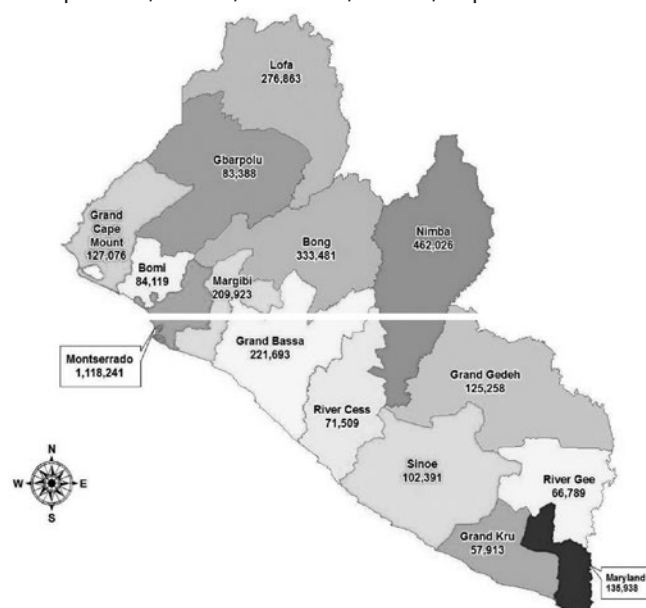
Mussah Alemame Kamara

Director, Regulation and Supervision Department, Central Bank of Liberia

Executive Summary

Fifty-three percent (about 1.8 million people) of the population of Liberia lives in rural parts of the country (Liberia Institute of Statistics and Geo-Information Services (LISGIS), 2008). A survey commissioned by the Central Bank of Liberia (CBL) in 2013¹ revealed that “only about 3 out of 10 adults kept a personal or joint account with a formal financial institution, showing that Liberia has one of the lowest penetration rates of the formal financial sector in Africa cited by Marx et al. (Liberia: RCFP Project Document, Marx et al., 2015) compared to “. . . 23% of adults in Africa and 24% in sub-Saharan Africa . . .” in the report on Financial Inclusion in Africa (Triki and Faye, 2013, p. 94).

Figure 1. Counties in Liberia and the Spatial Distribution of Population, LISGIS, Monrovia, Liberia, September 2011



Eleven of the fifteen counties have the presence of at least one commercial branch; usually these branches are concentrated in the administrative headquarters of the counties (see Table 1 below). Many economically active districts lack formal financial services. The absence of formal financial services has been a major constraint for the rural population in accessing basic and important financial services, including payments, savings, and credits.

Based on the current data on the Rural Community Finance Institutions (RCFIs), implemented under a pilot project, and evidence from other countries, such as Ghana, I strongly believe that the RCFIs are one of the effective policy options for expanding formal financial services in the rural areas, and recommend that the Central Bank of Liberia should promote the establishment of more RCFIs.

Background

Access to finance remains a key policy goal for the Central Bank of Liberia as articulated in its many policy statements, in the Liberia Financial Inclusion Strategy (2014–2019), and the bank’s commitment under the Maya Declaration. The Government of Liberia (GoL) also recognizes the importance of financial inclusion as a key pillar of its development agenda, the Agenda for Transformation (AfT), which is a five-year development plan for the Government to take Liberia to a middle-income country by 2030.²

Two of the important goals of the AfT under the Economic Pillar are: (1) to ensure rapid growth of micro, small, and medium enterprises (MSMEs) that will lead to increased employment and wealth creation and reduced poverty (p. 61) and (2) encourage gradual expansion of bank lending and other services to MSMEs and underserved communities (p. 69). The document also identifies as a major constraint, the low productivity of small-holder farmers (most of whom live in the rural parts of the country) due to several factors, including lack of adequate credit.

The existing financial services providers, including the informal providers, have not been able to adequately address this constraint.

The financial system of Liberia is composed of 9 commercial banks, 20 insurance companies with a number of insurance brokerage firms and agents, 1 development-finance company, 1 deposit-taking microfinance institution (MFI), 111 foreign exchange bureaus, and 7 RCFIs, which are still in the pilot phase. Currently, most of the activities of commercial banks are concentrated in Monrovia, the capital city, which is located in Montserrado County, as shown in Table 1 below.

Table 1. Statistics of Distribution of Banking Services (May 2015).

County	Population	Bank Branch	RCFI
Bomi	84,119	1	
Bong	333,481	3	
Gbarpolu	83,388		1
Grand Bassa	221,639	6	
Grand Cape Mount	127,076	1	
Grand Gedeh	125,258	1	
Grand Kru	57,913		1
Lofa	276,863	2	
Margibi	209,923	9	
Maryland	135,938	4	
Montserrado	1,118,241	50	
Nimba	462,026	7	2
River Cess	71,509		1
River Gee	66,789		1
Sinoe	102,391	1	1
Total	3,476,608	85	7

Source: LISGIS, 2008 Population and Housing Census; and Regulation and Supervision Department, Central Bank of Liberia (CBL)

There is a significant informal financial sector with a large number of unregulated credit unions (about 225 credit unions) and traditional credit clubs (“susu” clubs and Village and Savings Associations (VSLAs)). Notwithstanding the existence of these informal financial services providers, the rural parts of the country still have significant unmet financial services. According to Marx et al. (2015, p. 47), “More than half of the rural households of Liberia have no access to credit from any source (banks, relatives, savings clubs, etc.).³ In contrast to the formal sector, savings and credit mechanisms are diversified and dynamic in the semi-formal and informal sectors, which are the only sources of reliable capital for the rural poor.” The semi-formal and informal sectors themselves are significantly challenged with capacity constraints and financial resources to meet the financial needs of the rural households.

Two of the key findings of a financial-inclusion survey report (February 2015) conducted by the Central Bank of Liberia with technical support from the Alliance for Financial Inclusion were: (1) that only about 28% of the adult population (18 years and above) has an account with a formal financial institution; and (2) distance to access a financial institution was a factor discouraging the opening of accounts by members of the public.

An assessment undertaken by the CBL in February 2012, of four leeward counties revealed that there were urgent needs for formal financial services in not only those counties, but other counties in the country. The assessment revealed several causes for the absence of formal financial

services, especially commercial banks, in most rural areas in the country. Among the factors identified are:

1. Limited economic activities in some rural areas;
2. The business strategies/models of most commercial banks which are focused on servicing the “big-ticket” clients and low-risk sectors of the economy, rather than high risk sectors and clientele, generally associated with the rural population and activities;
3. The problem of poor infrastructure (especially bad roads) in most rural areas, which also increases the cost of doing business; and
4. Lack of the right financial services providers with the expertise and knowledge in servicing the financial needs of the rural population.

Problem

Rural Liberians lack access to formal payment, credit, and savings services due to an inadequate formal financial system in large part of Liberia.

Proposed Solution: Promoting Rural Community Finance Institutions

The CBL has implemented several policy interventions to address the financial constraints of the rural population.

These policy measures include: (1) initiatives to expand the use of mobile money in the rural areas; (2) reforming the credit-union sector, which operates largely in the rural areas; and (3) more recently implementing a pilot project of RCFIs.

Among the different initiatives, the RCFIs project has proven to be one of the effective policy options in addressing the financial constraints of the rural population so far.

The pilot project of the RCFIs commenced in December 2013 when the first RCFI was launched in a northern district, Gbeh-Geh, in Nimba County. As shown Table 1 above, there are currently seven RCFIs established under the pilot project (four in the south-eastern part of the country, two in the northern part, and one in the western part). The RCFIs are community-owned and managed “banks” with lower minimum capital requirement of US\$50,000 compared to US\$10 million for commercial banks. However, unlike the credit unions, they are allowed to provide most essential financial services, including mobilizing deposits from the communities, and providing credits and payments services. Unlike the commercial banks, they are not allowed to engage in cross-border transactions, which they have to do in partnership with commercial banks. The CBL is currently in the process of developing the prudential and regulatory requirements for these RCFIs to ensure their safe and sound operations.

As of March 2015, over 5,000 government workers, including teachers and health workers, received their salaries and allowances through five of the seven RCFIs for the first time. This development is helping in keeping teachers and health workers in those locations on their jobs and saved them the cost of transportation, and the associated risk of accidents with motorbikes in travelling from the rural areas to nearby cities to collect their salaries. Many of the teachers, health workers, and other civil servants have begun to establish accounts with the RCFIs, with the total accounts of 1,596 accounts with five of the seven RCFIs as of March 31, 2015.⁴

Some RCFIs have started offering “salary loans” (i.e., loans secured by salary accounts), while most of them are offering local transfer services as well as Western Union and MoneyGram transfer services. The total deposits of four RCFIs at the end of December 2014 grew from L\$4 million to L\$8.7 million of six RCFIs, while total salary loans granted as of March 2015 was

L\$7.297 million (about US\$87 thousand). These figures are encouraging considering the infant stage of the RCFIs. However, there is need for more time (at least after 2 years) in order to determine the actual performance of the RCFIs compared with other financial services providers.

Based on the foregoing, I recommend the promotion of the rural community finance institutions as one of the effective policy options for addressing the huge financial needs of the rural population in Liberia. The promotion of RCFIs will not only address the financial needs of the rural population, but also help in building a financial ecosystem that will support other financial services providers in the rural areas.⁵

There is also evidence (Nair and Fissah, 2010) which shows that rural community banks in Ghana, such as the RCFIs, are the largest providers of formal financial services in rural areas and represent about half of the total banking outlets in Ghana.

Rural banks are not a perfect model; rather there are a number of challenges associated with their operations, just like any sub-sector of the financial system. Nair and Fissah (2010, pages 25–26) have highlighted some of the lessons and challenges in their paper, which provide useful lessons for policy makers in developing a viable rural community banking sector. A few of the challenges are enumerated below.

1. Both poor operating environment and capacity constraints can negatively affect the performance and effectiveness of RCBs.
2. The requirement of location-specific ownership, as it is the case in Liberia, can be a key constraining factor for the growth and consolidation of the RCB network.
3. Local financial institutions, such as RCBs, themselves often cannot self-provide or obtain several services (such as specialized training, product development, market research) they need from the market.
4. Even if a good legal, policy, and regulatory environment are provided, failures of a certain number of institutions should be expected. This issue should be addressed upfront by ensuring that the regulatory system has the necessary capacity in terms of skills, political autonomy, and financial resources.
5. Donor funding for supervisory activities cannot sustain a supervisory regime in the long run, and mobilization of private funding to supervise services delivered to poor clients is not a feasible option. Government resources are thus fundamental to ensure adequate supervision of services delivered to poor clients.

Enabling Policy Recommendations

In addition to the broad recommendation stated above, I strongly recommend to the CBL to take the following concrete steps in order to create the enabling policy environment for RCFIs and rural financial inclusion.

- Continue support for the ongoing pilot project of the rural community banks in targeted areas of the country, particularly in areas with productive economic activities in order to ensure sustainability and growth.
- Develop a proportionate regulatory and supervisory framework to guide the operations of the rural community banks.
- Set up the institutional framework to oversee the regulation and supervision of the RCFIs.
- Make the case to central government for further policy interventions and support for the RCFIs, such as tax incentives and technical support through budgetary allocation.
- Commission an independent evaluation of the project after three years of implementation of the pilot project, in order to assess the effectiveness of the project.

Expected Outcomes of Recommended Policy

The current evidence shows that rural community finance institutions have a significant potential to positively impact the lives of rural population. As articulated in the AfT document (see background above), one of the key constraints for smallholder farmers and MSMEs is the lack of access to formal financial services. Additionally, the Financial Inclusion Survey Results as cited by Marx et al. (2015, p. 3) show that there is a highly pronounced savings habit: 23% of respondents stated that they regularly set aside money as savings, and another 51% stated that they did so sometimes. The conclusion from these results is that there is a large number of the population that would save in stable formal financial institutions once there are no bottlenecks, such as distance to access points and quality of services of formal financial institutions (Marx et al., 2015).

These figures show the demand for formal financial services, which support the need for the presence of formal services providers, such as RCFIs, in the rural areas. Some of the benefits expected from this policy intervention are:

1. increased access to basic financial services, including loans, savings, and payments, by the rural people;
2. development of the private sector, especially the rural farmers, the small and medium enterprises, and micro-businesses;
3. support to agricultural financing and improvement in the agricultural sector;
4. building of a financial ecosystem that will link the informal and formal financial institutions; and
5. a spur to growth and development in the rural areas, creating jobs and increasing income for the rural population.

Implementation Strategy

In order to achieve this goal, the following actions will need to be considered and implemented:

1. seek the approval of CBL Management for the establishment of a designated unit responsible for the regulation and supervision of RCFIs;
2. develop and publish the appropriate regulatory and supervisory framework for the RCFIs by the end of 2015;
3. develop the appropriate reporting requirements by end of 2015 for monitoring and analysis of the performance of the RCFIs;
4. seek further support from CBL to establish additional RCFIs in other areas, including capacity building support, for 2015–2016;
5. develop and implement public education and sensitization of RCFIs activities as a means of enhancing public confidence in their operations and to promote local ownership of the RCFIs; and
6. engage the government through the Ministry of Finance and Development Planning for budgetary support and other policy interventions to support the RCFIs beginning 2016 fiscal year for a period of 3 years.

Conclusion

The facts and evidence show that the rural parts of Liberia have significant unmet financial services, which could be considered as one of the binding constraints for the growth and development of the rural economy. As I have argued in this memo based evidence and analysis, I believe strongly that rural community banks are an effective model in addressing the financial needs of the rural part of the country and spurring growth and development in the rural areas.

They can also serve as foundation for building a financial ecosystem in the rural areas in terms of providing services to other financial services providers, such as credit unions, microfinance institutions, Village Savings and Loans Associations (VSLAs), and mobile-money operators including serving as super agents for mobile-money companies.

However, as indicated above, this will require the collective efforts of all stakeholders: the CBL, the central government, the rural community members, interested commercial banks, and development partners.

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Endnotes

1. Of these, 18% had an account in a commercial bank, 3% with a microfinance bank, 1% with a microfinance institution (MFI), and 9% with a credit union (CU); Central Bank of Liberia: National Financial Inclusion Survey Project for the Update of the Liberian Strategy for Financial Inclusion (LSFI), 2014–2019, implemented by Top Consulting Incorporated, Liberia, Monrovia, published, February 2015.
2. www.mfdp.gov.lr/index.php/document/resources/national-development-agenda/file/9-agenda-for-transformation.
3. Liberia Comprehensive Food Security and Nutrition Survey [CFSNS], 2012.
4. Data collected by Regulation and Supervision Department, CBL on the activities of RCFIs at end-March 2015.
5. The Liberia RCFP project document discusses in great detail the potential of the RCFIs/Rural Community Banks in effectively addressing the financial constraints of the rural population and accessing needed finances to the agricultural sector.

Bank More with Fewer Branches: A Conducive Branchless Banking Policy to Advance Financial Inclusion in Bhutan

Eden Dema

Deputy Governor, Royal Monetary Authority of Bhutan

Executive Summary

Bhutan's financial sector has registered a compounded annual growth rate (CAGR) of 9% since 2010 with remarkable progress made in terms of stability, profitability, and competitiveness. However, this growth remains skewed in terms of geographic penetration inhibiting the overall growth of the economy. Banks are mostly concentrated in urban areas, citing high costs and low returns in reaching the unbanked areas. With 70% (2014) of Bhutan's population (745,153) residing in rural areas (Source: NSB report June 2008); and with agriculture being the main occupation, increased access to financial services has great potential to improve its contribution to economic growth.

Success stories of mobile money in Kenya (M-PESA and M-Shwari) and Tanzania (M-PESA and Tigo Wekeza) have shown innovative technology-led models can play a pivotal role in delivering financial services to people in a safe, cost-effective, and convenient manner. For many countries, mobile money has been established as “*the*” driving force to advance financial inclusion, supported by accommodative regulatory framework. In Bhutan, new and innovative technology-based bank-led models have sparingly emerged but remain underdeveloped in the absence of a regulatory and supervisory framework, coupled with perceived risks of the providers.

Therefore, it is imperative to build a robust framework with the twin objectives of supporting these models as well as fostering competition from new players. These models would greatly reduce the cost and distance in delivering financial services to people, which are major impediments to advancing financial inclusion in Bhutan.

I propose the Royal Monetary Authority of Bhutan (RMA)¹ provide a regulatory framework through a “single licensing window” to potential financial-service providers in delivering financial services to everyone. The proposed policy intervention calls for the RMA to issue branchless banking regulations that will enable deposit taking, remittances, agent services and mobile-banking services in Bhutan, but no lending.

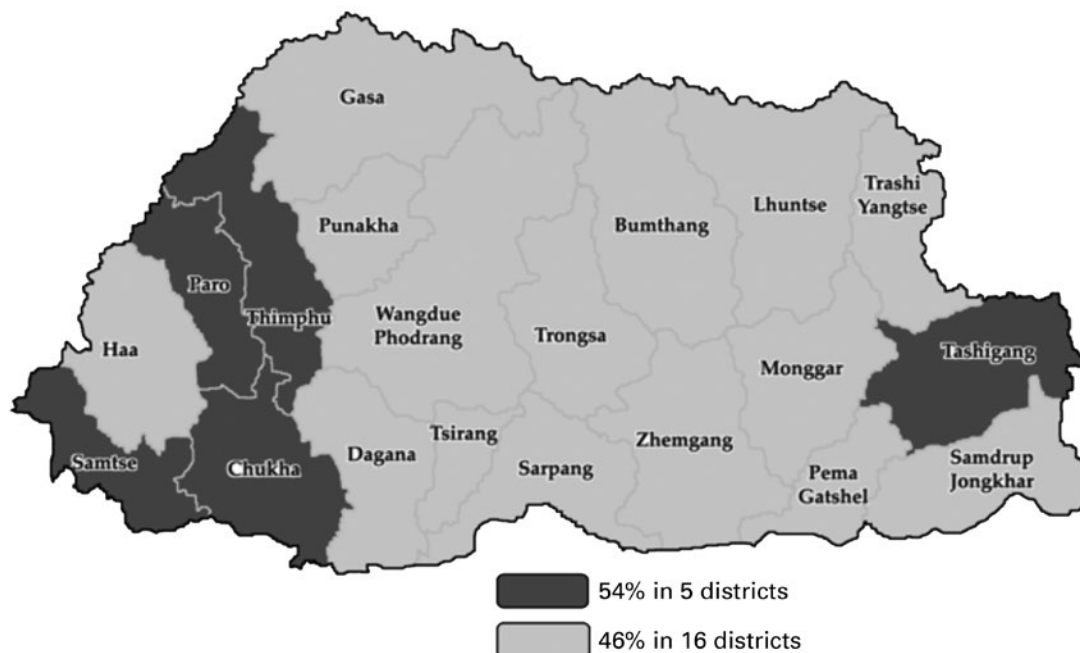
Background and Problem Diagnostics

Bhutan is a small country located in the Himalayas with a population of 745,153 (2014). It has 20 districts and 205 sub-administrative units. Despite being landlocked, Bhutan has experienced growth rate averaging 6.7% (2009–2013), fueled by hydropower sector. Bhutan's per capita income is USD\$2,440, with poverty rate at 12% (Source: NSB/WB 2012 report) and unemployment at 2.9% (Source: RMA Annual report). Bhutan's overall performance is impressive, although on a declining trend.

Bhutan's financial sector has experienced a growth rate of 9% with 15% and 21% growth in profitability and solvency. However, this growth is primarily concentrated in urban areas and few sectors.

In terms of access, although the number of access points per 10,000 adults is 5.08, with 23.41% administrative units having at least 1 access point, its distribution is highly skewed. From a total of 266 access points, around 54% are concentrated in Thimphu, Chukha, Trashigang, Samtse, and Paro (see Fig. 1) with a population of 368,270 (49%) (Source: NSB June 2008 report).

Figure 1. Geographical Concentration of Access Points



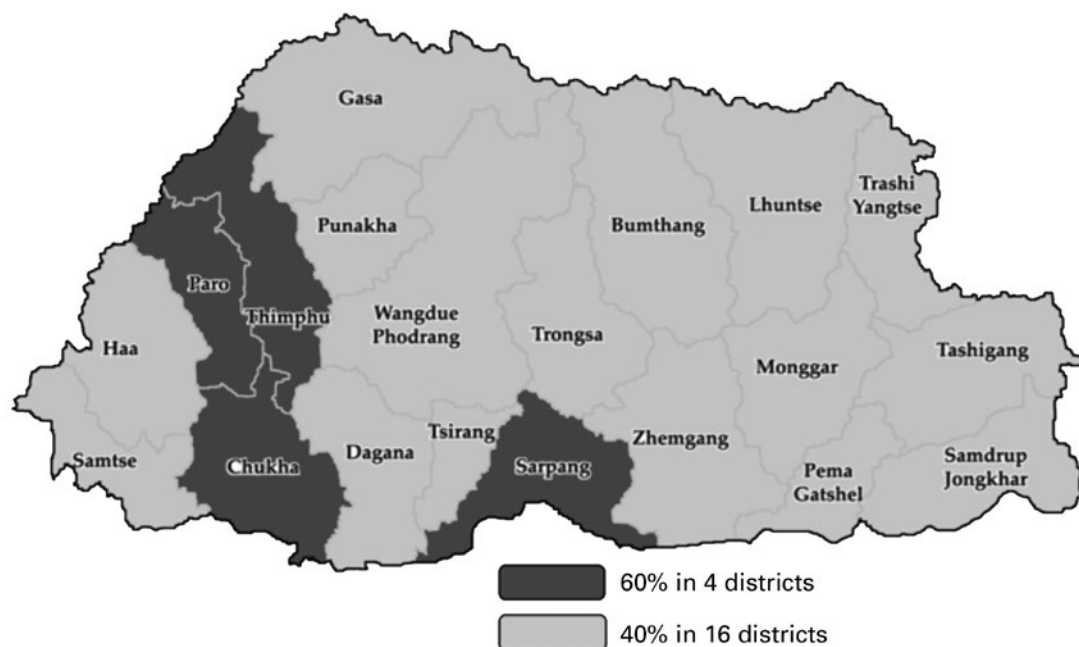
In terms of deposit-account penetration, according to the Global Findex 2014 World Bank report (Kunt, Klapper, Singer, and Oudheusden, 2014), 34% of adults in Bhutan have access to a deposit account as compared to the developing country average of 54%. Women hold 28% of bank accounts, compared to the developing economy average of 50%. In terms of concentration, Thimphu, Paro, Wangdiprodrang, and Chukha with 280,100 (38%) population account for 61% of deposit accounts; the remaining 16 districts with population of 465,053 (62%) have 40% (Source: NSB June, 2008 report).

Only 13% of the adult population has access to a loan account, of which 60% are concentrated in the four urban districts of Thimphu, Paro, Sarpang, and Chukha (see Fig. 2), with population of 287,979 (39%) (Source: NSB June, 2008 report).

