# THE FLETCHER SCHOOL

## Leadership Program for Financial Inclusion

**Policy Memoranda**

**2017**

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Policy Memoranda 2017

## Foreword

This September, we complete another year of the Fletcher Leadership Program for Financial Inclusion (FLFPI), a nine-month executive fellowship course for regulators and policymakers who are working in the financial inclusion space. The goal of the program is to support rising-star policymakers to design, implement and measure sound and innovative financial inclusion policies by using a blended learning model that focuses on the twin factors of leadership: *competence* and *confidence*.

This year, we accepted eighteen fellows from a large and talented pool of applicants, primarily public servants, who work for Central Banks, Pension Authorities and Ministries of Finance and Telecommunications. This year, our fellows hailed from the sub-Saharan Africa, North Africa, Latin America and Asia, and represented regulatory and supervisory bodies that focused on credit, savings, payments and small enterprises. FLPFI also welcomed its first fellow from a Ministry of Telecommunications, demonstrating that financial inclusion is not only the responsibility of Central Banks and Ministries of Finance.

Each year, the FLFPI team reflects on key themes that may have arisen during the Fellowship. This year, several questions emerged, such as: when faced with a problem as complex as financial inclusion, how can we choose (or should we choose) one policy? Do financial inclusion policies need to use legal tools, or can the same results be achieved by persuasion and negotiation? Does policy require "carrots," "sticks" or both? And how can policymakers effectively work with the private sector?

FLPFI fellows begin work in January with a twelve-week online course. Each session offers readings, videos, and the opportunity to engage in a vigorous discussion on provocative questions. In May, fellows convene on the Fletcher School campus at Tufts University in Medford, MA for two intensive weeks, during which time they workshop their policy ideas and build upon the work from the online course. Morning sessions feature lectures on topics in financial inclusion, as well as sessions devoted to the "ladder of influence"—negotiation, persuasion and communication. Afternoon sessions delve into the specific policy ideas of each fellow, using FLPFI's "Eight Question Method" (EQM).

Each policy idea begins with the articulation of a clear financial inclusion problem in a fellow's home country. We ask fellows to substantiate these problems and their corresponding causes with either secondary or primary data. Each policy solution must also be backed up with evidence and focus on the needs of target populations, ideally by using the principles of Human Centered Design, or, as is known in FLPFI speak, "People-Centered Policy (PCP). These policies are then narrowed down to one policy solution, using specific criteria, such as institutional priorities and capacities, existing evidence and gaps in the policy landscape.

Take Brazil, for example. Our fellow from Brazil had little trouble identifying a key financial inclusion problem in that country: overindebteness, with over 38% of borrowers with a debt service ratio of over 50%. While there are numerous causes of this problem, he identified three primary ones: understanding overindebtedness, access to information and incentives of different credit card providers. To address these issues, he identified two potential policy solutions: improved financial education and financial disclosure. Ultimately, by skillfully referencing research on the behavioral nudges and disclosure, as well as assessing the priorities and capacity of the Central Bank, he decided to focus primarily on better disclosure requirements for financial institutions.

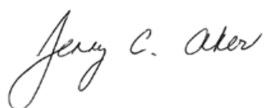
Of course, focusing on one policy, to the exclusion of others, requires a leap of faith. Addressing a problem as important as overindebtedness may require a bundle of policies, with both private and public stakeholders, and innovation.

Our fellows base their policy ideas on a proven problem, but financial inclusion problems are multi-faceted and complex. As a result, successful policies require that the necessary pre-conditions are in place, the policy is within an agency's purview, that evidence exists to support the policy solution, and that multiple stakeholders are involved as champions to shepherd them through the process, and that evidence exists to support the policy solution.

Indeed, in the cases of Ethiopia, Mongolia, Morocco and South Sudan, where fellows are developing financial policies to help households deal with shocks, there is an abundance of studies documenting the importance of savings and insurance. Yet no single case links exactly to the timelines and histories of the unique shocks that households in these countries face. Fellows from Costa Rica, Ethiopia and Zimbabwe are trying to find the best ways to support financing for SMEs, a priority sector in many countries but whose solutions are elusive. Fellows from Namibia, Pakistan, Tajikistan and Zambia are trying to find the best ways to extend payment services into remote rural areas—often using mobile money—whereas fellows from Nigeria and Rwanda are trying to find