According to the Bhutan Living Standards Survey (National Statistics Bureau, 2012), a greater proportion of urban households (30%) compared to rural households (11%) borrow from banks due to lower costs and easy accessibility. Likewise, in terms of emergencies, 80% of urban households use bank savings compared to 42% of rural households. Most rural people save at home rather than banks due to long distance and high cost in accessing bank branches. “Access to credit” has been cited the major impediment to private sector growth in majority of surveys conducted so far in Bhutan.

Therefore, it can be concluded that formal financial services are primarily in urban areas, with the majority of the population being underserved. As policymakers, we cannot ignore these realities, especially knowing that increased delivery of financial services can provide people with the opportunity to save, invest, insure and build financial resilience, which could support inclusive growth.

Figure 2. Geographical Concentration of Loan Accounts



In terms of infrastructure, delivery of financial services through technology is highly feasible; mobile penetration in Bhutan is 84%; and 88% of total households have access to electricity. The ICT-supported community centers in all the 205 administrative units in Bhutan could act as agents to deliver the services. Globally, experiences in Kenya and Tanzania have shown technology-led models as a powerful tool in advancing financial inclusion, especially among the poor and unbanked.

M-PESA was launched in 2007 by Safaricom as a mobile-money transfer service, which propelled financial inclusion to heights in Kenya with 70% adult population using it though it's network of 40,000 agents (source: Oyebode, A. 2014). Given the similar “hygiene” factors in Bhutan that supported its growth in Kenya such as the national identification system, early adoption by urban dwellers, government support for “e-payments,” and a pragmatic approach to “development led regulation,” the proposed model could prove successful in Bhutan.

In short, financial empowerment can lead to social and economic empowerment, thereby supporting the objective of pursuing financial inclusion as a “*means to an end and not an end in itself.*”

Analysis of the Problem

The financial system in Bhutan has always been bank-led, with banks' assets accounting for 88% of the total financial-sector assets. However, the “brick and mortar” model adopted by banks impedes financial services delivery to rural areas, as branches are expensive but provide low returns. Therefore, most banks do not see any “business case” in providing financial services to these areas, unless required by regulations or mandated by the government.

Other factors contributing to the problem are:

- limited and homogenous financial products supplemented by lengthy and complex procedures encourage people to **exclude** themselves from the formal financial system;
- long distances to banks' access points with poor customer care deter clients from visiting branches, even where available;

- informal providers like moneylenders, religious bodies, rotating savings and credit associations (ROSCAs), and accumulated credit and savings association (ASCA)-type associations service the unbanked population with easy and fast financial services, even though *people prefer formal financial services*;
- Bhutan's mountainous terrain with low density of population (19.4%) makes it difficult and costly to deliver financial services to everyone;
- lack of uniform fiscal and capital incentives from the government deters financial institutions from delivering their services in the unbanked areas; and
- absence of a clear policy in addressing the financial inclusion gap has led to mushrooming of stand-alone policies adopted by different agencies, which are often duplicating and confusing; and do not meet the required output(s); neither in addressing the gap nor in meeting related social and economic objectives.

RMA has taken various steps to modernize the financial sector infrastructure through the establishment of a credit-information bureau, a collateral registry, and an electronic-fund transfer clearing system, to deepen the financial system in advancing financial inclusion, with more focus on the unbanked population.

Still, the challenge lies in creating a “proportional regulatory framework” (source: E. Dema, AFI viewpoints) that will allow new technology-led models to flourish without stifling their growth, while mitigating risk.

Policy Recommendation

Based on the above analysis, the policy recommendation requires RMA to draft, finalize, and adopt a branchless banking regulation. The regulation would allow new models of “banking with fewer branches” and facilitate new players to deliver financial services to those excluded from the formal financial system.

The proposed regulations will allow provision of mobile payments, mobile banking, and agent banking through the establishment of a “single” and “separate” new entity. They will be subjected to RMA's supervision on a “solo” basis and not on the entity's entire business, thereby saving costs. Further, RMA will strive to balance the risks and the opportunities inherent in these models without stifling their growth.

The entire process of drafting the regulations to its implementation require the Government to take the responsibility of a “convener” of financial inclusion in meeting broader social and economic goals (source: CBK Policy reflections). The Government is also seen as an “enabler” in supporting the use of such models to make government-to-person, person-to-person, and person-to-business (source: AFI policy notes on MFS) and “vice-versa” payments in ensuring transparency, accountability, and openness, in collaboration with other parties.

The RMA would take the lead role in providing the regulatory framework by drafting, finalizing, and issuing the branchless banking regulations. The regulations will be finalized after several rounds of consultative meetings with stakeholders such as the mobile network operators (MNOs), existing financial institutions, non-governmental organizations, and the public.

Once adopted, the RMA will license MNOs and other applicants who have approached it to provide financial services through new models. Concurrently, the RMA and the Ministry of Information and Communication (MOIC) joint project on “interbank mobile payments system” and the “E-payment gateway” will support the implementation of the regulation in removing potential barriers to exclusivity and in meeting broader economic goals.

Conclusion

The above policy recommendation eliminates the need to obtain multiple licenses to provide mobile financial services, deposit taking, agent banking, and e-banking services for new and current service providers. In addition, it will foster competition, ultimately benefiting the customers. Further, it would revolutionize the way financial services are delivered to people, which would push the banks to completely wean away from their traditional “brick and mortar” approach of delivering services.

The regulations will formalize the existing but “unregulated” partnerships between banks and MNOs in providing financial services to those currently underserved by formal financial services.

For the RMA, the regulations will have twin benefits; meeting the goal of improving “access to an account by an adult” from the current 34 percent to higher levels, and transforming the Bhutanese economy from cash based to cashless. This will also reduce the huge costs incurred by RMA to “print and issue” Ngultrum currency.

For the government, the policy intervention from RMA will supplement its efforts in achieving balanced economic development in the country by providing a “legal, institutional, and regulatory” framework to support its initiatives in bringing public services closer to its people in a faster, cheaper, and efficient manner.

The policy intervention will also allow new actors such as MNOs and non-bank companies to propel financial inclusion to new heights, thereby meeting the government’s objective of financial empowerment, which is critical in accelerating economic and social empowerment, thereby enabling every Bhutanese to contribute meaningfully to the growth of the country.

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Endnote

1. RMA is the central bank and the integrated financial regulator in Bhutan.

Promoting Usage of Branchless Banking to Increase Access to Formal Financial Services in Rural Areas

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Executive Summary

In 2013, the government of Mozambique approved a Financial Sector Development Strategy (2013–2022) that defines specific measures to be undertaken regarding the lack of access to formal financial services by the rural population. In addition, the strategy empowers the Bank of Mozambique to develop a National Financial Inclusion Strategy (NFIS) (Banco de Moçambique, 2013a, b).

Recognizing the benefits of financial inclusion to the economic development and growth of the country, the Bank of Mozambique is currently developing a NFIS, together with an adequate regulatory framework that will broaden access to formal financial services in the rural areas. This is a priority topic in the government agenda due to the fact that a significant portion of the rural population (more than 50%) does not have access to formal financial services.

This memo focuses on how formal financial services can be extended to rural areas through branchless banking, by means of mobile financial services and agent banking networks. I recommend the introduction of an incentive framework (Notice) that will arise from collaboration among the Bank of Mozambique, commercial banks, and mobile money operators (MMOs).

Context

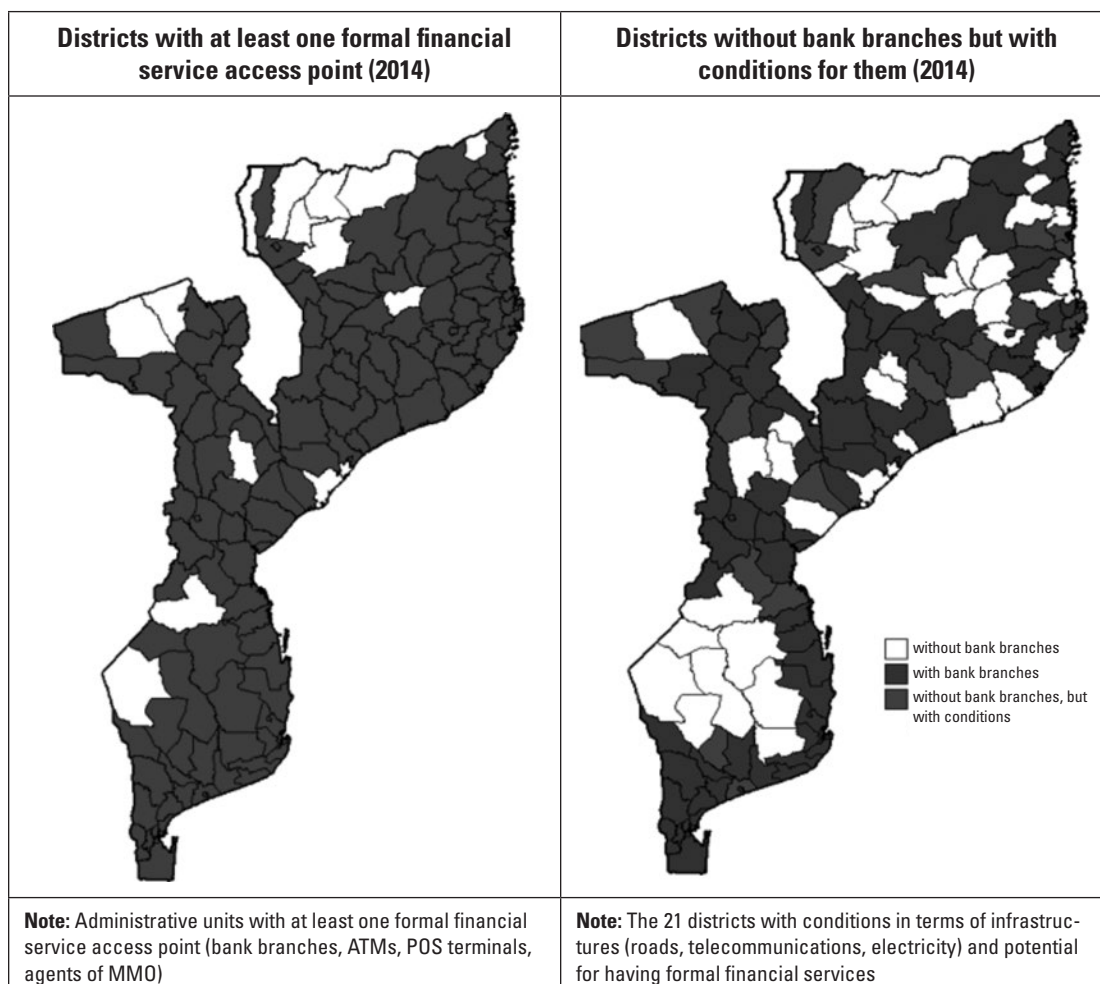
Mozambique's estimated adult population is 13,766,888; 24% have bank accounts (3,307,524), 13% of which are in rural areas. In terms of geographical banking coverage, available data at the Bank of Mozambique shows that from the 141 districts in the country, 113 provide formal financial services. Moreover, of the 28 districts that do not have formal financial services, 21 have sufficient infrastructure to enable the extension of bank structures.

From the total bank branches in the country (572 in December 2014), 144 are in rural areas and 428 are in urban areas (209 in Maputo city). In terms of geographic coverage, there is a concentration of bank branches in urban areas (35 branches per 10,000 km² in Maputo City), contrasting with the rural areas (where there are roughly two branches per 10,000 km²). The country also has 1,302 ATMs and 14,690 point of sale (POS) terminals with 15 ATMs and 155 POS terminals per 10,000 km² (Banco de Moçambique, 2014).

When including the activity of MMOs in financial service provision, the level of access to formal financial services in the country increases to 47%. In 2014, of the 141 districts in the country, 86 had bank branches and 90 had ATMs; 121 of the 141 districts also had POS terminals and 113 with agents of MMO (Banco de Moçambique, 2014). Currently, there are 11,461 agents of MMO and 3,197,507 users of mobile financial services out of the 12.01 million mobile phone subscribers (INCM, 2015). This evidence shows that while mobile phones are widely used in Mozambique, the financial inclusion advantages associated with their use is still low.

Problem

The majority of rural Mozambicans lack access to formal financial services. However, around 10% of the public-sector employees from rural areas receive their salaries through bank transfers, and face several constraints, including time, cost of transports, and several risks to get to the nearest bank branch or any financial service access point, among other constraints.



The lack of basic infrastructure such as roads, electricity, telecommunications, and transport are the main drivers for the low formal financial services in rural areas (bank branches, agents of MMO, ATMs, POS terminals, etc.). This constraint increases the cost of investment, making it unfeasible for the banks to invest in rural areas. The underserved adult populations in these areas obtain financial services from informal credit schemes or informal credit providers.

Solution

Given the strong political and institutional support for financial inclusion in Mozambique, there is great potential to expand and improve access to formal financial services in rural areas. Recognizing the high cost of establishing a traditional bank branch in the rural areas, I propose the problem of rural access be addressed through holistic interventions, based on promoting branchless banking (using agents of MMO and agent banking network) as a cost-effective way to expand the outreach of formal financial services. To this end, The Bank of Mozambique licensed Carteira Móvel (Mkesh) in 2011 and Vodafone Mpesa (Mpesa) in 2013 as MMOs.

In addition to that, the Bank of Mozambique has made significant progress in terms of developing crucial enabling regulatory framework to improve financial inclusion, through increased

access to formal financial services. The Central Bank Notice number 03/GBM/2015 from May 4th allows banks to expand their presence throughout the country by means of agent banking. However, this notice does not establish any criteria for geographical proportionality. Because banks are rational and profit driven, they will tend to open their agents in urban areas or in areas that already have at least one type of formal financial service, leaving the rural areas unattended.

Recommendations

As it is widely known, mobile financial services have the potential to accelerate inclusion of the rural population into the formal payment system, by providing this population with access to basic formal financial services (payments and transfers) at a low transaction cost. In light of the above, I recommend a strong collaboration among the Bank of Mozambique, commercial banks, and MMOs to overcome the lack of formal financial services in the rural areas, by incentivizing the provision of financial services in the rural areas. By inducing the opening of agents (MMOs and banks) in the 21 districts that have conditions in terms of infrastructure, the Bank of Mozambique will promote the increase of financial services in the rural areas. To implement this, I recommend a two-part approach, with differentiated strategies for districts with moderate to high infrastructure already in place, and those with little existing infrastructure.

For those districts with adequate infrastructure, I recommend the following steps:

1. Conduct a broad assessment of the districts in order to identify the financial needs of the rural populations, counting local agent outlets as well as public institutions that comply with the requirements for being agents of banks or MMOs. The assessments should be made onsite and take into account existing data from previous studies.
2. Once the assessments are concluded, separate meetings will be held (workshops) with MMOs and banks to present the results of the assessments, and promote their interest in new business opportunities identified in the rural market.
3. An evaluation of the main concerns presented in the workshop will help to identify the most appropriate (creative) incentive framework that will effectively reach the targeted population. Thereafter, a consultation workshop will then be promoted again with the MMOs and banks to obtain their feedback on the proposed incentive framework.
4. The impact of the incentive framework will be examined using a pilot method (duration of 3 months), which will be conducted in 3 districts of Inhambane Province (Funhalouro, Mabote, Panda) followed by a report and evaluation of the results. If needed, the incentive framework can be adjusted based on the results of the pilot.

The selected agents in the pilot program should be trained to perform agent's activities. Strategically, this could start with training on how to perform transactions that do not require bank accounts (e.g., bill payments). To ensure an adequate quality of access to formal financial services, the implementation of this recommendation should be synchronized with awareness campaigns about the products to be implemented in those areas.

This recommendation is supported by international experiences from Kenya that confirms that for "retail payment systems, mobile-money transfers are today the most widely used mode of payment in Kenya followed by the use of plastic cards" (AFI, 2015).

How the Policy Will Be Implemented

The incentive framework should take the form of a Central Bank Notice that responds to the interests of the Bank of Mozambique, MMOs, and banks involved in this process. The Notice should establish a special regime for the banks wishing to develop agent-banking activities in the 21 areas and will take into consideration the concerns presented in the workshops. Among other issues, the Notice should:

1. state clearly its objective—that is, to increase the level access to formal financial services by rural adults;
2. provide an incentive to the banks that will expand their activities through agent banking in those areas by lowering the level of reserve requirements; and
3. engage with the government (Mozambique Revenue Authority) to ensure that all imported equipment (ATMs, POS terminals, software, etc.) to be taken to the rural areas are tax exempted.

For all issues related to exemption of the tax payment, the Bank of Mozambique will engage with the Mozambique Revenue Authority in order to make this possible.

To address the needs of the 51 districts that do not have any type of infrastructure and consequently no financial services, the Bank of Mozambique will engage with the government in order to create basic infrastructure in rural areas in order to implement formal financial services. Since financial inclusion is a priority topic in the agenda of the Government of Mozambique, political and practical cooperation will be feasible and highly valued.

Conclusion

There is a need to increase the presence of formal financial services in the rural areas of Mozambique in order to increase financial inclusion, a key goal of the Government of Mozambique. Therefore, the collaboration of the Bank of Mozambique, commercial banks, and MMOs is critical for the solution. I expect that the proposed incentive framework will be successful and will contribute to increase the access to formal financial services by the rural population.

The implementation timeline will start in January 2016 with the onsite assessment of the districts in order to classify the financial needs of the populations and identify potential agent outlets that comply with the requirements for being agents of banks or MMOs. Engagement with the stakeholders will then follow and by September 2016, I would like to be able to come up with a Notice providing incentive framework to the banks and MMOs to run their business in the rural areas.

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Endnote

1. In Mozambique, adult population is 15 years and above.

Enhancing the Mobile Experience

From Cash to E-Cash: The Implementation of Digital Financial Services in Peru

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Executive Summary

Digital financial services, such as electronic money, can be one of the main tools to provide individuals with access to affordable and secure money-transfer and payments mechanisms. They also can be very important in facilitating low-value payment transactions and promoting access to formal savings and other more sophisticated financial services.

In Peru, approval of the electronic money law as an instrument for financial inclusion¹ enabled on paper, a large number of unbanked and/or underserved people to join the formal financial system, while improving the experience of those who are already included. Today, facing the implementation of electronic money, it is important to propose a set of actions to overcome the main challenges for its implementation such as the development of infrastructure and ecosystem for digital financial services, product design and lack of trust in the financial system; facilitating a smooth transition from cash to digital transactions.

Introduction

In recent years, Peru has been recognized as a global leader in financial inclusion due to its track record of public policy and regulation.² The Peruvian government has established financial inclusion as one of its priorities under its social-inclusion goals. Therefore, it considers financial inclusion as a mean to achieve economic growth, reduce inequality, and decrease poverty. In June 2015, the Multisectoral Committee for Financial Inclusion (CMIF) approved the National Strategy of Financial Inclusion (ENIF), which includes as one of its strategy objectives the promotion of safe and efficient payment mechanisms.³

Despite public and private sector commitments toward enhancing financial inclusion, most of the Peruvian population still does not have access to simple, useful, affordable and reliable⁴ alternatives to cash for sending and receiving money transfers and making payments. Some studies identified that individuals can spend more than three hours on average to reach a bank branch, which increases the cost of services received.⁵

Some beneficiaries of social programs have to travel long hours in order to receive the subsidy, leaving their own businesses unattended. Moreover, due to transportation costs incurred by the beneficiaries, the net benefit they receive is even lower. “Whether it is to support friends and family back home, collect government payments or international remittances, pay bills and services or conducting business remotely, in Peru, many people have to incur a high cost and much inconvenience as the vast majority of these payments still are made in cash” (World Bank, 2014).

In rural areas, internal cash remittances have been provided informally (i.e., family, friends, bus transportation agencies and informal financial services providers). “Very often, poor migrants living in the capital Lima find themselves sending money to their relatives by informal means, using bus services to send cash hidden in packages or using informal bus transportation remittance services, in order to avoid the high commissions that a regulated financial entity may charge” (Sotomayor, 2011).

Financial inclusion in Peru remains low due to a history of economic and financial instability that started in the eighties and lasted until early nineties. During this period, Peru was affected with high inflation rates and fell into economic and financial crisis that resulted in the bankruptcy, intervention, and liquidation of many financial institutions, affecting the overall trust in the formal financial system.

The implementation of regulatory framework and strict prudential supervision were important to recover trust in the financial system. Later, the introduction of well-supervised microfinance institutions as well as new regulations allowing innovations such as tiered accounts and bank agents contributed to increase access and usage of financial services. From 2004 to 2014, the number of access points in the financial system increased from 1 thousand to more than 54 thousand and the number of credit customers increased from 2.5 million to 5.9 million.⁶

Despite all these advances, in Peru, only 29% of adults have access to a bank account and even fewer (12.3%) adults save money in a formal financial institution.⁷ Under this scenario, electronic money is hoped to be the first step to incorporate individuals into the financial system as well as to introduce them to more complex financial products and services, such as formal savings, credits, micro-insurance, etc.

Like other innovations, digital financial services have the potential to efficiently reach millions of people and present an opportunity to develop economically viable business models targeting low-income population. Currently, approximately 88.9% of the Peruvian population has access to a cellphone, implying the almost every household has access to mobile phones. These figures are more relevant in lower socioeconomic levels, which experienced the faster growth in the last decade. Between 2004 and 2014, the number of poor households⁸ with a cellphone grew from 5.5% to 70.3% (INEI/ENAHO, 2014).

Even though the number of mobile-banking transactions is still low,⁹ some qualitative studies showed that in Peru, internet and mobile transactions would have some acceptance, especially in urban young people, who perceive mobile money as an opportunity to do safe and convenient transactions. On the other hand, these studies also revealed some individuals still have some concerns related to internet and banking, especially when it comes to payments (World Bank, 2013; GSMA, 2015).

Hurdles for Transforming Payment Transactions from Cash to Digital

The implementation of digital financial services requires overcoming a number of challenges related to infrastructure and ecosystem, product design, and trust in the financial system.

1. *Infrastructure and ecosystem for digital financial services.* Due to an inadequate infrastructure and lack of alternatives to deal with large volume and low value transactions, transferring money is relatively expensive in the country. This situation is more critical in certain areas due to tough geographical conditions in the country. “The Peruvian geography presents acute challenges in moving cash to certain parts of the country, especially in certain isolated, low-density areas in the highlands and jungle. Banks wishing to reach more remote areas are constrained by the high costs simply in procuring cash for those areas” (World Bank, 2014).
2. *Product design in digital financial services.* The design of products taking into account clients’ needs is critical for the success of any financial product. In spite of a well-structured regulation for basic saving accounts, the low uptake of this financial product¹⁰ showed that it is very important to involve the private sector in designing of financial services for financial inclusion and to align clients’ need with their own business model.
3. *The lack of trust in the financial system* is one of the main barriers that explain the low uptake of financial services available in the market. The lack of confidence in the financial system is related with the low levels of financial education¹¹ as well as the clients’ concerns of high

and unclear service charges, service downtime, poor customer service support, bank agent liquidity, bank agent unavailability, fake messages, and untrustworthy bank agents, among other concerns (Arenaza, 2014).

In Peru, lack of trust is also related with previous periods of economic crisis and bankruptcies that affected the relationship between individuals and formal financial system. In other cases, it is also related to limited information available through different channels and their limited interaction with the formal financial system resulting in low financial capability levels.

For instance, in areas where bank agents have recently opened as the only point of access to the formal financial system, there is still from the client side, a limited and/or lack of interaction with the formal financial system. Under these circumstances, it is difficult to getting people to know much about their rights and duties in their interactions with financial service providers and therefore, they are not able yet to acquire financial knowledge and develop financial capacities to make informed decisions. In these areas, the user or the experience of a close friend with the service will determine, to some extent, trust in the system.

Proposed Actions to Support the Transition from Cash to Digital Transactions

The development of new technology and innovations such as digital financial services can contribute to incorporate those individuals that are currently excluded from and/or underserved by the formal financial system. The proposed policy solutions to support the transition from cash to digital transactions comprise a combine set of actions that required a strong coordination and leadership from the public and private sectors in order to promote an adequate usage of digital financial services. Moreover, the proposed solutions rely on the recognition that their implementation has to be perceived as a win-win solution to all the stakeholders involved in the implementation process.

1. *Developing infrastructure and ecosystem for digital financial services* is critical to provide potential clients (individuals and businesses) with financial services that can add value to their decision to work with formal financial services. This is possible by developing a system that allow digitizing the value chain and make digital money to be accepted everywhere. The system also should ensure that all points of access keep adequate liquidity levels,¹² making it possible for anybody to get cash when required.

The implementation process has to involve traditional actors, such as financial services providers, as well as new actors, such as electronic money providers, governmental agencies, distribution companies, retail companies, and other relevant actors. From the beginning, the private sector should have the right incentives to promote digital financial services by perceiving it as a business opportunity and an economical mechanism to serve a large volume of low amount transactions that currently are not able to use traditional access points such as branches, ATMs and bank agents.¹³

The Peruvian government is the largest user of the payment system and should play an active role in enhancing the ecosystem through the introduction of digital payments on its social programs and other governmental payments. Also, administration fees collection of government-related affairs will be an important way to provide a critical mass of transactions during initial stages, while contributing to reduction of some transaction costs.¹⁴

The participation of other stakeholders, such as utility companies, distributors and retailers should be incentivized by digital finance operators. In particular, it is very important to promote recurrent payments, such as school fees, utility bills, etc.; in order to allow the end-user to familiarize with new services.

2. *Customer centric approach in product design for digital financial services.* As with any new product or service, it is very important from the beginning to design products focused on users' needs. The same principle applies to digital financial services. Part of the solution can be taken into account recent experiences of the Philippines, Tanzania, and Kenya in the design of products that are reliable, simple to understand, and easy to use.

Current initiatives for digital financial services developed by the private sector have the challenge to design products that add value to the user experience and take into account the needs of a large number of individuals and businesses that currently do not use any financial service for their day-to-day financial transactions. "If recipients do not see the value in the system or do not trust in it, they will not continue to use it" (Zimmerman et al., 2014).

3. *Consumer protection and market conduct framework for digital financial services* has to take into account that one of the main characteristics of this service is the lack of face-to-face interaction during the transaction. Consumer protection requirements should be practical and understandable for both financial service providers and end-users, protecting users during the process of interaction with new digital user interfaces, generating trust in the system.¹⁵ "Over time there will also be a need to optimize consumer-protection models in a digital and branchless environment" (World Bank, 2014).

The public sector through the Peruvian Superintendence of Banking, Insurance and Private Pension Funds (SBS) plays a catalytic role in creating the right conditions by enhancing current regulatory framework on market conduct and consumer protection for digital financial services. The new regulation should state clearly the characteristics and conditions of the service provided, information about the cost of the service, client rights and adequate consumer complaints and redress mechanisms. Reputational risk is critical during the implementation process, and therefore, it is very important that all actors are able to have adequate recourse mechanisms to address any consumer concerns, enquiries and complaints.

4. *Financial education.* The participation of different actors actively promoting the new financial service is very important in making digital financial services popular to everybody and to create conditions to generate a more trustful environment to the end-users. The implementation of financial education programs for digital financial services should target different population by using innovative solutions such as bank agents and mobile applications to teach individuals how to use this new technology.

Branchless banks should play a very important role during the implementation as they will be the main—if not the only—point of contact between the electronic money issuer and the client to facilitate cash-in and cash-out transactions, and will serve as the initial point of contact to promote and explain the services provided and its functionalities.¹⁶

The SBS should take a leading role with financial education and awareness campaigns. At the beginning, it will be very important to have a communication strategy allowing individuals to learn about the benefits and opportunities of digital financial services and to enhance the implementation of educational programs to teach newcomers about the functionality and benefits of this new service. "Financial inclusion will not be achieved by building infrastructure and slashing costs alone; equally important is the need to instill much larger perceptions of value in formal financial products in the minds of ordinary citizens" (World Bank, 2014).

Conclusion

Digital financial services seems to be one of the main alternatives to reach a large number of the Peruvian population that is currently unbanked and/or underserved; however, its implementation comes with big challenges from both the demand and supply side.

The proposed policy solution in this document comprises a combined set of actions led by the public and private sectors aimed to develop an adequate infrastructure and ecosystem for digital financial services, to design financial services focused on the customer's need as well as to create awareness and build trust in this novel financial service by enhancing the current consumer protection and market conduct framework and implementing financial education initiatives.

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Endnotes

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2. According to the “Microscopio Global 2014” of The Economist Intelligence Unit (2014), for the seventh consecutive year, Peru was considered to have the best environment for microfinance and financial inclusion among 55 countries around the World.
3. Peruvian National Strategy for Financial Inclusion (2015).
4. An e-payment system will not be effective and could even have adverse effects if it doesn’t work well. (Zimmerman et al., 2014)
5. Superintendencia de Banca, Seguros y AFP. “Encuesta de Acceso y Uso de Servicios Financieros” (2012).
6. Data of access points as of June 2014 and includes financial institution branches, ATMs and bank agents. According to the study on “The Potential of New Delivery and Business Models for Financial Inclusion in Peru” (Byskov and Mas, 2014), bank agents are strongly accepted nationwide and are well-perceived among users as they provide fast, convenient, and accessible services. In some regions, bank agents are highly used due to proximity to people and emotional attachment of the end-user with the operator of an agent bank.
7. The Little Data Book on Financial Inclusion 2015; pp 120.
8. According to “Encuesta Nacional de Hogares” (INEI, 2014), in Peru about 22.7% of the population is considered poor.
9. As e-money issuers are still in the early stages of development, mobile banking transactions are only performed through existing bank accounts, representing only 0.2% of all banking transactions. (ASBANC, 2014)
10. Market response to regulatory change for basic accounts was slower than originally expected. (GPFI, 2014)
11. Encuesta de medición de capacidades financieras en los países andinos. Informe para Peru 2014. (CAF, 2014)
12. Working with agents networks in which liquidity is a problem can undermine the implementation digital transfer programs as recipients could fail to trust or understand the new system. (Zimmerman et al., 2014)
13. One of the main initiatives of the private sector to promote electronic money is known as “Modelo Peru.” This platform is a unique model that involves a collaborative competition approach among financial institutions. It is expected that this new platform will contribute to increase capillarity and guarantee interoperability among different financial services providers of digital transactions.
14. Every government reform in the way payments are made can generate important savings in the public expenditures, such as in Mexico with a savings of more than 3.3% of payrolls expenses, pensions, and social transfers. (Byskov, 2015)
15. According to the World Bank, current consumer protection and transparency of information regulation in Peru should be reviewed, particularly for situations when there would be limited or no face-to-face contact between the customer and the financial institution (World Bank, 2014).
16. Agent banks have a big potential due to its flexibility to penetrate in areas inaccessible for traditional branches and for its complementarity to the potential development of mobile banking. With the use of electronic money, the possibility to recharge the mobile device from a bank agent might be very important for financial inclusion, in particular for low income people who live in isolate areas. (Alonso et al., 2013).

Enhancing the Ecosystem of Digital Financial Services

Ricky Satria

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Executive Summary

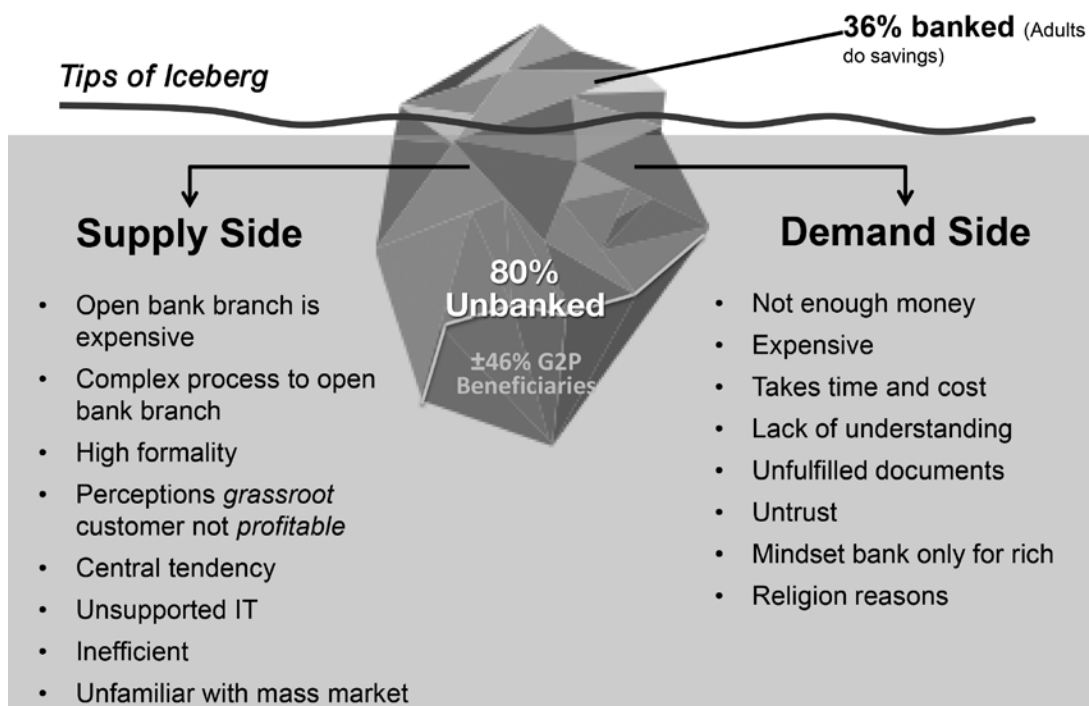
In 2014, Bank Indonesia (BI) issued digital financial services (DFS) regulation. The goal of this regulation was to increase financial inclusion through a digital ecosystem for the unbanked, where unbanked people do their daily financial transactions, and to make these transactions in a non-cash or digital way. This key financial inclusion regulation promotes a bank-led model, with electronic money and agent banking as hallmarks of Indonesia's response. However, on its own this regulation will not automatically achieve the country's financial inclusion agenda. Additional policies, regulations, and actions must be in place to fill the financial inclusion agenda gap. We must adjust existing regulations and add new supporting policies to ensure the sustainability of DFS.

This memo proposes to create policy that allows more players such as more banks and non-bank financial institutions to be DFS providers. For better outcomes, these non-banks should create synergies with banks. For example, electronic money (non-bank) might link to savings accounts (bank). Operationally, the role of non-banks should be tested before they are granted approval for full implementation. This "test and learn" approach will check the capability of non-banks to carry-out financial services properly. Additionally, cash-lite or electronification policies should support banks and non-banks to enable a functional DFS ecosystem. Moreover, increasing awareness of people about DFS through suitable campaign strategy is necessary. Finally, the capacity of supervisors to monitor and supervise the development of DFS should be enhanced in order to mitigate risk and to ensure the implementation occurs smoothly and as anticipated.

Background

In 2014, Findex, a World Bank survey, showed that only 36% of the adult population of Indonesia had a bank account, or roughly 64 million adult people from a total adult population of 178 million (National Statistic Bureau, 2010). In general, this low adoption is due to price barriers, information barriers, product and service design barriers (Honohan, 2005), and distribution channel barriers.

The challenging topography of the country, with 17,000 islands, makes the provision of financial services challenging for financial service providers, resulting in low bank infrastructure to provide services. From the bank's side, it is not cost effective to open a brick and mortar branch to serve small-ticket sized clients in the last mile. From the people's side, it is time-consuming and costly to travel to the nearest branch. Furthermore the existing bank product may not fit for their needs, and at the same time banks require more stringent requirements compared to using cash or other informal options. The result is that poorer population segments perceive banks to be only for upper-income and educated people. This perception discourages low-income people from opening an account as they think their funds are not suitable for or wanted by a bank, and that efforts they do make to transact with a bank are time-consuming and costly. Taken together, these perceptions have led to a scenario where many people prefer to save money in an informal way such as keeping the money under the mattress or in a saving club. When in need of funds, they tend to ask relatives and neighbors; if these options do not work, they seek loans from money lenders. These behaviors are very expensive to low-income populations and make it difficult to improve their livelihoods or build toward a better future.



Source: Bank Indonesia (2015) Expanding DFS, Board Seminar material; and Demircuc-Kunt and Klapper (2012)

Present Policy

To address the situation, in 2014, BI introduced digital financial services (DFS) regulation. DFS is a bank-led model under electronic money regulation, with limited maximum balance (Bank Indonesia, 2014) and limited implementation partners—only banks in the category of Book 4 (four banks).¹ Other banks in Book 3 (23 banks), Book 2 (36 banks), and Book 1 (57 banks) that have lower core capital requirements and other potential sectors (mobile network operator (MNO), post office, rural banks, etc.) are prohibited to implement the DFS regulation. This bank-led model is justified due to risk management, monitoring, and customer protection capability, in addition to the ability to provide a robust platform for real-time transactions.

DFS is similar to agent banking or mobile money, where banks can use agent and telecommunication technology to provide basic and limited financial services. So far, only three of four banks in Book 4 have been approved to execute DFS. However, none of them has enough experience to set-up and manage retail informal agents. As of April 2015, with less than six month of DFS implementation, there are more than 30,000 agents in the field, most of them searching for effective ways to deliver the service. Collectively these agents service 1.1 million accounts. However, more than 90% of these accounts are from government-to-people (G2P) recipients, beneficiaries of a pilot project of cash conditional transfers through DFS. As is true in the cases of India (GFI, 2013) and Pakistan (SBP, 2014), these accounts tend to become dormant.

Policy Gap and Analysis

Though there are more than 250 mobile money implementations worldwide, less than 10% can be considered successful (Scharwatt, Katakam, Frydrych, Murphy, & Naghavi, 2014). This poor performance threatens the sustainability of DFS and, in the case of Indonesia, four key factors hinder the goal of financial inclusion.

First, Indonesia has few market players. Only Book 4 banks are allowed to be DFS providers in the current regulation; other countries allow a broader range of banks to participate such as in India (RBI, 2010) and Brazil (CGAP, 2010) etc. as well as other non-banks such as MNOs as

showed in Tanzania (BOT, 2013) or in both the Philippines (BSP, 2009) and Kenya (CBK, 2010). In the past two years, some promising and innovative elements show potential to increase and speed-up financial inclusion. For example “payment” or “niche banks” have emerged in India (RBI, 2014) and Colombia (The Fletcher School Leadership Program for Financial Inclusion, 2015), which allow any kind of non-financial business, which meets certain requirements, to perform basic and limited financial services.

Second, in Indonesia among Book 4 banks, only one has addressed the mass market, while other banks are relatively new in this segment. The mission, vision, and goal of an entity is important because companies will set their strategies and capacities to meet these goals. Unlike traditional retail banking, which focuses on a few high value customers, financial inclusion typically requires targeting the broader market, with small value transactions, but potentially massive volume. It is believed that this is why MNOs have traditionally led this segment in other country contexts.

Third, in Indonesia there is no effective business synergy between banks and MNOs, where the two industries can collaborate to ensure a mutually beneficial competitive advantage that can benefit the customer such as lower charges. Yet we have evidence of mutually beneficial competitive advantage in Bangladesh (Chen and Rasmussen, 2014) and Pakistan (Bold, 2011). Today, many existing cross industry partnerships focus on building and supporting a network, instead of other aspects of companies’ specific value propositions. For instance, MNO airtime sellers are already in place to cross sell or leverage other services such as M-Shawari in Kenya (Cook and McKay, 2015).

Fourth, Indonesians believe in a cash-based system (BI, 2013). This mindset is especially prevalent in rural areas and low-income communities, further hampering the implementation of digital financial services.

Recommendation

To overcome these barriers and enable financial inclusion to flourish with a more sustainable framework, this memo proposes the following policy actions.

Expand DFS

- **More providers:** In order to provide suitable financial services for the low-income segment, BI should allow other sectors, beyond Book 4 banks or banks in general, to become DFS providers. In addition to fulfilling all requirements in the current regulation, eligible providers should satisfy three factors: 1) providers should understand financial services and 2) they should already have robust infrastructure in place for delivering the services and monitoring the risk. 3) They should have a good customer protection system. Using these criteria, some possible providers would be banks from Book 2 and Book 3, MNOs, and post offices. The following are some ways BI could operationalize this recommendation: For non-bank institutions, such as MNOs, they should establish a subsidiary with a minimum capital requirement that limits risk as limited financial services–like functions. Allow post offices to issue electronic money through their branches. For smaller players, such as banks in Book 1, they could undertake last mile distribution initiatives in a more efficient way through co-branding.
- **Synergy between bank and non bank:** For non-banks, electronic money must be linked to the savings account of any kind of bank, where customers can easily transfer money from electronic money accounts, which currently do not earn interest, to bank savings accounts, which do earn interest and vice versa. This model can assist them in balancing interest earned, liquidity, security, and managing the fund. This approach can support them in managing their fund wisely.

From the bank's perspective, collection of transaction data from MNOs such as frequency of top-ups, bill payment regularity and promptness, tendencies to increase their balances, etc. is powerful behavioural data for future business opportunities. This is a base for banks to offer a savings product, particularly to those customers with a habit of increasing their balances regularly. In addition, banks can set a credit score for micro-loans. Consequently, banks can offer a micro loan especially to customers from non-banks.

Proportional Regulation

Proportional regulation is a prerequisite to accommodate innovation and more flexible services. However, it should achieve four goals: enable branchless banking, maintain integrity (anti-money laundering (AML)/counter-terrorist financing (CTF)), provide education, and ensure customer protection. It needs more explanation for some important aspects, which are risk management, AML and simple customer due-diligence (CDD), customer protection, and other system requirements.

For customers, regulation will tier accounts by using proportional CDD processes. This is crucial as not all people have national IDs. Imposing some restrictions either through maximum balances or transaction limits is a way to manage it.

For governments in charge of social protection for poor people, regulation of bulk registration will be a good method. This recommendation will assist millions of G2P recipients to register more easily.

Ecosystem

Cash is the main obstacle of electronic money growth among unbanked populations (BI, 2013). Simply having a mobile phone or prepaid card does not automatically mean people will use it for their financial transactions. Thus, another policy is important to support financial access, which can assist behavior change. This complementary policy recommendation is a cash-lite or electronification policy whereby all payments must be on a non-cash basis, especially G2P payments, such as government cash transfers for poor people and pensioners, as well as payments from people to the government, such as paying taxes and utility bills. Bank Indonesia should coordinate with relevant ministries and regional government to set-up memorandums of understanding to make a cash-lite policy works.

Operationalizing Recommendations

Test, Learn, and Regulate

Before full implementation, non-bank providers should conduct a pilot project as a part of test to see whether the new framework will work for them. This pilot project would be limited in its particular period and area. The aim of a pilot project is to find the obstacles on the people side (e.g., how to transfer funds through mobile phones easily), agent side (e.g., how to handle customer problems if the system cannot be accessed), and provider side (e.g., how to set a system to monitor money laundering). For regulators, the outcome of pilot projects provides an input for regulation, interpretation of that regulation, and an opportunity to set a strategy and implement it. For the providers, it will assist them to understand the real situation and to get common understanding about regulator expectations as well as how best to set an implementation strategy.

Enhancing Supervision Function

Good monitoring and supervision are a prerequisite to guarding the implementation of DFS. Thus the resources and capacity to supervise are key to mitigating the risk early on, as well as to get input for further development. A suitable approach is important; one of them is a risk-based supervision model since it is impossible for supervisors to visit or inspect all agents.

Campaign

Both financial access policy through DFS and a cash-lite policy need a suitable communication strategy. A “below the line” approach, a customer-centric communication strategy (McKay and Breloff, 2011), is one of them. This approach will improve understanding of policies for low-income people, create engagement to use DFS, and bolster trust in agents and mobile devices for their daily financial transactions. Collaboration among stakeholders is a prerequisite for effectiveness and efficiency.

Those recommendations are in combination with an improvement of supply side and demand side to provide a more sustainable DFS implementation and broader financial inclusion.

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Endnote

1. In Indonesia, banks have been grouped into four categories based on their amount of core capital. The highest core capital is called Book 4 while the lowest one is Book 1 and in between them are Book 2 and Book 3, respectively.

Mobile Money as an Enabler for Improved Financial Inclusion in the Kingdom of Swaziland

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Executive Summary

Mobile money's success in Kenya was owed to a combination of government support and consumer demand, driven by the need for secure cash transactions during political instability, says research from the University of Manchester's Centre for Development Informatics, United Kingdom. According to a post on the World Bank's internet blog by Wolfgang Fengler, who is World Bank's Lead Economist in Trade and Competitiveness for the Western Balkans, adds

. . . having a mobile operator (Safaricom) with more than 50% market share also helped. According to the Consultative Group to Assist the Poor (CGAP) globally, more than 2.5 billion adults do not have a formal bank account, most of them in developing economies. Low levels of financial inclusion represent a barrier to socio-economic development in developing countries. Mobile Money (MM) can be a game changer for the poor and an enabler for financial inclusion in developing countries.

The Kingdom of Swaziland has identified mobile money (MM) as low hanging fruit for advancing the Kingdom of Swaziland's financial inclusion agenda. However, the uptake of MM has not been impressive and the actual usage is even more disappointing. Of the 260,000 registered users, only 40% are active. Mobile money has the power to significantly increase financial inclusion by leveraging technological solutions in order to overcome traditional financial inclusion constraints such as financial infrastructure, cost, and customer familiarity. Swaziland has identified financial inclusion as a major impact on poverty as it allows the poor to have easier access to income and savings, credit facilities can be used as nest egg in times of difficulty, and insurance can help dampen the often crippling effect of death or damage on a family's financial position. Access to financial services in the rural areas is a huge problem as ATMs are not in reach, and grocery stores, which house point of sale (POS) terminals, have limited operating hours. However, these options are currently the only option in rural areas for financial inclusion in Swaziland.

Introduction/Context

Background

Swaziland is a small landlocked country surrounded by Mozambique to the east and South Africa to the west and south. It has a land area of 17,364 square kilometres and a population size of 1.1 million (Central Statistics Office (CSO) National Population Census, 2007). The majority of the population (73%) is rural. According to the Swaziland Household Income & Expenditure (SHIES) Report (2009), 85% of the poor population is in the rural areas.

Swaziland is trailing behind in economic growth relative to the other sub-Saharan African (SSA) countries. According to the Ministry of Economic Planning and Development (MEPD) Quarterly Report (MEPD, 2012), the country achieved an economic growth rate of 1.3% in 2011 relative to the average of growth of 4.9% for the SSA region. The country's economic growth rate has been declining, with 2012's growth estimated at 0.7% (Central Bank Annual Report, 2012). Despite the gloomy picture, the government of Swaziland's key developmental goal is to attain first world status by 2022.

In line with the government's goal, The Ministry of Finance sees financial inclusion (FI) as a key developmental goal. The Ministry of Finance established an FI task team, which aims to increase financial inclusion to 75% by 2022 using MM. Furthermore, the increase in FI from 43.9% in 2011 to 54%, according to Finscope (2014), shows that there is potential to attain 75% financial inclusion by 2022. This is supported further by the fact that 96% of Swazis have access to mobile phones and 83% know about mobile money (but only 21% actually use it).

Problem

Background

According to a Swaziland Genesis Analytical Team Analytics research report commissioned by FinMark Trust in January (2015), as part of the enhancement of Swaziland's FI agenda, for any country to have a successful e-money initiative, the country has to have the following five elements that will determine success:

1. a conducive banking environment,
2. an enabling regulatory framework,
3. corporate commitment,
4. appropriate product offering, and
5. an agent network.

Swaziland has prioritized the creation of an enabling regulatory framework as the main component for improved FI. Currently Swaziland has 2 e-money product offerings. The first one is hosted by the country's mobile operator MTN Swaziland, which launched its MM platform in 2011. MTN MM uses mobile technology and agents to deliver its services. It currently has approximately 260,000 registered customers. Mobile money has been dubbed as the most frequently used transacting method after cash in the country; however, only 40% of MTN MM accounts are considered active according to MTN's Swaziland Annual Report (2014).

The second e-money technology is hosted by the First National Bank of Swaziland, which is a subsidiary of FNB South Africa. FNB launched an e-wallet in 2013, which was initially launched as a value-add to support technological capabilities for the FNB account holders. The "wallet" uses mobile technology and FNB's ATM infrastructure. Currently MM has no fixed infrastructure but pays out using store tills; the kiosks have not yet been put in place. FNB's e-wallet allows anyone to send money to anyone with a valid Swazi cellphone number, even if they don't have a bank account. The money is transferred instantly and can be used to withdraw cash from any FNB ATM, buy prepaid airtime or electricity, send money to another cellphone, pay to a bank account, and more. Currently this bank has 38 ATMs and 65,000 customers of which 45,000 (69%) are active accounts. There is one difference between the e-wallet and MM in that MM pays out anywhere there is a vendor; however, the e-wallet pays out only at FNB ATMs. Both of the e-money products have had a low uptake in terms of outreach.

Why the Problem Statement

Various studies conducted in Swaziland since 2011 have shown that MTN MM is being used by 58% of the currently unbanked population of Swaziland, which makes it a tool to promote FI in Swaziland. Seventy-five percent of the country's population lives in the rural areas, of which 85% is a poor population. Government, as a shareholder of MTN Swaziland, would need to promote FI through MM as this will enable remittances to the rural areas.

According to a Genesis Analytical Team Analytics (2015) report commissioned by FinMark Trust, consumers claimed that they have been discouraged to use MM. Network downtime and cash shortages are two reasons cited. Also the lack of standalone visible advertising of the product contributes to low awareness, which discourages use, as does complicated menus. Finally,

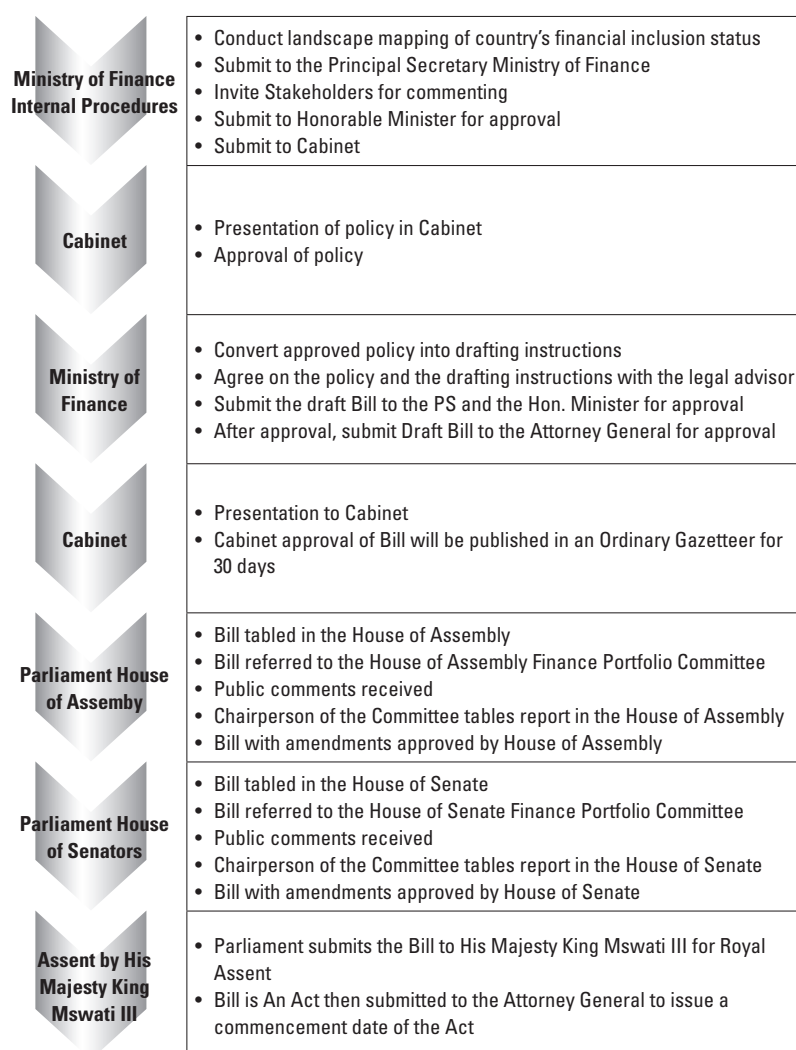
the sector of the population that currently has bank accounts has been discouraged by the lack of interface between the banking system and MM even though MM is a bank-backed product.

Though MM has its detractors, users of MM have found it to be an easier, faster, and safer way to send money. The system, when working, settles accounts in real time, thus making it conducive for business transactions and inter-personal payments.

Recommendation/Proposed Solutions

Solution

There is no one-size-fits-all solution for the promotion of MM in Swaziland; however, there are 3 key parties/stakeholders that need to hold hands in order to enhance the provision of MM to promote FI. Swaziland has earmarked the year 2022 as the year of “*Promise*” for Swazis. Ultimately this means that the government is willing to partake in any developmental agenda that is within the law to improve the lives of the Swazis. The Ministry of Finance has identified the FI agenda as a key milestone to attaining first world status—the FI agenda is part of Government Plan of Action 2022. The key to making finance work for the poor now is to transform the FI framework into an Act of Parliament, which is enforceable and measurable. As part of its obligation and commitment to the Swazis, the Honourable Minister will in every budget speech announce initiatives that promote financial inclusion. Furthermore, the country will make concrete Maya Declarations each year to the Alliance for Financial Inclusion. The announcement will be monitored by Parliament and this will mean they have made a commitment to also ensure an obligation to include the FI agenda in all national budgets they pass.



How the Policy Will Be Implemented

The key aspect to be considered is how the policy will be implemented. A policy in its own right is hardly enforceable in most jurisdictions. There is, therefore, a clear need for the policy to be converted into an Act of Parliament. Why an act? An act usually has both dissuasive measures and sanctions for those that do not comply with it. A policy alone cannot be dissuasive as it is just a stepping stone into a lengthy process. To promote FI, there is need to build a comprehensive Financial Inclusion Act, which provides enablers for financial inclusion within the legal structure of the country. Swaziland is a common law jurisdiction; the diagram below shows how the country's financial inclusion policy will be converted into an Act of Parliament:

Conclusion

Can Swaziland attain first world status by 2022? That answer goes beyond financial inclusion, but financial inclusion is a key pillar for development. Swaziland can leverage from other Sub Saharan African Countries with some of the fastest growing economies,

which have attributed some of their growth to having used MM to advance their economic growth rate through the enhancement of financial inclusion. Kenya, Uganda, and Rwanda have been cited by the World Bank's Ease of Doing Business Report as some of the 10 fastest growing economies in Sub Saharan Africa; the commonality of these countries is that they use mobile money for transactions as a complement to the banking sector. These countries, especially Kenya, have become the hub of promotion for financial inclusion using innovative technology. Swaziland is strategically placed to utilize mobile money as a tool for the promotion of financial inclusion to meet their target of 75% inclusion by 2022. There is a need to create an appropriate product that will be suitable to our target group. Furthermore, MTN needs to invest in more infrastructure, such as standalone ATMs/kiosks for cash disbursement so as to promote this innovative product. In order to create a financial ecosystem that has integrity and stability, there is dire need to have inclusivity. Regulators must be careful of the unknown; therefore, there is a need to bring the underserved population into the formal sector using tested and trusted systems such as mobile money.

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Improving upon Institutional Mandates

Integrating Gender Mainstreaming in Financial Inclusion Strategy

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Executive Summary

In Zambia, women comprise 51% of the adult population and make a significant contribution toward social protection, economic development, job creation, and poverty alleviation, both at the household level and through the ownership and management of micro, small, and medium business enterprises. However, women face challenges in the access and usage of formal financial services, as measured by the financial inclusion gender gap in the FinScope Zambia surveys of 2005, 2009, and 2015 (Bank of Zambia, 2015; FinMark Trust 2010).

Gender mainstreaming—which is described as a strategy for making women’s as well as men’s concerns and experiences an integral dimension of the design, implementation, monitoring and evaluation of legislation, policies, and programs—is a policy intervention that can be integrated in financial-inclusion strategies to close the gender gap and overcome the challenges faced by women.

Two national initiatives attempt to address financial inclusion, albeit with different areas of focus. These are the Financial Sector Development Plan (FSDP)² for broad national financial inclusion and financial sector development programs/targets, and the Task Force on Women’s Financial Inclusion, which focuses on the implementation of the National Gender Policy in the financial sector through advocacy on women’s financial inclusion and gender mainstreaming. However, coordination between them to effectively mainstream gender in financial inclusion strategies and in the financial sector as a whole is weak.

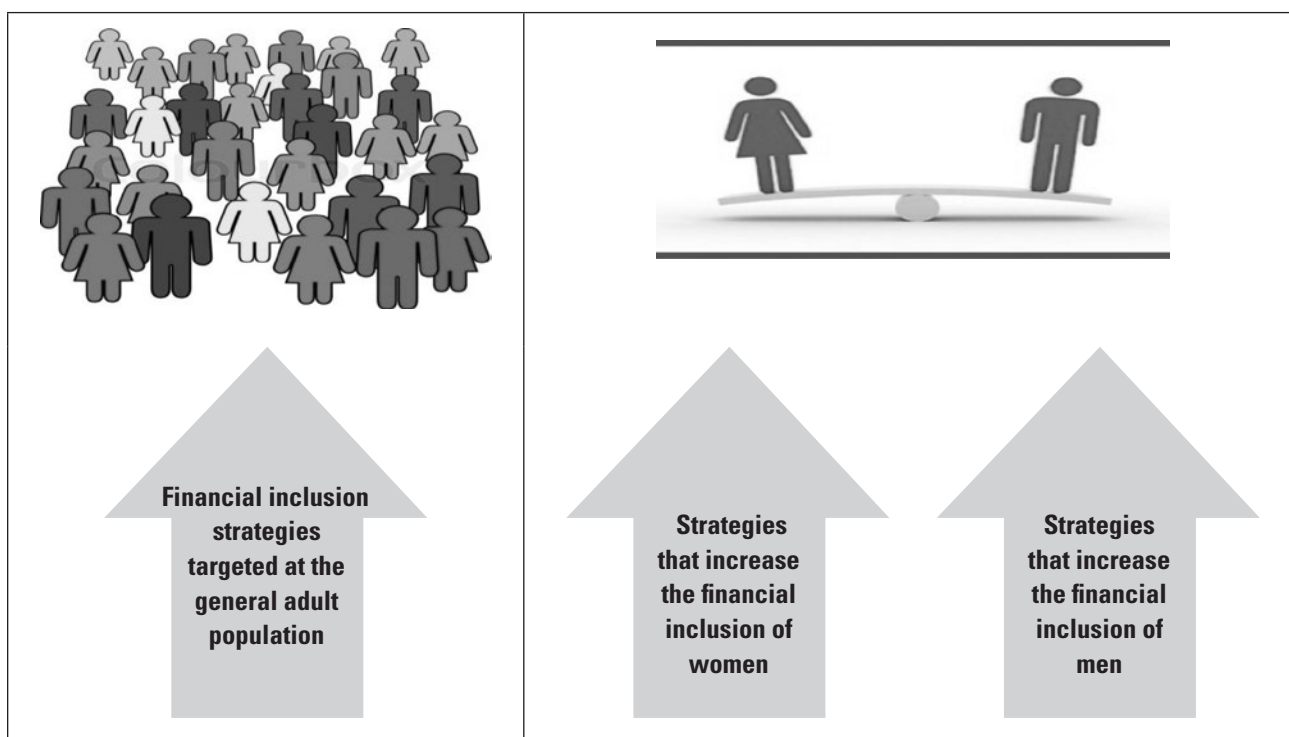
The author here suggests a strengthening of the institutional framework to harmonize the work of the FSDP and the Task Force, and the development of a Toolkit on the Gender Dimensions of Financial Inclusion Policy. It is envisioned that this will not only close the gender gap, but also increase the level of financial inclusion of women.

Introduction

The Bank of Zambia (BoZ) has a strategic objective and commitment to the Maya Declaration to increase the financial inclusion of the adult population from 37.3% to at least 50% in the medium term, between 2012 and 2015 (Alliance for Financial Inclusion, 2014). Financial inclusion strategies within the BoZ’ operations and in a multi-stakeholder FSDP have been developed to achieve this target, which has been surpassed (59.3% in FinScope Zambia 2015 survey).

While various financial-inclusion strategies may be implemented to increase the level of inclusion, not much progress can be made if these strategies adopt a one-size-fits-all approach. Taking into account the “gender” dimension of the adult population, there is an opportunity to increase awareness and *tailor* financial-inclusion strategies, as well as financial services, to narrow the financial gender gap between men and women.

FSDP is due to conclude in June 2015, and its planned successor is a National Financial Inclusion Strategy (NFIS). In view of the financial-inclusion gender gap that exists in Zambia, and the National Gender Policy that has been developed by the Ministry of Gender and Child Development for implementation across all sectors, it is import for the planned NFIS to integrate gender mainstreaming in its framework.



Problem

Problem Statement

A 2014 qualitative study on Women’s Access to Financial Services in Zambia and the FinScope Zambia surveys of 2005, 2009, and 2015, respectively, have established that Zambia has a financial inclusion gender gap. Despite women constituting 51% of the adult population, they have less access and usage of formal financial services than men, as shown in Tables 1 and 2.

Table 1. Highlights from the 2014 Report on Women’s Access to Financial Services in Zambia

Financial Coping Mechanisms	Women	Men
Chilimba (an informal rotating savings group composed of 2 or more people)	46%	16%
Kaloba (an informal moneylender)	37%	26%
Friends and family	41%	16%

Despite women’s aversion to risk:

- women tended to use more informal financial services than men;
- women’s use of formal financial providers was very low and limited to microfinance providers; and
- about 61% of the participating women in the survey use informal credit, compared to 21% who use formal credit; and
- 49% use informal savings compared to 20% who use formal savings.

Table 2. Statistics from the 2015 and 2009 FinScope Surveys*

	2015 FinScope	2009 FinScope	2005 FinScope
Percentage (%) of financial inclusion of adult Zambian population	59.3%	37.3%	33.7%
The level of financial access by gender—for females	57.4%	33.9%	31.6%
The level of financial access by gender—for males	61.2%	40.8%	35.6%
Financial inclusion gender gap	3.8%	6.9%	4%

*Source: FinMark (2010)

The FinScope Zambia 2015 survey recorded a decrease in the gender gap between 2009 and 2015, alongside the findings that females also recorded a significant increase in financial inclusion. This could be partly due to advocacy programs that began in 2010 to promote gender mainstreaming and financial inclusion strategies that are favorable for women-owned enterprises.

Why the Problem Persists

Research such as the survey on Women’s Access to Financial Services in Zambia, the Global Fin-dex Database, and the Policy Memo on Women’s Access to Financial Services (of which Zambia is a signatory) have established that some of the root causes of the financial-inclusion gender gap are attributable to cultural norms, low financial literacy, lack of collateral, legal barriers or discrimination against women, geographical constraints that limit access to financial services, low income, and differences in the financial behaviours of males and females (Bank of Zambia, 2014; Making Finance Work for Africa, 2012; Demirguc-Kunt, Klapper, and Singer, 2013).

However, one contributing factor from within the financial sector itself that perpetuates this problem is the “one-size-fits-all” approach toward financial sector policies, products and ser-vices, and the fact that financial-inclusion strategies remain largely gender blind.

“Gender” is not a term typically used by the financial sector, and there are no guidelines or tools on how regulators and financial service providers can integrate gender mainstreaming in the devel-opment, customer service, marketing, and distribution channels of financial products and ser-vices, or in the crafting of regulatory policy. Furthermore, apart from the FinScope surveys, there are few compilations of sex-disaggregated data and gender indicators in the financial sector.

To address this constraint, BoZ formed a strategic partnership with the International Labour Organisation (ILO), the Ministry of Gender and Child Development and other stakeholders to form a Task Force on Women’s Financial Inclusion (“Task Force”) to strengthen the application of the National Gender Policy in the financial sector through advocacy on gender mainstreaming, gender-responsive budgeting, and the rollout of a gender tool called FAMOS among finan-cial service providers (ILO/FAMOS, 2006).



However, the challenge with current institutional arrangements is that on one hand, the gender initiatives of the Task Force exist outside the FSDP, which is main national framework for financial inclusion. On the other hand, the FSDP only has a gender bud-get line which is not supported by any documented action plans as this depends on proposals from the Task Force or other stakeholders. Hence, coordina-tion efforts to mainstream gender in the financial sector are weak.

Recommendations/Proposed Solutions

Proposed Policy Solution

The proposed policy solution is for gender-mainstreaming to be integrated in the planned NFIS by consolidating the institutional arrangements on gender in the financial sector.

I therefore recommend a four-stage approach to be implemented by the NFIS Secretariat at the Ministry of Finance



in collaboration with the BoZ Financial Sector Development Unit, Pensions and Insurance Authority (PIA), Securities and Exchange Commission (SEC)), the Task Force on Women’s Financial Inclusion and the World Bank Team on the Financial Inclusion Support Framework.

Enabling Policy Recommendation

Gender-mainstreaming should be carried forward from the FSDP into the planned NFIS.³

- Under the FSDP, gender mainstreaming took the form of a gender-responsive budget to fund activities of the Task Force or BoZ on women’s financial inclusion. In the NFIS it is envisioned that gender mainstreaming will consist of well-documented activities, human resources, and a Toolkit for financial inclusion strategies.

Gender-mainstreaming in the planned NFIS should be integrated in the following four financial-inclusion strategies, which have the potential to accelerate financial inclusion of males and females at a personal and business enterprise level: SME Finance, consumer protection, financial literacy, and retail payment systems.

- The FinScope Zambia 2015 survey established that the increase in financial inclusion was attributed to adults who earned salaries/wages from employment or as business owners. Taking into account that the inclusion of females also increased more significantly than males, the financial inclusion strategies on SME Finance, consumer protection, financial literacy, and retail payment systems in the NSFII can be deemed to work better for females and therefore be integrated with gender mainstreaming.

Policy Implementation

The national coordination structure of NFIS (World Bank, 2013) should integrate the Task Force on Women’s Financial Inclusion as a Gender Working Group. Its main responsibilities will be to provide technical assistance on gender mainstreaming in the selected financial-inclusion strategies, harmonize gender activities with the National Gender Policy, and develop a Financial Inclusion Gender Toolkit.

- The Gender Working Group can include selected members from the Task Force, with key members from BoZ, the Ministry of Gender and Child Development, ILO, the Bankers Association of Zambia, and Zambia Federation of Associations of Women in Business (ZFAWIB). Additional technical assistance can be obtained from the office of the Special Envoy on Gender at the African Development Bank (2014).

Financial Inclusion Gender Toolkit

The Toolkit is intended to spur institutional change in the financial sector by integrating gender mainstreaming in the following processes: licensing, regulatory development, strategy, product development, distribution channels, pricing, budgeting, customer service, marketing, communication strategies, and data measurement.

- The Toolkit will include templates of gender policies and gender-responsive budgets, specialist human resources and tools that have been created by the ILO and Women World Banking.

Toolkit: Resources and Tools
Gender Policy and Strategy Document
Participatory Gender Audit (PGA) ⁴
Female and Male Operated Small Enterprises (FAMOS) Self-Check audit ⁵
Gender Focal persons and facilitators ⁶
Gender Performance Indicators (GPIs) ⁷
Gender Responsive Budget (GRB) (Budlender and Hewitt, 2003) ⁸

- The role of the Gender Working Group will be to collate and distribute materials, explain their value to stakeholders, and, most importantly advise on their application in financial-inclusion strategies.

The Bank of Zambia has utilized the above tools, with the exception of the GPIs, and found that they help address perceptions and attitudes of gender mainstreaming in the financial sector.

Conclusion

Harmonizing the work of the FSDP/NFIS and the Taskforce to develop a Toolkit on the Gender Dimensions of Financial Inclusion Policy for the financial sector is expected to have a positive bearing on women's financial inclusion, as evidenced by the FinScope Zambia 2015 results. It is hoped that the Toolkit developed for Zambia will also be useful for members of the Alliance for Financial Inclusion.

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Endnotes

1. The author is writing in her capacity as Specialist – Financial Sector Development, and at the time of writing this Policy Memo, is currently on a two-year assignment as Executive Assistant to the Deputy Governor—Administration (DGA), BoZ. The Bank's Executive is championing gender mainstreaming in the financial sector, and the DGA chairs a multi-stakeholder Taskforce on Women's Financial Inclusion.

2. The FSDP is a comprehensive strategy by the government, the three financial sector regulators, namely BoZ, the Pensions and Insurance Authority, and the Securities and Exchange Commission to addresses reforms in the Zambian financial system.

3. The FSDP is due to be wound up in June 2015. Its successor is a National Financial Inclusion Strategy, which is being developed under the World Bank Financial Inclusion Support Framework (FISF) program.

4. International Labour Organisation (ILO). (2012). A Manual for Gender Audit Facilitators. The Participatory Gender Audit (PGA) was developed by ILO and is an audit aimed at enhancing an organization's capability to promote gender equality and implement gender mainstreaming effectively in policies, the allocation of resources, structures, programs, and the development and delivery of gender-sensitive products and services.

5. FAMOS was developed by ILO and is tailored for organizations which work with MSMEs. It assesses the extent to which FSPs target and serve women entrepreneurs and their needs. It involves a thorough self-assessment of an FSP's promotional efforts, staffing, training, communications, culture, and processes in order to determine its readiness to serve women entrepreneurs as clients. FAMOS helps identify practical, simple, and effective responses that can help an FSP have better outreach to female clients. It is also applicable to male clients. Kabinda Kawesha was certified as an ILO-FAMOS Check Trainer and Facilitator in June 2015.

6. Gender Focal persons and facilitators are trained and certified people that can conduct or facilitate a PGA and FAMOS self-check audit of an FSP, the recommendations of which will be implemented by the FSP.

7. GPIs were developed by Women's World Banking and are used to track and improve "gender performance." They are part of an evaluation framework of key metrics that enable FSPs to measure how effectively they are serving women by considering— its commitment to women (as employees) or targeting women (as clients); how many women it serves, that is, the "numbers"; and how well it serves women.

Beyond Boundaries of Financial Access: Trigger the Transactions for Meaningful Financial Inclusion

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Executive Summary

India professed financial inclusion to have a path of sustainable inclusive growth. The sustained efforts of the government and the Reserve Bank of India (RBI) to promote financial inclusion bore fruits and discernible progress, bringing the majority of India's people into the banking gambit. Since 2010, the implementation of the Financial Inclusion Plan (FIP)¹ and the Pradhan Mantri Jan Dhan Yojana (PMJDY)² resulted in the opening of 400 million new basic banking accounts. Despite this overwhelming success, the majority of these accounts remain dormant. Meaningful financial inclusion can't be achieved unless these new accounts are used. Lack of financial education, unsuitable product designs, and barriers in the Business Correspondent (BC) model are some of the reasons for non-usage of accounts. A structured financial education campaign, suitable and simple products, and appropriate compensation to bank agents may improve the usage of new bank accounts.

Introduction

India has a population of 1.2 billion and nearly 60% live in rural areas. As per the World Bank Group's Global Findex Database (2014),³ only 53% of adults have an account with a formal financial institution. With a view to improve the financial outreach, the Reserve Bank of India (RBI) introduced the Business Correspondent Model (Agent Banking) in the year 2006. With a view to give fillip to financial inclusion efforts, the RBI relaxed the "know your customer" (KYC) norms for small accounts, strengthened the BC model in terms of enlarging the list of eligible entities, inter-operability, removal of distance criteria, etc. From the year 2010, the RBI pushed financial inclusion aggressively by introducing a three-year FIP. After successful implementation of phase-I (2010–13), the RBI rolled out phase-II of FIP for the period 2013–16. While the implementation of FIP-II is under way, the Government of India unleashed a big push toward financial inclusion in August 2014 by introducing PMJDY with a goal to have at least one bank account for every Indian household.

Impact of the Policy

The above policy interventions have resulted in discernible progress. From the perspective of numbers of new accounts opened, the PMJDY has been a tremendous success story. As many as 125 million banking accounts were opened in the short period of six months. Since 2010, a total of 400 million new bank accounts have been opened under the FIP and PMJDY. Of these, about 187 million new accounts were opened through BC model. The number of banking outlets in villages managed by the BCs had gone up to 499,587 at the end of March 2015 from 34,174 at the end of year 2010.

Problem

While access to financial service has been achieved in terms of service points, concerns have emerged about transactions in newly opened basic bank accounts. There are no or low transactions in the basic bank accounts newly opened under recent financial inclusion campaigns. InterMedia's India FII Tracker survey showed that only 25% of the bank accounts were reported

as active. About 85 million of the roughly 400 million newly opened have maintained a balance of zero, and in the majority of the remaining accounts, total transactions are negligible. In order to provide a policy solution that addresses the core causes of this problem, a close examination of both demand and supply side factors is necessary. As a part of Fletcher Leadership Program on Financial Inclusion, a field survey based on Human Centered Design (HCD)⁴ was undertaken with a target group consisting of male, migrant domestic workers. The survey revealed some of the following concerns both on the demand and supply sides.

Demand Side Factors

The RuPay⁵ debit cards distributed to the new account holders under PMJDY have inbuilt free accident insurance of INR 100,000 (≈ USD 1600) and life insurance of INR 30,000 (≈ USD 480). Further, an overdraft facility of INR 5000 (≈ USD 80) is available, if the operations in the accounts are satisfactory. The debit cards must be used at least once every 45 days to keep the insurance policy active.

Most of the account holders are not aware of the benefits of using accounts. For example, only 8,000 account holders have availed themselves of the overdraft⁶ facility under the PMJDY.⁷ After discussing this with account holders, it was clear that some of them have only a vague idea of how the policy works, but are not fully aware of the benefits. They indicated that if they had known the incentives and benefits of using the bank accounts, they would have operated these accounts. And a number of clients were not conversant with the usage of their new bank account.

Supply Side Factors

Ease of use: The HCD survey also revealed that account holders did not use the accounts as they have to forgo their wages if they went to bank branches. It was also found that the BCs are not turning up at the clients' locations, when this is actually required. It is noteworthy that many used mobile phones and were also adept in using social media. They found that it is very cumbersome to use the mobile banking application, as they had to click 3 to 8 times in order to access a balance enquiry or money transfer.

The BC model: The success of the financial inclusion agenda in India hugely depends on the efficacy of the BC model. As on March 31, 2015, bank agents serviced about 187 million accounts. Agents dominate the proximity to banking services. Per the InterMedia India FII tracker survey, 45.9% of people have access to banking services through the BC model within a distance of one kilometer and 65.8% can access BC-enabled banking services within 15 minutes. Yet, surprisingly, only 0.2% use agent banking services. About 97.5% still depend on transacting across the counter in a brick and mortar branch. Though access is available through the BC model, account holders are not availing themselves of this access. One of the important issues that continues to hamper BC operations, despite PMJDY making INR 5000 (≈ USD 80) a minimum remuneration for BCs, is non-payment of adequate and timely remuneration to BCs by banks or to BC agents by an authorized BC company. At present, the government pays a commission of 1% subject to an upper limit of INR 10 per government-to-person (G2P) transaction undertaken through the BC model. MicroSave's Paper (Sharma, Wright, and Bakhshi, 2015) estimated that the cost of G2P delivery would be 2.63%. MicroSave estimated the split costs at BC agent, BC network manager, and bank level would be around 0.85%, 0.96%, and 0.82%, respectively. The Report of the Task Force on Aadhaar-Enabled⁸ Unified Payment Infrastructure suggested a commission of 3.14% for G2P transactions. The Discussion Paper on India's Business Correspondent Model (Ensure and Grameen Foundation, 2013; p. 27)⁹ states that most BCs are not able to meet their costs and are often losing money, especially in the initial years.

Recommendations

To address low performance of agent banking, this memo proposes the following three-pronged policy interventions.

First, the Reserve Bank should initiate a nationwide financial literacy campaign, targeting the holders of new accounts using the existing Financial Literacy Centres (FLC)¹⁰ across the country at Panchayat¹¹ level. This campaign, among other things, should cover the benefits of using bank accounts and using bank accounts through mobile phones. The Reserve Bank may also make NGOs and other regulators as partners in this regard.

Second, supply-side actors must fine-tune their product design and product offers. Banks should customise their mobile banking product meeting the limited needs of this segment with a simple and easy to use limited menu with two to four clicks for balance enquiry and money transfer. This digitization of the money transfer will not only contribute to faster financial inclusion but also reduce the transaction costs drastically.

Third, the BC model requires strengthening. Increasing the number of transactions in the accounts would improve compensation to the BC agents. A correction in the demand side by way of targeted financial literacy will help in increasing transactions in these accounts (addressed in the first recommendation). Additionally, the Government of India must speed up completion the process of G2P, including the commission guidelines for agents, within a more aggressive timeline, say by the end of 2016. At present, the government pays a commission of 1% subject to an upper limit of INR 10 per G2P transaction undertaken through the BC model. This commission needs to be increased to at least 3% to encourage the banks to better compensate the BCs.

Implementation Strategy

The above recommendations need to be implemented in a timely manner by using the already available financial inclusion eco-system:

1. The RBI, on a priority basis, will initiate policy blue prints for a financial literacy campaign targeting the newly opened bank accounts through FLCs.
2. The RBI will issue guidelines asking the banks to tweak their mobile banking product designs for simpler and easy-to-use accounts, particularly for this target segment, and vigorously promote these enhancements.
3. The RBI may work with the Government of India to increase G2P agent-based transaction commissions from 1% to 3%.

Conclusion

Sustained meaningful financial inclusion is a must for India's inclusive growth. While we have initiated several policy measures in this direction, we need to encourage a more enabling financial ecosystem to see hoped-for results. Access alone is not enough to ensure usage and adoption. Financial education for consumers, easier to use mobile products, and adequate compensation for bank agents will go far to ensure that good value propositions fuel demand and a good business case fuels supply.

Disclaimer: The author is working as General Manager with Reserve Bank of India. The views and recommendations in this paper do not necessarily reflect the organisation he is working for.

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1. RBI advised banks to prepare a three-year board-approved Financial Inclusion Plan in the year 2010. FIPs contain bank's self-set targets for covering the unbanked villages by opening brick and mortar branches or through agent banking model leveraging technology.
2. Pradhan Mantri Jan-Dhan Yojana (PMJDY) is Prime Minister's National Mission for Financial Inclusion to ensure access to financial services, namely, banking/savings and deposit accounts, remittance, credit, insurance, and pensions in an affordable manner.
3. <http://datatopics.worldbank.org/financialinclusion/country/india>
4. Human Centered Design is an approach to problem solving process for new tailor-made solutions suitable to people's needs.
5. RuPay is the Indian domestic card payment network set up by National Payments Corporation of India with the approval of the Reserve Bank of India.
6. All PMJDY account holders are eligible to have an overdraft facility of INR 5000 provided if the account is operated satisfactorily for a minimum of six months.
7. Source: Business Standard Newspaper dated May 22, 2015.
8. Aadhaar is a 12-digit individual identification number issued by the Unique Identification Authority of India on behalf of the Government of India. This number will serve as a proof of identity and address, anywhere in India.
9. Grameen Foundation and Enclude are formerly ShoreBank International and Triodes Facet.
10. There are 1136 Financial Literacy Centres across India propagating financial literacy. These FLCs are mandated to organize outdoor financial literacy campaigns. The Reserve Bank monitors the conduct of financial literacy camps on a quarterly basis.
11. Panchayat is a village-level self-governing institution.

**Promoting Sound Practice through
Transparency & Proportionality**

Bringing Light to the Shadows: Regulating and Supervising Remittances in the Philippines, an Attempt to Address Shadow Banking Activities for Low Value Accounts

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Executive Summary

The growth of remittances for the past 5 years (from nearly 20 billion pesos in 2010 to almost 25 billion at the end of 2014) has increased the number of international remittance-service providers operating in the Philippines, yet these providers remain largely unregulated. To address this need, Bangko Sentral ng Pilipinas (BSP) must work with local government units (LGUs) to (1) efficiently register remittance-service providers (RSPs) and pawnshops and (2) effectively supervise these institutions without stretching BSP resources and tighten regulations where it matters.

The proposed policy would entail a network-based supervision of remittance agents (RAs), including pawnshop operators, which have remittances as their corollary business. This policy would be aligned and consistent with the BSP's risk-based approach to supervision and examination. From a regulatory standpoint, this is a major shift from the current process of merely registering remittance agents and pawnshop offices on an individual basis. Once manpower and logistical constraints are overcome, this recommendation would enable the efficient supervision of more than 15,000 non-bank financial institutions currently unsupervised, with wide coverage, in terms of monitoring and examination.

Introduction

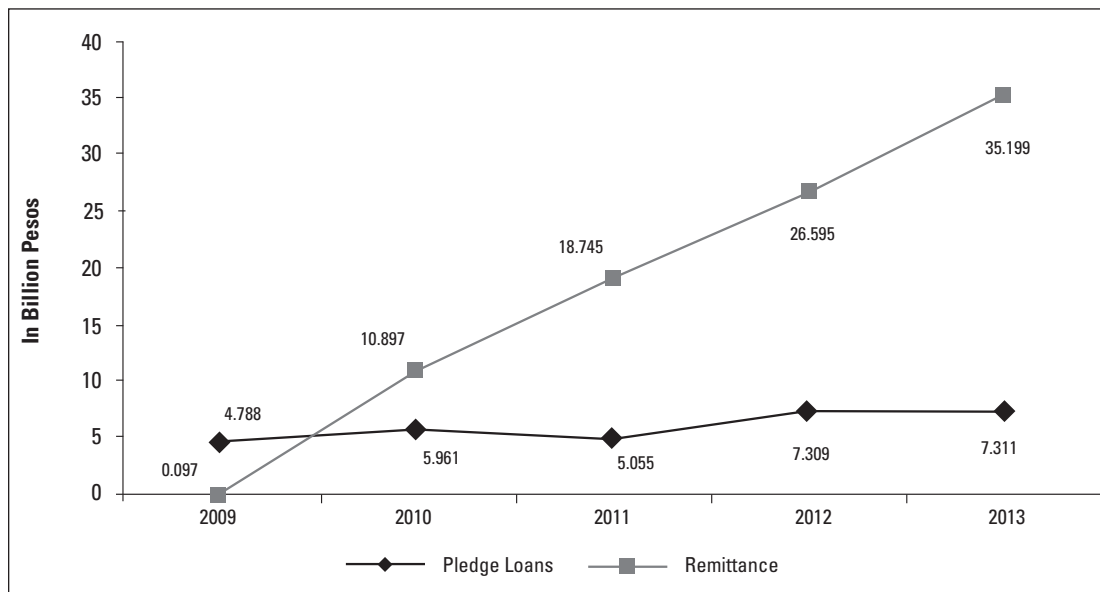
Shadow banking is broadly defined as financial (credit) intermediation involving entities and activities outside the regular banking system (Financial Stability Board, Global Stability Banking Monitoring Report, 2014). The World Bank, in its March 2012 Philippine Quarterly Update, noted a shift toward non-bank financing. Historically, BSP focused on the practices of shadow banking within the real-estate sector, closely monitoring the lending practices of real-estate developers where credit underwriting standards are lax compared to banks. However, innovation and technology in the money-transfer business brings improved access, and shifts the concentration of shadow-banking activities from traditional real-estate business to low-value/high-volume transactions. Remittance agents as instruments of money transfer provide alternate liquidity for intermediation activities of pawnshops and other lending institutions. In the end, shadow banking is a key constraint in realizing the BSP goal of financial inclusion, because if these businesses are not appropriately supervised and regulated, it will have an undesirable impact on the aspect of transparency and disclosure, anti-money laundering and control, and ultimately prudent operation and appropriate customer protection.

Over the years, financing outside of the banking system has shown a parallel convergence. From stand-alone units and single services in the 1980s, NBFIs are now offering a variety of parallel services such as pawning, remittance, insurance, bill payment, electronic loading, collection services, foreign exchange, etc. The largest of these services are remittance and pawning (pledge loans). In terms of network reach, given the Philippine archipelago's 7,101 islands, pawnshops dominate the non-bank financial institutions (NBFIs) landscape. Per BSP registry there are

6,648 pawnshop units, and 8,916 business establishments both BSP-registered and operating as remittance agents as of 31 March 2015.

In fact, in the last 5 years, the growth of remittance services (see Figure 1) dominate the volume of services being offered by the pawnshops. Thus, remittance supervision must be done in consideration of pawnshop operations, which due to their vast networks, became the natural take off points for remittance operations.

Figure 1. Volume of Remittance versus Pledge Loans



Source: Supervisory Data Center, BSP, on Pawnshop Activities

The large number of overseas Filipinos (OF), approximately 10 million or 10% of the country’s total population brings a robust remittance business. Recent studies showed that the Philippines is the third largest recipient of volume of remittances after China and India (World Bank Press Release, 2014). Also, BSP data showed that the trend of inward remittances is expected to grow by 5% annually; its present volume already accounting for 8–12% of the country’s GDP.

The remittance industry has been an effective tool for the BSP in building a more inclusive financial system, due to its unparalleled capability to reach a great number of financial consumers with its numerous offices/branches scattered throughout the country. However, this phenomenon also brings a number of consumer problems such as non-transparent pricing, inefficient services, closed payout centers, etc.

The Problem

The growth of remittances brought by the increased of demand for OF workers in the Middle East, North America, and Europe which predicted to be sustained in the future (Philippine Overseas Employment Agency, 2010), have increased the number of international remittance-service providers operating in the Philippines to cater there remittance service needs, yet these providers remain largely unregulated. Hence, there is no “level playing field” in the market, with unsatisfied consumers experiencing higher costs of service, hidden charges, fraud, and in some cases, finding closed pawnshops/RAs without recourse.

Two problems were identified from a regulatory standpoint: (1) the BSP had trouble evaluating voluminous number of applications for the registration of remittance agents, and (2) the ineffective supervision over these institutions. These problems exist because of the following:

- *Limited supervisory resources.* The sheer number of BSP-registered pawnshops and remittance agents is a tall order to overcome in supervising and examining these institutions considering

BSP's limited supervisory resources. This is aggravated by the applications for registration received on continuing basis.

Applications for registrations are individually (per office/branch) evaluated and processed. Due to this, most applications can take over 90 days to process, in violation of the 30-day period prescribed by Anti-Red Tape Act (ARTA).

- *Outdated regulatory regime.* The rapid growth of remittance businesses, together with the evolving landscape of the pawnshop industry, has outpaced the existing registration process and regulations. Market conditions and trends toward convergence in the pawnshop industry and remittance space dictate peculiar but proportionate regulations anchored on the principles of good governance.

Although anti-money laundering (AML) regulations and consumer protection frameworks have already been established, they have not been implemented for these institutions. Off-site monitoring activities and on-site examination procedures remain wanting.

Recommendation

The BSP recognizes the need to provide an environment conducive to fair competition and instill market discipline consistent with the principles of good governance. Proportionate regulations focused on AML and consumer protection are essentially critical to have a better handle of shadow-banking activities, particularly in remittance.

While this proposed approach introduces corrective action for non-compliant supervised institutions, it also provides added benefits to supervised institutions in terms of liberal branching opportunities. These benefits would require that an institution can demonstrate expected standards toward healthy operations before activation. Thus, on a macro-economic level, this pragmatic approach will open up the competition for shadow-banking players that may lead to lower and more transparent costs from pawnshop and remittance services, as well as improved customer experiences for many Filipinos.

Thus, the proposed solution shall be anchored on a two-pronged policy and action aimed at (1) efficiently registering RSPs and pawnshops and (2) effectively supervising these institutions without stretching BSP resources and tightening regulations where it matters.

1. Adoption of a network-based approach to supervision of Pawnshops and RSPs

The strategic shift to network-based supervision or regulation of RSPs and pawnshops is a pragmatic arrangement that will enable BSP to maintain effective supervision of the industry without overstressing its limited supervisory resources. The supervision approach is analogous to the approach with banks where the focus is collectively on the aggregate rather than on the individual components.

With the new approach, pawnshops would be aggregated based on the operator (referred to as a pawnshop network operator (PNO)); RSPs shall be aggregated by which network they are connected and aptly classified as a remittance network provider (RNP).

New offices/branches within the network of a PNO or RNP are no longer required to be registered with the BSP before commencing actual business operations. Instead, the responsibility of ensuring that the offices/branches are established and operating within the framework and limitations of existing regulations shall be delegated with the RNP. This also includes the responsibility of ensuring the orderly closure of any branch with the prompt reporting thereof to the BSP.

Registration processes shall be off-loaded to focus on effective monitoring of large RNPs. The shift of working arrangement shall also pave the way for an efficient coordination of

on-site and off-site activities. Existing personnel that used to evaluate and process applications for registration shall be re-trained to perform off-site monitoring activities and analysis of operating environment.

The resulting number of institutions that will be effectively supervised is reduced to 20 PNOs and 20 RNPs covering about 80% of the market in terms of asset size.

2. Enhance the coordination with LGUs and other government regulatory agencies

The supervision of small players (or about 20% of the market) in the industry not falling under the definitions of a PNO or RNP shall be strengthened through the enhanced coordination and cooperation between the BSP and LGUs through the Department of Interior and Local Government (DILG). The existing agreement between BSP and DILG only needs to be implemented and operationalized in a way beneficial to all parties concerned. Also, existing working agreements with other government agencies, i.e., Financial Sector Forum, Working Groups may be improved in the aspect of sharing of information and joint-review/examination. This may be included as among the agenda during the periodic intra-agency meeting.

Implementation

The implementation of the proposed solution shall take at least one (1) year, which will include the following steps.

1. the formulation of key amendments on the regulations and policies shall commence within the year 2015 including approval of the higher management of the exposition draft;
2. exposition, deliberation, and consideration of comments from peers/colleagues, experts/consultants and industry players shall not be later than 31 March 2016;
3. approval by the Monetary Board of the BSP on the proposed amendments on the regulations including the corresponding supervision guidelines shall not be later than 30 April 2016; and
4. coordination with the LGUs and other government regulatory agencies regarding the approved amendments shall not be later than 30 June 2016.

Upon approval of the policy, it will provide a 1-year transition period to afford ample time for industry players to adjust to the new regulation.

Conclusion

The two-pronged solution to the problem is envisioned to effectively cover not just the major players in the industry but all supervised institutions in the non-bank financial institutions, with a focus on low-value accounts. The streamlined registration process and enhanced disciplinary action will make market entry easier and the remittance and pawnshop networks more responsible.

Specifically, the proposed regulation is expected to benefit the following stakeholders.

1. *Remittance clients.* Clients shall experience improved services in addition to low and transparent remittance fees. The families of OFs can plan better use of resources that can lead to savings and investments.
2. *Regulators (BSP, LGUs, FATF, and other government agencies).* The proposed regulation puts in place a supervisory approach that will remedy loopholes in the present system. The result will be enhanced monitoring of remittance activities and the efficient supervision of the industry. The standard-setting body shall consider this development as a positive step toward appropriate solution to money-laundering concerns. Likewise, it will improve coordination and relationship between government agencies thus, sharing of information will be easier.
3. *Remittance system.* The market players shall boost trust to the remittance networks that may bring more clients into the formal system. They can also benefit from fair treatment from regulators across the globe.

The proposed policy change brings benefits in terms of liberal branching, other business opportunities and promotes corporate discipline. Likewise, it advances higher standards in corporate governance, risk management system, control, reporting standards, and consumer protection.

Ultimately, it aims to build trust and confidence in the system that serves a large segment of population that are vulnerable, uneducated, and needs guidance and protection.

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Enhancing Formal Credit Adoption among Adult Nigerians through Transparent Screening and Monitoring

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Executive Summary

The majority of adult Nigerians access more loans from informal sources, including family and friends, than they do from formal financial institutions. Analysis revealed that this is occasioned by dearth of trust in the latter. This memo proposes that the Central Bank of Nigeria implements a policy to enhance transparency in the screening and monitoring processes of formal financial institutions. By implementing this policy, better credit information will become available to support credit appraisals by lenders while borrowers' financial capability will be enhanced toward appropriate loan sizes and reduced defaults. This is expected to engender mutual trust between both parties, thereby increasing credit uptake from 3% in 2014 to 40% by 2020, as espoused by the National Financial Inclusion Strategy.

Introduction

As far back as the 1970s, the Federal Government of Nigeria has been undertaking steps to promote access to finance in the country. Related initiatives included rural banking policies, sectorial allocation of subsidized agricultural credit scheme, and establishment of the People's Bank, as well as community banks (Central Bank of Nigeria, 2013a). The launching of the National Microfinance Policy, Regulatory and Supervisory Framework for Nigeria on December 15, 2005 in particular led to the emergence of 916 microfinance banks and over 6,000 non-bank financial institutions, under the aegis of the National Association of Non-Bank Microfinance Institutions. While varying degrees of progress were recorded, Nigeria's overall financial inclusion rate stood at a conservative 53.7% in 2010. Specifically, access to formal credit among adult Nigerians remained at a paltry 2% while a total of 39.2 million adults or 46.3% of Nigeria's population were excluded from any form of financial services (EFInA, 2010).

Reasons for Low Use of Formal Credit

Irregular Income: 65% of financially excluded people around the world cite irregular income as the reason for not having a bank account (Demirguc-Kunt and Klapper, 2012). This presents a challenge for financial policymakers and financial institutions alike in the shared quest to bring more people into the formal financial system.

Distance: Globally, 20% of unbanked people have identified distance as a key barrier to financial inclusion, while 31% of unbanked people in sub-Saharan Africa have expressed the same challenge (Demirguc-Kunt and Klapper, 2012). In Nigeria, the average distance to Bank branches varies widely, from about 60 kilometers in Kebbi State to less than 1 kilometer in Lagos State (The Central Bank of Nigeria, 2012). The dichotomy between the dispersion of financial access points within the rural and urban areas is also very wide: about 86% of commercial bank branches and 68% of microfinance bank branches are located in urban areas. Furthermore, 42% of the local government areas in Nigeria have neither commercial nor microfinance bank branches (Martin, 2014).

Trust: The crisis in the banking industry during the 1990s adversely affected the trust between lenders and borrowers in the banking sector. The dearth of consolidated credit information on

borrowers adversely affected credit appraisal procedures, classification of loans, and overall risk profiling of borrowers. High incidences of loan defaults were therefore recorded from multiple loans beyond borrowers' financial capability.¹ Subsequent reforms between 2004 and 2009 sought to promote financial system stability—case in point, the Comprehensive Revision to the Guide to Bank Charges that promotes transparency in pricing (Central Bank of Nigeria, 2013a).

Strategies to Improve Credit Use by Adult Nigerians

In order to address the lingering challenges, financial sector stakeholders, led by the Central Bank of Nigeria (CBN), launched the National Financial Inclusion Strategy (NFIS) on October 23, 2012. The Strategy defined and assigned various interventions with the overall target of reducing the percentage of financially excluded adults from 46.3% (in 2010) to 20% by 2020 (The Central Bank of Nigeria, 2012). The specific targets for various access strands were as follows:

	Strategy Targets	2010 Baseline	*2014 Actual	2015 Target	2020 Target
% of Total Adult Population	Payments	21.6%	24%	53%	70%
	Savings	24%	32%	42%	60%
	Credit	2%	3%	26%	40%
	Insurance	1%	1%	21%	40%
	Pensions	5%	5%	22%	40%

*Source: (EFinA, 2014)

It is noted here that some initiatives have already been implemented to drive credit uptake, namely:

- Issuance of the Guidelines for the Licensing, Operations and Regulations of Credit Bureaus and Credit Bureau Related Transactions in Nigeria (Central Bank of Nigeria, 2008, 2013b).
- Credit enhancement schemes such as the Small and Medium Enterprises Credit Guarantee Scheme (Central Bank of Nigeria, 2010), Micro, Small and Medium Enterprise Development Fund (Central Bank of Nigeria, 2013) and Nigeria Incentive Based System for Agricultural Lending (Central Bank of Nigeria, 2013). These schemes are focused on de-risking lending to low-income people and growing enterprises.
- Introduction of Tiered Know Your Customer Requirements (Central Bank of Nigeria, 2013), which stipulates the documentation and transaction thresholds based on customer risk profile. Tier 1 allows clients to open bank accounts with only their name, address, passport photograph, and mobile phone number, all of which does not require independent confirmation by the bank.
- Issuance of the Guidelines for the Regulation of Agent Banking and Agent Banking Relationships in Nigeria (Central Bank of Nigeria, 2011) to address the challenge of distance to financial access points through third parties (agents).
- Establishment of the Consumer Protection Department within the Central Bank of Nigeria in 2012 to address issues bordering on fair and just treatment of bank customers and building confidence in banking systems and services.

Outcome of Past Efforts and Outstanding Issues

Despite the concerted efforts to improve credit access levels, the EFinA 2014 *Access to Financial Services in Nigeria Survey* revealed that only 2.8 million or 3% of the total 93.5 million adult population had access to formal credit as at December 31, 2014. Also, as many as 13.4 million adults were reported as having used trade credit—that is, purchased goods and services on

credit from sellers within the year. Another 6.5 million adults obtained loans from family members or friends, 1.7 million adults borrowed from traditional savings groups, and 1.2 million adults received loans from moneylenders.

One of the major outstanding factors is the gap between the lenders and the excluded Nigerian population in terms of their respective understanding of credit processes. The procedures for applying for credit are often not understood by potential borrowers. In other cases, reasons for loan denials are not communicated to credit applicants, thus exacerbating mistrust between lenders and borrowers. Banks, on the other hand, are vulnerable to high-risk borrowers because of inadequate information on their financial capacity and obligations. For the number of adult Nigerians with access to credit to increase and reach 40% as espoused in the National Financial Inclusion Strategy, there is need to address these challenges.

Proposed Solution

Economists have long believed that trust mediates the risk of socio-economic interaction; researchers have also explored the relationship between social trust and economic prosperity in a broader sense. As regards financial transactions, lenders need to be able to screen and monitor potential borrowers in a prudential manner to make optimal credit decisions while borrowers have concern for fairness and credible information in credit contracts (Tonkiss, 2009). Efforts should therefore be made to entrench transparency in the credit processes for a better fit for both borrowers and lenders.

Policy Recommendation

The Central Bank of Nigeria should pursue a directive on transparency in the credit screening and monitoring processes of formal financial institutions as a means of promoting increased access to credit in the country. In particular, the following recommendations should be implemented.

1. Eligibility criteria for credit products must be clearly communicated by the financial institutions to borrowers; this communication must include but not be limited to the pricing and the components thereof, permissible activities/businesses, repayment, and contractual terms.
2. Decision about credit requests must be clearly communicated to the borrowers within a stipulated timeframe through appropriate communication channels. This should be done along with an advisory on how borrowers can improve their chances for favorable decisions. This is essential toward building their long-term financial capability for credit. Notably, 92% of participants in an Aspen Institute-led, Credit Pilot Program introduced to an entry product (secure credit card) and financial education/coaching were able to develop appropriate credit scores within 12 months (Gomez and Alisultanov, 2014).
3. Similarly, financial institutions should maintain a database of both approved and denied loan requests, indicating rationale for the decisions. While credit decisions are at the discretion of the institution, it is expected that data generated will provide deeper insights for both bank and client. The 2005 National Credit Act of South Africa (The Banking Association South Africa, 2005) contains a clause on the right to be given reasons for credit being refused.
4. Mandatory linkage of the financial industry Bank Biometric Verification Number (BVN) to Credit Bureau data. This will enable unique identification of the borrower and ascertain credit exposure and/or risk profile. The use of biometrics in providing loans to rural farmers in Malawi led to lenders advancing increased number of low-valued loans and higher returns of N382.18 (\$1.94) per loan. Borrowers on the other hand, took out more appropriate loan sizes and recorded less defaults (Poverty Action Lab, 2011). In Uganda, the BVN equivalent known as the Financial Card System (FCS) has been successfully linked to the credit bureaus in the country (AFI, 2013).

5. Review of the Credit Risk Management System (CRMS), the central database that consolidates borrower information on bank loans of N1,000,000.00 (One million naira) and above, including outstanding principal and interest. Inclusion of lower valued loans of up to N100,000 (one hundred thousand naira) recommended to reduce multiple borrowings, beyond the financial capacity of low-income clients as this portends the risk of over-indebtedness and loan default.

How the Policy Will Be Implemented

The Financial Inclusion Secretariat will secure the buy-in of the Financial Inclusion Products Working Group under the auspices of the National Financial Inclusion Technical Committee. The Group will be charged with espousing an appropriate framework for credit screening and monitoring through collaboration with Central Bank of Nigeria, Bankers' Committee, National Association of Microfinance Banks, Nigerian Inter-Bank Settlement Scheme, and credit reference bureaus. It is anticipated that the review and approval process for the implementation of the recommendation will require about 6–8 months. The Central Bank of Nigeria through its Harmonized Sensitization Campaigns and national media outreach programmes including radio, television, national dailies, and social media should educate the Nigerian public on the new policy.

Conclusion

The importance of financial inclusion, particularly formal credit to low-income individuals, households, and small enterprises cannot be over-empathized. The demand for the use of credit among adult Nigerians was evidenced by the high patronage of informal credit providers. The pursuit of a directive on transparency in the credit screening and monitoring processes for formal financial institutions is anticipated to further engender trust among the users and providers of formal credit, thereby enhancing uptake in line with the set target for the National Financial Inclusion Strategy in Nigeria.

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Informal and Unlicensed Providers of Funeral Insurance Pose a Risk to Low-Income Households

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Executive Summary

Funerals are a major expense for many poor South African households. The high costs of a funeral can detrimentally affect a low-income family's stability; consequently, people in this market segment use a variety of methods and financial instruments to cope with funeral costs. These include burial societies, funeral insurance from a number of sources, such as funeral parlors, and other formal and informal means.

The costs of funerals in South Africa are relatively high, markedly affecting low-income households who often struggle to meet their most basic needs. Funerals can cost anywhere between R5 000 (416 USD) and R100 000 (8,333 USD), or 46% of the average low income household income.¹

In many communities, the sociocultural value attached to a dignified funeral is deeply ingrained. Thus, when someone dies, it is important to ensure that he or she is buried with much extravagance and festivity; this may prompt the bereaved family to go to great lengths to provide food and care to people attending the funeral. For some poor families, these costs can be equivalent of 5 to 15 times their average monthly household income (Roth, 2000).

Funeral service providers, also called funeral parlors or undertakers, are a prominent part of many South African communities. Funeral insurance is the most popular type of insurance taken out by low-income individuals, due to cultural beliefs that it is necessary to have an expensive funeral to show proper respect for the deceased. In order to secure a market for their expensive services, funeral service providers themselves offer a range of financial services to the public, including funeral insurance. By providing cover to South Africans against the risk and cost of a funeral, which can financially cripple low-income families, these providers fulfill an important social protection role. Despite such protection, many providers operate informally, without proper licences. As a result of the demand for elaborate funerals, informal and unlicensed funeral parlors market and sell funeral insurance to many vulnerable members of society.

Low-income households are at the risk of losing their benefits when dealing with informal and unlicensed providers of funeral insurance. The risk is that there is no recourse for consumers in case of a dispute with an unlicensed provider. Considering that this segment of the population is characterized by low levels of financial literacy, it is particularly vulnerable to abuse. For example, one of the most prevalent abusive practices in this market occurs when funeral parlors refuse to give policyholders the option of a monetary benefit instead of a benefit in-kind. They offer one or more funeral service packages that consumers can choose from at different premium levels, and they rarely attach a monetary amount to the service provided. The in-kind benefits are the funeral services provided by the funeral parlor, which includes, among others, storage and treatment of the body, coffin, hearse for transport of the coffin, lowering device for lowering of the coffin into the grave, flowers, tents for shade at the graveside, chairs for mourners, pamphlets, etc.

Licensed providers, in contrast, are subject to insurance legislation that demands a provision for clients to be given this option when claiming for their funeral policy benefits.

This state of affairs is of concern to policymakers and regulators. A solution to the problem is to develop a proportional regulatory and supervisory framework in which the informal providers of funeral insurance can operate formally. The International Association of Insurance Supervisors (IAIS) refers to the "proportionality principle," which means that regulatory and supervisory requirements should take into account the nature, scale, and complexity of risks inherent in the individual insurance business (IAIS, 2012). Funeral insurance products are simple in nature; it would therefore be justified to have simpler and less burdensome requirements in this market segment.

Problem

Out of a total of 37.2 million funeral policies sold in South Africa, approximately 20% (7 million) of the policies are sold by funeral parlors that lack insurance licences (FinScope, 2014).²

Due to the general non-enforcement of both health regulations and the requirement to register funeral parlors, it is difficult to precisely identify the number of funeral parlors operating in South Africa; however, recent estimates provided by industry players suggest that a conservative estimate is between 5000 and 7000.³ In order to secure a market for their services, these funeral parlors offer a range of financial services, including funeral insurance. By covering their clients against the cost of a funeral, which can financially cripple low-income families, they fulfill an important social protection role. However, in doing so, many do not comply with insurance legislation. Such legislation includes prudential insurance regulation concerned with the financial soundness of insurers and conduct of business regulation, which focuses on the suppliers' conduct in relation to clients; in yet another form of misconduct, many parlors do not separate their funeral services and insurance businesses, instead using the insurance premiums as cash flow.

This practice has serious consumer protection implications and is of concern to regulators (e.g., Financial Services Board) and policymakers (National Treasury, Ministry of Finance).

The problem of informality in the funeral insurance industry exists due to the onerous requirements for obtaining an insurance licence.

According to a 2005 study conducted by Genesis Analytics (Pty) Ltd. (Chamberlain, Bester, Short, and Walker, 2005) entitled: *A regulatory review of formal and informal funeral insurance markets in South Africa*, the current registration requirements imposed by the Long-term Insurance Act, for a minimum capital of R10 million (833,333USD) are unduly restrictive and hamper the development of the market. In 2014, the Office of the Regulator engaged various funeral parlor associations with the aim of addressing the challenges that the funeral parlor industry is facing in respect of funeral insurance. The associations mentioned legislative requirements as the main challenge their members are faced with, as they are unable to raise the required amount of capital for obtaining an insurance licence. They also mentioned other on-going compliance requirements as a barrier for them to enter the insurance industry—for example, the appointment of a statutory actuary and governance requirements.

Policy Recommendation

In view of the challenges in the informal funeral insurance market, I recommend that we develop a proportional regulatory framework for funeral parlors, which should be tailor-made to their level of risk, and at the same time consider the protection of consumers.

In 2011, attempting to address the challenges in the informal insurance market, including funeral insurance, the policymaker (National Treasury) published a policy document that proposes a microinsurance regulatory framework. Relevant proposals include creating a dedicated

microinsurance licence, offering a monetary benefit option, lowering prudential requirements (R3 million upfront capital), and requiring simpler governance requirements. However, in 2012 the Centre for Financial Regulation and Inclusion (Cenfri) conducted a study on the nature and practices of informal funeral insurance providers to establish their readiness in respect of the proposed microinsurance legislation (Cenfri, 2013). The main finding of the study is that most funeral parlors would not be able to comply with the proposed regulation without substantial assistance and support or partnering with other entities—the proposed capital requirement of R3 million (250,000 USD) is still too high for most funeral parlors, and presented the highest barrier.

Therefore my recommended regulatory framework is even more customized to meet the capital requirement challenges faced by smaller funeral parlors.

The development of the framework entails introducing a significantly reduced set of regulatory requirements. The requirements must be low so as not to discourage formalization, but sufficient enough to improve consumer protection to an acceptable level. These requirements could include the following.

- Creation of a lower tier microinsurance licence that allows licence-holders to provide in-kind funeral benefits only (no cash benefits). This will overcome the prudential problems stemming from inadequate liquidity.
- A requirement for all funeral parlors that provide insurance to register with the regulator, Financial Services Board (FSB).
- Submit regular returns to the FSB including minimal data, sufficient to build an understanding of the industry (e.g., number of policies, premium income, claims, etc.).
- Abide by basic good business practices (e.g., annual financial statements prepared by a qualified person).

Apply pressure from many angles to incentivize compliance with low-level requirements—for example, educate consumers that there are advantages to dealing with compliant funeral parlors. The education campaign should be backed up by a strong and intense media campaign with that there is no protection when dealing with a non-compliant funeral parlor. Another pressure point could be to encourage formal insurers to move down market and formalize the informal funeral parlors, as this will increase competition in this space. Consultations with the industry indicate that the less risk-averse insurers are prepared to deal with funeral parlors that have a good claims experience. Poor business practices and record keeping is not a big issue for these insurers, as they will provide business support services for the funeral parlors.

To ensure consumer protection and avoid prudential risk, the proposed regulatory framework should provide a graduation path for funeral parlors wherein the licence-holders in this category will provide in-kind funeral benefits only; as soon as they exceed a certain minimum size, they should graduate to a full microinsurance licence, where they will be required to satisfy all the prudential and governance requirements for microinsurers.

It is also recommended that to incentivize the current informal providers to formalize their operations, the regulatory framework should provide for a transitional period, to be determined after consultations with all relevant stakeholders. During the transitional period, informal providers will be entitled to amnesty from regulatory prosecution in order to allow them to formalize all their activities, including registering with the tax authorities. However, at the end of the agreed transitional period, those informal entities that did not register and continue operating outside the regulatory net will be subject to immediate prosecution.

To achieve the above regulatory framework and ensure that it will be successfully implemented, a number of important stakeholders need to be part of the process.

- Consult with the National Treasury (policymaker) after developing a discussion paper on the reduced regulatory requirements for funeral parlors. This is a key stakeholder because as the policymaker, they will give the policy direction to the discussion paper.
- The funeral industry will be requested to provide inputs into the discussion paper, including internal stakeholders within the office of the regulator. The industry includes funeral parlors, insurance companies that provide funeral insurance, intermediaries, and relevant industry associations. Their input into the discussion paper is important and will possibly result in a regulatory framework where there is buy-in from all stakeholders.

Conclusion

The lower regulatory requirements for informal providers in the funeral insurance market will lead to a reduced number of informal operators and increased consumer protection. Low-income households will have the peace of mind of buying insurance products from regulated entities where they know they will have recourse should a problem arise.

Significantly simpler regulatory framework will make enforcement easier, but enforcement remains a challenge given the large number of funeral parlors. Formalization and inclusion objectives will be met, as there is scope to increase formalization over time once funeral parlors are within the regulatory net.

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Endnotes

1. An approximate exchange rate of 1 USD = R11.92.00 (rounded off to R12.00) is used throughout document (as obtained from www.oanda.com in May 2015).
2. FinScope 2014 is a nationally representative demand-side survey of financial inclusion conducted by FinMark Trust.

**Financial Inclusion for the Lifecycle:
Tailoring to the Needs of the Young and the Old**

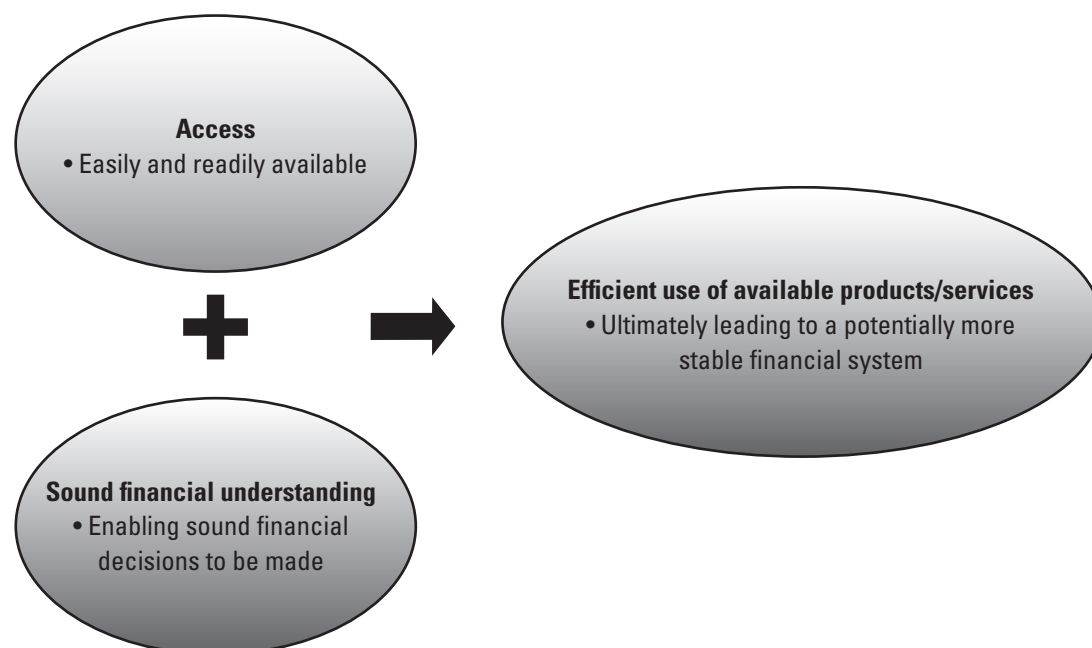
Enhancing Financial Education in Seychelles

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Executive Summary

It is vital that our Seychellois citizens are taught from a very young age basic concepts of finance in order for them to make optimal use thereof. Access to financial services alone is a necessary but not sufficient condition to make informed and efficient financial choices.¹



Several initiatives aimed at enabling efficient use of our formal financial sector have been established recently in Seychelles. We shall briefly describe some of these, and propose a complementary approach to what is currently being done, via the introduction of a specialized and exciting financial education program in our public schools, thereby ultimately enhancing both the quality and quantity of use. This proposal follows the examples set by several other jurisdictions globally, as many nations realize the importance of having strong financial literacy programs from a young age.

Introduction/Context

In Seychelles,² our financial inclusion priorities are shifting away from merely providing access, and tending also toward efficient use. Financial education is believed to be the secret ingredient to attaining such a goal. Chart 1 provides an illustration of some proxies relating to financial access in Seychelles.

“Financial inclusion is a multidimensional concept that goes beyond access to encompass usage and quality”

–Triki and Faye (2013, p. 40)

Kobliner (2013) cites that “[t]o help the next generation avoid the mistakes of their elders, and to live financially fit lives, they need to be taught the essentials about money.” Moreover, she notes that “children as young as three years old can grasp financial concepts like saving and spending.” This corroborates with Whitebread and Bingham’s (2013) research, which goes further to point out that money habits are formed by age 7. It is thus vital that we make full use

of this narrow window to include basic concepts related to finance as part of our official public school curriculum. Along the way, we also briefly touch upon some complementary efforts being made.

Development of financial education in Seychelles has been highlighted as a key area within our Financial Sector Development implementation Plan (FSDIP).³ Additionally, it will also play a key role in our efforts to develop our financial sector as the third stable pillar of our economy.⁴

Statistics from the National Bureau of Statistics (2014, p. 8) indicate that as of 2013, nearly 20% of the Seychelles population was aged below 15. A growing youth population offers a ripe opportunity: school-aged children, shown to be receptive to learning new concepts, are a captive audience for the teaching of financial concepts. The classroom⁵ provides us with the medium for financial empowering, thereby providing the strong foundation required for our citizens to make sound financial decisions, as many aspects of modern life involves finance. This can in turn play an important role in potentially yielding a sound and more responsive economic state.⁶

Problem

Based on complaints/queries received, Central Bank of Seychelles (CBS) has inferred that many Seychellois lack basic financial understanding⁷ to allow them to make wise financial decisions. This thus prevents a significant portion of our population from making full use of the array of financial products/services at their disposal and also hinders their ability to understand the reasoning behind prevailing macro-economic conditions and policy actions which are implemented in response.

Managing finite resources is a vital skill set in life, and finance is generally one such unavoidable finite resource. It is thus crucial that our children are taught basic proficiencies such as the purpose of and how to save and invest, making rationale decisions when taking credit, and budgeting just to cite the most prominent ones. These will lead to greater financial discipline.

Viewed in conjunction with the lack of a national implemented strategy to formally teach our children about basics of finance, one would surmise that a gap potentially exists in this regard.

Recommendations and Proposed Solutions

Throughout this paper, we assume that a sound understanding of some fundamental concepts will empower one in making wise choices in life, which often involves finance-related matters. We thus propose an active role be taken to teach our children about finance from an early age, covering such basic things as:

- understanding the importance of saving,
- things to consider when taking on credit or becoming a guarantor, and
- how to budget and manage one's finances.

We also posit that enhanced financial knowledge will improve the efficiency of our financial system.⁸

As a starting point, Seychelles has acceded to a grant from the African Development Bank for the hiring of a consultant to conduct a baseline study⁹ to confirm or refute the hypothesis that Seychellois lack basic financial understanding, which is currently based on anecdotal observations and CBS complaints data. We expect that the study will conform to our hypothesis, but will be eager to incorporate its detailed findings into the design of our proposed policy solutions. Completion of this study is expected by end of 2015.

Our proposal focuses initially upon delivery of financial education within our public schools. Students must not merely be taught the concepts, but also be shown its future potential real-life applications and given the opportunity to put these into practice. Details will be up to the stakeholders to agree upon collectively.

As a suggestion, a “School Finance Fair” could be organized promoting regular savings and investment competitions, both within and among schools, assisted at a National level by the Seychelles Bankers’ Association (SBA) and CBS. Students could form small groups, headed by teachers, through which pooled funds would be voluntarily contributed for investment purposes.¹⁰ The return would be redistributed proportionately to investing students based on the size of their investment. Due care has to be given to ensure that participants are not rewarded for taking excessively risky positions.

Participants should collectively decide what to do with the return, ideally opting to save and re-invest at least a portion thereof. Via such initiatives, by the time they young people reach the age of 18, they will better understand how to manage their finances, as well as have a good amount saved up. Having worked hard over the years saving and investing, they will hopefully not binge spend it.¹¹

CBS must take a strategic role throughout this process and ensure that the baseline study is conducted before the end of 2015. Results of the study will pave the way to concretely understand specific areas requiring greater focus and assist in rallying stakeholders. CBS should establish a National Committee to implement and guide the process. Key members will include, but not be limited to representatives from the following bodies:¹²

- government of Seychelles;
- Ministry of Finance, Trade and the Blue Economy;
- Ministry of Education (crucially including the teachers);
- SBA; and
- the media.

It is crucial that this Committee is involved in the design and conduct of the baseline study, thereby helping to establish a sense of ownership. The focus will be primarily upon determining the level of general financial understanding in Seychelles, hence allowing for the identification of weaknesses and helping in the formulation of a structured solution for both the short and longer term.

Following this study, the Committee will be tasked with acting on its findings and developing and implementing solutions. We expect that financial education within public schools will require some attention and the approach taken by the National Bank of the Republic Macedonia in this regard (Alliance for Financial Inclusion, 2013) can serve as a guiding point.

Potential delivery could, as a non-exhaustive proposal, include but not be limited to:

- official school curriculum,¹³
- simple comic-style publications depicting real life applications of the concepts being taught,
- television and radio programs for children (including use of mascots), and
- children’s songs.

It shall be the Committee’s duty to establish the actual list. However, we wish to emphasize the need for clearly identifiable and tangible results that the children can easily relate to in order to keep them motivated.

It will be critical to engage teachers as the conduit for this learning. Teachers must also have a strong sense of ownership in this program. The core intention is not to merely have a simple program taught in the schools, but one whose practical implications are clearly demonstrated

beyond the classroom experience. It must be inspiring. The creation of competitions, both within and among schools, could serve to motivate the teachers to give their best under this program, especially at a national level.

During the entirety of this process, it is proposed that CBS provide strategic guidance. The formulation of the finer details must be left to the specialists in the respective fields, particularly the representatives of the Ministry of Education and the teachers. Specific finance-based trainings will thus also be required for teachers. CBS along with SBA's support will prove very useful in this regard. It will thus potentially imply some out-of-classroom sessions.¹⁴ It is hoped that such trainings will further enhance teachers' commitment to this national cause.

This program will not sit in isolation. Several complementary steps have already been taken, such as the endowment of pre-funded newborn children's accounts¹⁵ and CBS' present awareness campaigns.¹⁶ In fact, more can be done in relation to the latter, and we propose using online resources¹⁷ to host and disseminate tutorials to a wider audience.¹⁸ It will accord greater flexibility to all parties involved, and the students can review as and when they please.¹⁹

The call for a financial education program is aimed at empowering our citizens with the tools and skills set that will allow them to make rational and wise financial choices. We hope the approach will mirror successes in other regions. One such program in Brazil is cited to have yielded "statistically significant and sizeable increases in the average level of financial proficiency of students" (World Bank Institute, 2012). Additionally, Mandell (2009, p. 3) provides that such programs do in summary tend to yield an improvement in terms of financial behaviors, albeit a lack of strong evidence that it improves financial literacy. Ultimately, our focus ought to be primarily on the former.

To further complement the in-classroom initiative, we also propose that due consideration is accorded to the potential of re-instating the "savings-stamp" program which used to be in place in schools.²⁰ This will allow students to at least deposit a portion of their savings or return from their investments onto their pre-endowed accounts. It will provide the students with a more practical experience following from the lessons being learnt and help them fund their pre-endowed accounts.²¹ This part of the project can also be facilitated by the proposed Committee via the inclusion of SBA and CBS' participation. Students ought to also be encouraged to keep proper record of deposits made and must be able to see their account balances periodically and evaluate interest accrued. This will provide them with more tangible motivation to continue along such a saving path.

Upon roll-out of the program, subsequent studies are recommended in order to determine the effectiveness of the program and to help guide required adjustments along the way to optimize its outcomes.

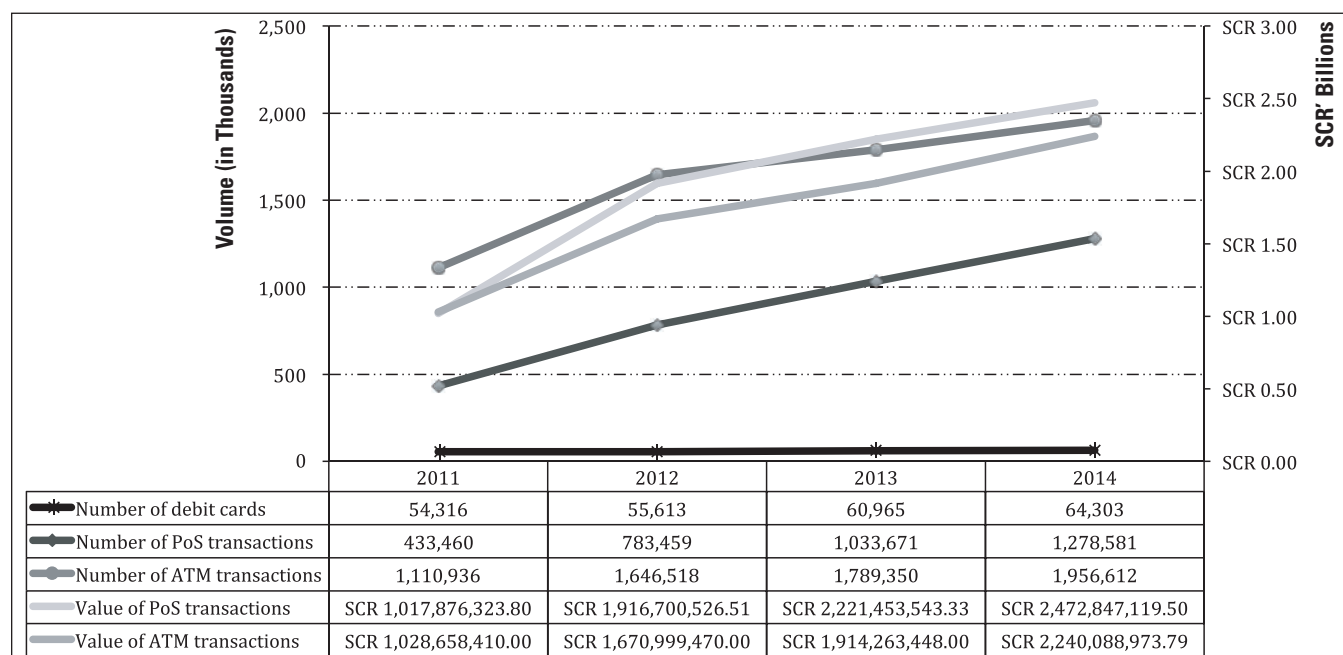
Conclusion

There is increasing recognition of the importance of one's ability to manage one's finances and financial education is a powerful enabling tool allowing the achievement of such objective (Manje, Munro, and Mundy, 2013, p. 1). We thus propose the development and deployment of a financial education program within public schools in Seychelles²² which stretches beyond the classroom and emphasizes strongly upon practical applications of the lessons being taught.

We posit that by implementing this proposed strategy, we will at least be teaching our children a fundamental, practical set of life skills, including savings, investment, budgeting, and how to appraise the vast array of financing options that they will invariably face at some point in their lives. This will help mold our future society and aid in enhancing and deepening our financial sector through financial empowerment.

To further complement such efforts, we propose that subsequent studies are undertaken to monitor the impact of this program and to allow for improvements along the way.

Figure 1. Snapshot of Proxies of Financial Access in Seychelles



According to the International Monetary Fund Financial Access Survey (2013) Seychelles Dataset, there were, as at the end of 2014, 118, 183 depositors spread across 7 commercial banks in Seychelles. This figure surpasses the population figure, which indicates that this data does not distinguish between individual and corporate customers. Additionally, as a proxy for the level of financial inclusion in terms of access data provided by CBS, we note that the use of payment facilities has increased over the period spanning 2011 to 2014. For instance, an increase of close to 10,000 new debit cards have been issued over this period, bring the total to 64,303 cards as at end of 2014. Correspondingly, the number of Point of Sale (PoS) transactions has increased threefold, and the total value of these transactions more than doubled. Concurrently, a similar trend has been observed in the volume of Automated Teller Machine (ATM) transactions which has almost doubled both in terms of volume and value. Credit cards are relatively new product offering in Seychelles. Based on data available for last quarter of 2014, there were 2,163 issued credit cards, accounting for over 23,496 transactions totaling a value of close to SCR48.98 million (approximately equivalent to USD3.84million).

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Endnotes

1. While we focus upon efficient use in this paper, it is worth noting, however, that national effort is also being rallied to, in a complementary manner, enhance the quality of the available financial products/services. This effort is being led particularly among relevant regulatory bodies in Seychelles, thereby also tackling the possibility of enhancing the quality of products/services from the supply side.

2. The Seychelles is an archipelago located in the middle of the Indian Ocean, with a population of 93,574 to date (World Population Review, 2015). According to the National Bureau of Statistics (2013, p. 1), “. . . 98.9% of the population reside on the 3 main islands (Mahe, Praslin and La Digue).” Bank branches are present on all three of these islands and available access is deemed to be quite readily available. It is estimated that over 90% of our population has access to a bank account.

3. The Cabinet of Ministers has already accorded their support for this program via their approval of the FSDIP, developed with the help of the World Bank. This implies that support from a strategic element within the government has already been obtained, and thus already support from the two key Ministries—Ministry of Finance, Trade and the Blue Economy, as well as the Ministry of Education.

4. Presently we rely upon principally tourism and fisheries. It is our aim to add income from our financial sector as a third supporting pillar of our economy and to diversify to some extent our reliance portfolio.

5. The Seychelles’ government provides free mandatory schooling up till year 10 (typically around the age of 16). Discussions are currently under way to extend this by an additional year.

6. Mehrotra and Yetman (2015) cites that “increased financial inclusion significantly changes the behaviour of firms and consumers, in turn influencing the efficacy of monetary policy.”

7. This includes, but is not limited to, such basic areas as understanding interest rates (shown by the multitude of queries/complaints received relating to both interest rates on credit or savings rates on offer by the banks). While one could argue that there could potentially be room for improvement in terms of competition among banks (and decreasing the interest rate spread), we posit that through enhanced financial education, society will be better empowered to help in leading to such improvements. This will complement efforts being taken at a regulatory level to further improve the quality of financial services.

8. As stated by Ibrahim (2015, p. 2), the former Chairman of the Irving Fisher Committee on Central Bank Statistics, "...[financial inclusion] supports economic, monetary and financial stability, by making saving and investment decisions more efficient, enhancing the effectiveness of monetary policy instruments, and facilitating the functioning of the economy."

9. It is expected that this study will be guided by the Organisation for Economic Co-operation and Development/International Network on Financial Education's High-Level Principles (OECD/INFE, 2012).

10. Ideally, these should be biased toward less risky (preferably principally risk-free investments). However, children must also learn that most investments carry risks and the consequences that could arise. This will enable them to learn to be financially wise, or risk losing their investment. Prudent portfolio allocation will thus also be a crucial element that must also be taught.

11. This resonates in some respects with Walter Mischel's marshmallow experiment, in that a child could over the years be taught potential benefits of delayed gratification for a bigger return in the future.

12. There might be the need for additional stakeholders based on the specific results of the baseline study, although the listed stakeholders are the key ones which can reasonably be determined in the absence of this study.

13. The use of formal examinations is not being called for under this project. Rather, a more proactive evaluation process would be more desirable via inter-school savings and investment competition. Rewards should not necessarily be for the school/team with the biggest return on investment, but rather the one demonstrating a sound understanding and good balance of the risk-return trade-off as well as efficient use of potential risk mitigation techniques. This competition should however be all-inclusive and allow the participation of more than one group per class year, thereby giving the possibility for as many to participate. It could become much like a "National Finance Fair."

14. It might also prove useful to have former students of the specific schools who are working in the financial field to give motivational and inspiring guiding sessions.

15. These accounts are provided by the Seychelles' government with no withdrawal rights up till the child reaches 18 years of age (when they acquire full control). These accounts are initially pre-funded with SCR1,000 (equivalent to approximately USD80) per newborn Seychellois.

16. Published as part of CBS' aim to enhance financial literacy in Seychelles and includes newspaper articles such as the role of CBS; the roles, responsibilities and implications of being a guarantor; monetary policy; and understanding exchange rates; just to cite a few. In fact, several of these articles have actually been published in the local language, which is Creole. However, this merely reaches primarily the adult segment of the population.

17. This will complement CBS' current efforts and allow people to conveniently and at their own pace access these materials, which could be prepared for various age groups. Children can also guide their parents to these resources, thereby also allowing the adult population to learn from it. It will also allow CBS and SBA to reach out to several schools simultaneously and without actually requiring a physical presence at all times.

18. Links to and snippets of these video tutorials could feature on CBS' main website, so that visitors get to find out about this new initiative.

19. The amount of followers that CBS can attract will impact upon the effectiveness of this knowledge dissemination initiative. Feedback mechanisms will also allow in gauging the public's opinion thereupon, thereby allowing content tailoring to address areas of demand.

20. This was discontinued in the early 1990s. It is recommended that the National Committee conducts a thorough review to identify the strengths and weaknesses of the former program as part of this consideration.

21. In order to ensure the success of such an initiative, it is vital that proper internal controls are established around the management of such funds. The stakeholders need to feel confident and secure about such an initiative. CBS along with SBA has the potential to help in this regard.

22. This proposal is made prior to the launch of the baseline study, but we remain flexible to adjust to its findings and recommendations.

Financial Education in Republic of Macedonia—Need or a Must?

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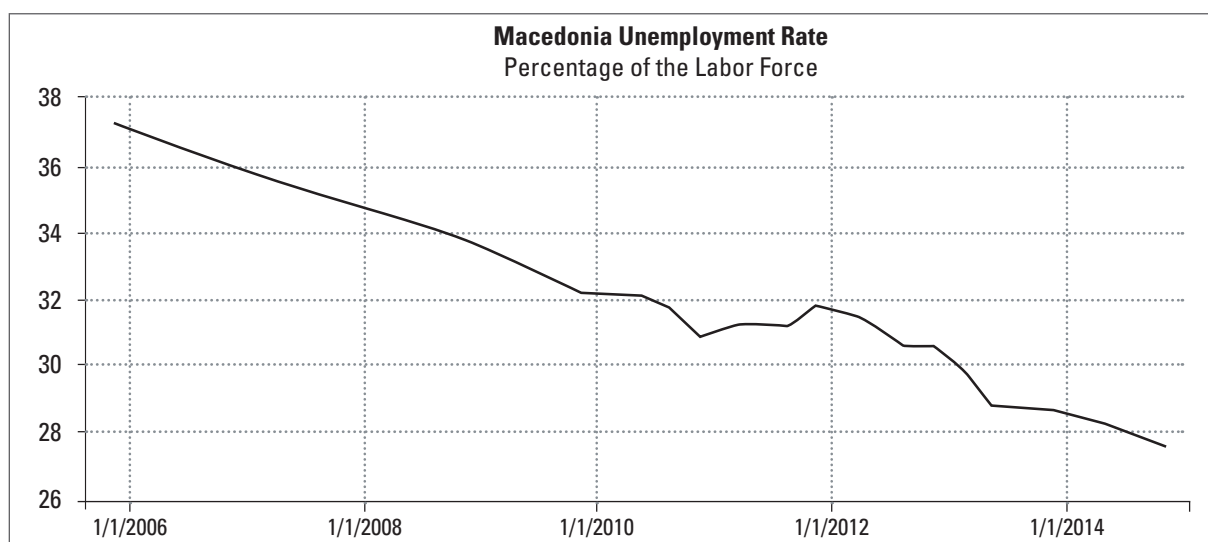
Executive Summary

The lack of financial literacy of the population in Macedonia, and consequentially the choices of ill-suited financial products and services made by the population, may lead to a less stable financial system and economy. Recently, much of the population, unaware of the consequences of taking out high-interest loans, have become indebted. This recent crisis has highlighted the importance of financial education, financial consumer protection, and financial inclusion to complement financial stability measures in Macedonia. Consumers need to learn about long-term consequences when making important financial decisions. The financial regulators and policymakers together with the financial institutions must work on the development of one National Financial Education Strategy in order to provide consumers with the education to inform critical financial decision-making and to elevate the current financial literacy level.

Background

After the breakup of Yugoslavia in 1991, Macedonia faced arduous economic challenges posed by the transition to a market economy. Like most transition economies, problems persist, even as Macedonia takes steps toward reform. Moreover, the unemployment rate in Macedonia averaged 31.7% from 1993 until 2014, reaching an all-time high of 37.3% in the fourth quarter of 2005 and a record low of 27.6% in the fourth quarter of 2014. Unemployment is a big reason that many of the households in the country are low income (Fig. 1; Trading Economics, 2015).

Figure 1. Macedonia Unemployment Rate

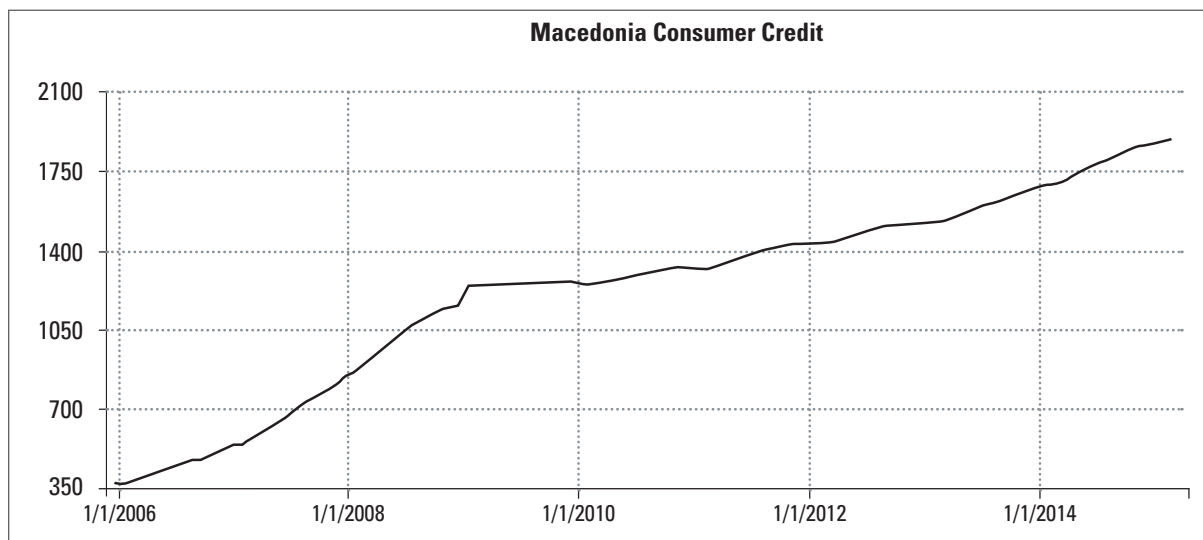


Source: www.tradingeconomics.com, State Statistical Office of the Republic of Macedonia

With a low standard of living and high unemployment rates, many households to go in debt in order to meet their financial obligations at the end of each month. In 2014, household loans grew faster than business loans. The annual growth rate of credit exposure by consumer loans comes to 19.6%, which is higher than residential and commercial real-estate loans, overdrafts, credit cards, car loans, and other loans (State Statistical Office of Macedonia, 2015). The share

in total annual growth of credit-risk exposure of the consumer loans is 25.9%, which higher than other household loans (Fig. 2; National Bank of the Republic of Macedonia, 2014).

Figure 2. Macedonia Consumer Credit in USD Million for the Period of 2006–2015



Source: www.tradingeconomics.com, National Bank of the Republic of Macedonia

The lack of financial knowledge, the growth in lending to households, and the low standard of living increased the non-performing consumer loans in the recent years.¹ One of the recently stated goals of the National Bank of the Republic of Macedonia is to reverse this trend. Part of the solution’s package would be to raise the level of financial literacy in order to help the population to make sound financial decisions by choosing the most suitable financial products and services. With consumers making sound household-level decisions, Macedonia may feel improved stability of the macro financial system.

In 2013, the National Bank of the Republic of Macedonia formed a national Coordinating Body with a mandate to launch initiatives to the relevant institutions to adopt legislation that would support the financial education of the population in the Republic of Macedonia. The Body was formed by way of a Memorandum of Cooperation between the National Bank of the Republic of Macedonia, the Ministry of Finance, the Insurance Supervision Agency, the Agency for Supervision of Fully Funded Pension Insurance, and the Securities and Exchange Commission of the Republic of Macedonia. The Coordinating Body has carried out many activities related to financial education and literacy during the past two years.

Problem

Despite the work of the Coordinating Body, levels of financial literacy in Macedonia remain low. There have been some research analysis and small-scale attempts from nongovernmental organizations to measure the financial literacy level in recent years, but no official data are available. Lack of official data makes it difficult to develop sound financial-inclusion policies and programs.

The low level of financial literacy is evident, especially among students in elementary and secondary schools. The evidence is collected by the lecturers, members of the Coordinating Body, who are making direct visits to the schools across the country. Financial-education programs are not included in the school curricula, which, we suspect, has led to the current state of low financial literacy in the Macedonian adult population. It’s not just schools—financial regulators, policymakers, and institutions don’t have policies on financial education or financial literacy. And when financial education programs are launched, there is no coordination between

them, and no centralized guidance on a national level. A decentralized, unorganized approach to policymaking will cause bigger costs for every party and greater efforts for any side to implement the proposed policies.

Recommendation

Macedonia needs to create a coordinated national plan that will comprise all relevant parties, processes, and actions to enable current and future financial-education programs to be less costly and more centralized.

- Macedonia needs a national plan on financial education because there are many successful stories in other countries that confirm the benefit of creating one National Strategy.
 - In Mexico, there is a National Development Plan enshrining in law financial education mandates and the National Strategy structures. The starting point for the development of the Strategy was the realization that despite the great advances in the structure for financial access, the use of formal financial services was still hindered by the low level of financial education and awareness among important sectors of the population (OECD/INFE, 2014).
 - India explicitly combines financial education and financial inclusion at all points of its draft National Strategy, stating that its mission is to undertake massive finance education campaigns to help people manage money more effectively to achieve financial well-being by accessing appropriate financial products and services through regulated entities with fair and transparent machinery for consumer protection (Atkinson and Messy, 2013).
 - The Portuguese National Plan for Financial Education shows how a national approach to financial education can be used to tackle aspects of financial exclusion. The plan includes an objective to improve awareness of the Minimum Banking Services (access to a basic bank account; Atkinson and Messy, 2013).
 - In the United States, the National Strategy identifies the unbanked as a potential target group, while the Australian National Financial Literacy Strategy recognizes the role of improved financial literacy in preventing financial exclusion. The National Strategy for Financial Literacy in the United States explicitly includes a call to strengthen connections among those working on financial education, financial access, and asset building strategies to improve effectiveness of each (Atkinson and Messy, 2013).

The solution to the stated problem for Macedonia would be to construct a National Financial Education Strategy that will take into consideration all stakeholders that will be affected by the process in the phases of drafting, approval, and implementation of the Strategy. This will be done through several steps interconnected and subordinated to each other:

Solution Step 1—Mapping the Existing Initiatives on Financial Education

The existing financial education activities and initiatives from different stakeholders need to be catalogued by the Coordinating Body as a prerequisite to the establishment of a National Strategy. The Coordinating Body will analyze the initiatives and log them in a database, paying special attention to their structure, target audience, methodology used, publications issued and other materials.

Solution Step 2—Measure Financial Literacy Level

In addition to data from the catalogue of existing initiatives, we must measure the national financial literacy of consumers to establish a baseline measurement in the country. The necessary activities will be undertaken by the Coordinating Body, in cooperation with the Organisation for Economic Co-operation and Development (OECD)/*International Network on Financial Education* (INFE), using the standing toolkit for measuring financial literacy and financial inclusion (OECD/INFE, 2015).

Solution Step 3—Identifying the Relevant Stakeholders

The National Strategy recognizes the need to engage a wide diversity of public- and private-sector stakeholders, so that the financial education initiatives reach the respective target groups and cover a broad territory. The Coordinating Body will collaborate with all other relevant stakeholders in the stage of development, including competent education authorities and other stakeholders, and will promote a national platform in cooperation with the Ministry of Education and Science, Bureau for Development of Education, Economic Chamber, Banking Association, Consumer Organization, Ministry for Labor and Social Policy, Ministry of Economy, Agency for Promotion of Entrepreneurship, and others. All of the mentioned institutions will have roles in the different phases of the creation and development of the National Strategy that are going to be set up for regular meetings of the platform.

Solution Step 4—Building National Financial Education Strategy

After the phase of consolidating the previous and new programs on a national level and following the recommendations of the multinational international organizations such as OECD-INFE, AFI, G20, EU, etc. on financial literacy topics, the phase of construction and consultation of the National Strategy will begin.

Solution Step 5—Implementation and Program-Based Activities

After the adoption of the National Strategy there must be drafted an Action Plan on how to implement it, using many programs that will follow the recommendations mentioned.

Solution Step 6—Evaluation of Implementation

The goal in this step is to identify, enhance, and share effective practices and develop and disseminate tools and strategies to encourage and support program evaluation such as common evaluation metrics to measure key outcomes, behavioral change, and program effectiveness (Financial Literacy and Education Commission, 2011).

Conclusion and Outcome

The National Strategy will provide a framework for the development of financial-education initiatives and will be promoted by the Coordinating Body in Macedonia. The Strategy is a complex task whose success will be evaluated over the medium and long term. The Strategy proposes to coordinate the efforts of various stakeholders and encourage their participation in financial-education initiatives, aiming for a wider effect (National Council of Financial Supervisors, 2012). Ultimately, the National Strategy's basic objective is to improve the public's financial literacy so citizens can confidently negotiate today's financial marketplace (Banco De Espana – Eurosistema, 2008). This will be achieved with compilation of the already existing policies and initiatives, the construction of new initiatives, and encouraging intensive collaboration between different stakeholders. The Strategy is, above all else, inclusive, in the sense that it addresses all population groups and will touch the full range of financial products and services. It will promote understanding of basic financial concepts, develop savings habits, and enhance the general understanding of financial products and services, so that households can properly make distinction between risks and opportunities and promote the responsible use of credit and raise awareness about the risks of over-indebtedness. The Strategy must be very comprehensive and also involve the development of a financial consumer protection regime and mechanisms. Through the constructed programs that are going to be evolved with the introduction of the Strategy, it is expected to make more stable and accessible financial system.

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Endnote

1. The annual growth of non-performing loans (NPLs) entirely derives from the increase in NPLs to companies. In October 2014, the annual growth rate of NPLs reached 16.2%. NPLs to households remain at the same level, and within their framework, non-performing consumer loans and credit cards loans increased, with a simultaneous reduction of non-performing car loans.

Bringing Responsible Lending to the Payroll-Credit Market: Protecting Pensioners from Aggressive Lending

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Executive Summary

Payroll credit is a very popular financial product in Brazil due to its easy accessibility and low interest rates. However, thanks to its low credit risk to institutions, financial institutions have encouraged aggressive sales practices to gain market share. The resulting high usage rates of payroll credit have made pensioners especially vulnerable to shocks and over-indebtedness.

Our recommendation of establishing a “clearance period”—a period of time immediately after taking on a loan when pensioners/employees cannot take on additional loans or reschedule the existing ones—will create a more sustainable environment, enabling debt repayment while reducing harassment of pensioners and government employees by financial agents and salespeople for new loan releases.

A pilot test should be developed with the Brazilian National Pension Fund (Instituto Nacional do Serviço Social (INSS)), which is responsible for repaying one-third of the payroll credit stock in the Financial System. The expected outcomes are reduction of default rates among people aged 65 and over and a reduction in churn (the loss of customers to some other company), as creditors will no longer offer the possibility of switching financial institutions tied with a new loan release in order to maximize their commissions.

Background

Since December 2003, when Law 10,820 was published, the Brazilian financial industry has been celebrating the benefits of “payroll credit,” in which loan repayments—usually in monthly installments—are directly deducted from the Brazilian National Pension Fund monthly pension payment or from the government organizations’ payrolls. A person’s payments may be reduced up to a legal limit of 30% of their monthly wage.

The guaranteed nature of payroll-credit repayment allowed banks to offer significantly lower interest rates—as of March 2015, non-collateralized consumer loans average 104.49% APR, while INSS payroll credit averages 28.50% APR and general payroll credit, 26.79% APR.¹ Though attractive to consumers, the guaranteed repayment also enabled aggressive sales practices to blossom among credit agents and bank employees, incentivized by high commissions offered.

Problem

Payroll credit can be an attractive, inexpensive financial tool to help people finance purchases and expenses since it is very easy to use and access. However, when pushed by aggressive sales practices, people who may not be in dire need of credit may still take on these debts. The result can be an available income reduction of 30%, leaving these customers more vulnerable to shocks.

In October 2014, a survey conducted by the SPC Brasil (2014), a Brazilian credit bureau, estimated that 26% of people aged 65 or older were in default in non-financial bills (such as utility bills or store-financed good sales) or in non-guaranteed financial loans (such as credit cards). The yearly increase of default among people aged 65 to 94 was 8.9% between August 2013 and

August 2014, while the national average for the same period was 5.1%. The survey pointed out that 21% of the pensioners that were in default had taken loans to help relatives and friends to pay their debts and 19% justified the default by lack of financial planning.

According to the March 2015 Financial Stability Report of Central Bank (Banco Central do Brasil, 2015), payroll credit increased significantly after October 2014, due to a legal provision that extended the term from 60 to 96 months for pensioners and public employees. The report highlighted that most of new concessions were used to repay other open credit lines.

The Central Bank of Brazil has already tried to mandate responsible lending through regulation.

The Resolution 3,954, published on February 24, 2011, made the certification of credit agents mandatory. The certification meant to train agents about consumer-protection law, applicable regulation, ethics, and ombudsman processes. All agents were to be certified by March 2, 2015.

On December 20th 2013, the Resolution 4,294 established that the financial institutions offering credit through agents should have to monitor and control the viability of credit products: commissions paid upfront would be limited to 6% of total amount of the credit operation, effective January 5, 2015.

The National Association of Banks (Febraban) has also published a non-binding guideline for responsible credit, directed to consumers (Federação Brasileira dos Bancos, 2012).

However, these approaches were not effective. Credit agents continue to offer their clients new loans without proper care or information disclosure, driven only by the commissions paid by the financial institutions. The enforcement of any quality standards to credit agents is difficult to reach, since the regulator depends on financial institutions' cooperation. In March 2015, complaints concerning payroll credit filed at the Central Bank were the most common type of complaint, with a full 515 complaints or 17.6% of the total considered "true"—meaning that the financial institution involved could not defend itself by presenting documents.²

So, the question remains: how can we effectively bring responsible lending practices to this market?

Recommendation

As the payroll credit repayment is guaranteed by the pension from the INSS or the salaries from the governmental organizations, financial institutions are eager to fill their balance sheets with these loans as they are extremely low credit risk.

So, our approach is to establish a standardized "clearance period," in which the employee/pensioner won't be able to register a new loan repayment nor reschedule the existing one in order to obtain a new money release. This is expected to reduce harassment by credit agents and financial institution salespeople as the salary/pension collateral would no longer be available during this clearance period.

The first step to implementation is to define the current natural clearance period, which should be stretched long enough to enable consumers to reduce their total debt. We can create this period using data from the Sistema de Informações de Crédito do Banco Central (SCR), the Central Bank credit information system.

We must highlight that the clearance period must be proportional to the original term of the loan, meaning that short-term loans will have shorter clearance periods than long-term loans.

Apart from consumers, the financial institutions will benefit from the policy, as one of the biggest complaints of the industry in relation to the market is customer churn. In an over-saturated market, credit agents tend to encourage consumers to switch financial institution

in order to maximize their commission, justified to the consumer with a rescheduling of the debt repayment and new money release. In October 2014, which was the peak month, there were 59.468 switches, in a total amount of R\$ 500 million (approximately USD 204 million).³ In April 2015, there were 45.613 switches, totalizing R\$ 438 million (approximately USD 146 million).^{4,5}

The switch cannot legally be forbidden during the clearance period, as the Resolution 3,401 states it as a consumer right. However, as interest rates are capped and no extra releases are allowed, motivations for switching financial institutions will be minimized.

Modifications in the payroll-credit rules should have heavy impact in the National Financial System and in people's lives, so we plan to test them whether they will achieve the desired impacts or not before we roll it out to the whole market.

The pilot project of this new approach might be the INSS, which is responsible for the repayment of one third of the total payroll credit stock. In March 2015, the total payroll credit stock was USD 90 billion, out of which USD 30 billion were linked to the INSS.⁶

The INSS already uses *Dataprev Reserva de Margem Consignável* (RMC),⁷ a computerized system to register loan repayments. Nevertheless, new parameters must be applied in order to allow the "clearance period." It is necessary that no new registration is allowed before the financial institution reschedule or renegotiate the last debt. Historically, the INSS has been forced to file many complaints about payroll credit: in 2013, 40,769 complaints were filed (21.4% of complaints received by the INSS ombudsman). Based on this reality, we believe that INSS would be willing to work to reduce the number of complaints regarding the product, by piloting the "clearance period" approach.

The new regulation could be issued by both Central Bank, which possesses the legal mandate for regulating credit matters in Brazil based on Law 4,595—or by the INSS—which is in charge of approving the repayment and controls the repayment system to deduct from pensions, regulated by Law 10,820. The last option would fit better the regulation needs as it would address the repayment deduction limitations directly, instead of loan taking, simplifying the policy implementation.

Consumers might perceive the new policy negatively at first, since they will lose flexibility in their payroll credit operations. The clearance period will force consumers to plan ahead the amount they will need, as no other additional payroll credits would be available for the duration of the clearance period. But we can foresee a beneficial side effect of it. As consumers are reducing their total debts, other credit lines might be available at more affordable rates as "bridge loans" during their clearance period. This new rule should affect only new loans and consumers should be fully instructed by the time they are signing these new contracts about the restrictions during the clearance period. To achieve this awareness level, educational campaigns within the financial institutions and their distribution channels should be developed.

Major backlashes are expected from credit agents, which will have their main product affected. Currently, credit agents manage their clients' indebtedness limit, offering new loan releases and loan reschedules very frequently; this will be severely affected by the introduction of a clearance period. A negotiated solution might be proposed, by eliminating the current commission cap because the control over the velocity of credit will be reduced by limiting repayment and not incentives to distribution channels.

If the pilot project succeeds and achieves the goals of reducing complaints at the Central Bank, at the INSS and reducing the default rate among people aged 65 and over, we shall issue regulation with other Governmental Organizations to reach the two-thirds of payroll credit left.

Conclusion

With the introduction of a “clearance period” for payroll credit, we expect to bring responsible lending practice to this specific market by reducing incentives to frequent loan offers, guaranteeing profitability by churn reduction and decreasing the total outstanding debt before a new loan with salary/pension collateral is released.

Through the new requirement of financial planning—once the short-term renegotiations of payroll loans will not be available—and aggressive sales practices slowdown, financial education efforts might significantly increase their impact in people’s lives, driving them to financial health.

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3. Exchange rate on October 31st 2014: USD 1.00 = BRL 2.445
4. Exchange rate on April 30th 2015: USD 1.00 = BRL 2.995
5. Banco Central do Brasil. Retrieved May 25, 2015 from <http://www.bcb.gov.br/pom/spb/estatistica/port/PortabilidadeCr%C3%A9dito4292.asp>. Exchange rate: USD 1.00 = BRL 3.000
6. Banco Central do Brasil. Retrieved May 11, 2015 from <https://www3.bcb.gov.br/sgspub/localizarseries/localizarSeries.do?method=prepararTelaLocalizarSeries>.
7. Instrução Normativa INSS/PRES N° 28. Retrieved May 23, 2015 from <http://www010.dataprev.gov.br/sislex/paginas/38/INSS-PRES/2008/28.htm>.

Bringing Income Options to Non-Pensioners in Colombia

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Executive Summary

In Colombia, non-pensioners comprise 75% of the population over 65. This percentage is due to cumbersome requirements. Under the current regulation, these non-pensioners receive a lump sum of their overall savings during their work life at the age of retirement. Most don't have the experience or the education to make these resources last. I propose here that non-pensioners have the option of using their savings to purchase a financial product that will provide them with life-long income stability. Not only will pensioners benefit, but also the government will benefit: we will see the reduction of future costs for social non-contributory programs. Periodic payments to non-pensioners associated with the new financial product will be lower than the minimum wage, which means current Periodical Economic Benefits Policy (known in Colombia as BEPS) regulation must be changed to accommodate this proposal.

Introduction

Colombia is a country with low pension coverage rates and a large informal sector. Non-pensioners represent around 75% of the population over 65, much higher than the 59% average for Latin American countries (Bosch, Melguizo, and Pages, 2013).¹ This group will increase in proportion to the total number of pensioners as long as the population keeps aging and the requirements to receive a pension become more stringent. Under the current regulation, the only option available for non-pensioners is to receive a lump sum of their work-life pension contributions plus returns. In this way, non-pensioners are excluded from the social security system and lack predictable, modest-sum payments over time. A lack of steady payments makes non-pensioners a vulnerable social group.

The goal of this proposal is to create an option for non-pensioners to use their savings to purchase a financial product that will transform the lump sum into a future stream of regular income. Regulatory changes will be needed to include these financial products as part of the BEPS that permits benefits of a lower level than the minimum wage. With the protection of this new financial product, based on an adjustment in the current regulation, non-pensioners will become less vulnerable against negative shocks.

Problem Statement

Non-pensioners, at the time of retirement, receive a lump sum for their overall work-life savings.² Current regulations do not provide them with any other alternative. Many do not have the experience of managing large amounts of money and have not been taught how to make the lump sum last. Often non-pensioners will use this lump sum to cover all kinds of expenses and once it is spent, they no longer have any buffer to face future negative shocks. As a result, non-pensioners are, and will continue to be, excluded from the current social security framework and the government will have to bear the cost of creating and sustaining non-contributory social programs.

This problem is more severe in Colombia than in other countries, because of the low coverage rates and the small percentage of the workforce that contributes to the mandatory pension system. As of December 2014, around 49.4% of workers in Colombia were in the informal sectors and

just 45.9% of workers paid a contribution to the pension system (República de Colombia, 2015). Furthermore, high minimum requirements to attain a pension were included in the Constitution in 2005, tying the minimum pension to the minimum wage. This requirement is too high for workers. When we compare the minimum wage with their productivity, which is consistent with the findings of the Organization for Economic Cooperation and Development (OECD, 2015), Colombia has the highest minimum wage as a percentage of median wage (85%) in G20 countries. The forecasts of pensioners are also pessimistic. Different simulations estimate that approximately only 25% of the affiliates of the pension system will obtain a pension (Trujillo, Salazar, Ramirez Baquero, Nieto Ramos, and Hurtado Martillett, 2013; Reveiz, León, Laserna, and Martínez, 2008), leaving the proportion of non-pensioners to increase year by year.

There is a social non-contributory program designed for the poorest elderly group of the population in Colombia (called *Colombia Mayor*) but its coverage is limited to 1.26 million beneficiaries. Non-pensioners that are not fully served by social programs will be a significant group in the future, and the current regulatory framework only includes the lump sum option to attend to their future needs.

Recommendation and Proposed Solution

The main recommendation is to create the option for non-pensioners to purchase a financial product that will transform the lump sum into a future stream of income. The Ministry of Finance and the Ministry of Labor will have to adjust the current regulation so that non-pensioners can have the option of buying these financial products as part of the BEPS, implemented by the Colombian government with the issuance of the Decree 604/2013. These financial products will not necessarily be designed for low-income beneficiaries of the main social program for the poor in Colombia (members of the SISBEN 1, 2, 3), like the current BEPS beneficiaries.³ It is important to note that this proposal does *not* require additional fiscal resources from the government as do the current subsidies contemplated in the BEPS program. Therefore, adjustments to the current framework of BEPS should be addressed by the Ministry of Finance, Ministry of Labor and the National Planning Department (DNP), which were the institutions that created the current disposition for the BEPS.

The current lump sum option will be a possibility for non-pensioners but it will cease to be the only option for them when reaching retirement age. The Ministry of Finance will have to strengthen the advisory role of pension fund administrators by adjusting the consumer protection framework. Pension fund administrators will be required to explain the new option to non-pensioners, including its advantages and costs, to promote responsible decisions that will be crucial for the rest of the non-pensioners' lives. Also, an appropriate electronic platform where all the choices from the market providers are available for non-pensioners should be used for the supply of the new financial products, like the recently proposed SICOP.⁴

The implementation of the recommended policy needs to be discussed with insurance companies, pension fund administrators and with all the government officers involved in the design of pension policy reforms. Some of the suggestions included in the CONPES 156/2012 will have to be revised with the Ministry of Finance, Ministry of Labor, and DNP. This proposal is consistent with the recommendations of the OECD and Inter-American Development Bank (IDB) of reviewing the BEPS system.

Insurance companies and pension fund administrators will be the private agents that will supply the new financial products. They will increase their customer base and their bottom line, as they will charge non-pensioners a fee for administering their work-life savings. The government will bring them together to discuss the main goals of the reform and obtain feedback, highlighting that the proposal is focused on non-pensioners and the products will not be legally

called a “pension” if they become part of the BEPS policy. Based in their experience understanding consumers’ needs, the private sector will provide the main recommendations about the characteristics of the financial products used in the proposal.

After an agreement is reached within the government and feedback from the private sector is received, the recommendation will be legally structured in a draft Decree modifying the Decree 604/2013. The modification will include non-pensioners as beneficiaries of the BEPS, limit the subsidy to the current BEPS beneficiaries (avoiding new fiscal pressures), and include the main characteristics of the new financial products. This draft will be publicly disclosed in order to receive comments from all stakeholders.

Conclusion

Non-pensioners lack suitable regulation to make them part of the social security system. The government will have to attend to this group with special programs that will compromise fiscal resources. The magnitude of the problem is significant: forecasts show a high growth rate of non-pensioners and the current BEPS system and non-contributory social programs include only a small fraction of non-pensioners. Changes in the actual regulatory framework will give non-pensioners the option of buying a financial product with their savings that will provide greater stability for the rest of their lives. The proposal requires a unified effort by the governmental officers who design the BEPS system and the market agents who have the means to supply the market with these new financial products. If the proposal is implemented, non-pensioners will have a viable option to reduce their vulnerability through small monthly disbursements instead of a large lump sum, and will be less costly to the government as they will depend less on expensive social programs.

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Endnotes

1. Statistic does not include the coverage of non-contributory programs.
2. Articles 37, 45, 49, 66, 72 and 78 of Law 100/1993.
3. Complete information of the SISBEN can be found online at www.sisben.gov.co.
4. The SICOP is an electronic system in which pensioners will buy annuities and other financial products for pension, similar to the Chilean SCOMP system. A draft proposal that describes the SICOP can be found at <http://www.urf.gov.co/portal/page/portal/URF/ProyectoDecreto/2015/Proyecto%20de%20Decreto%20Sistema%20Electr%F3nico%20Cotizaci%F3n%20SECOP.pdf>

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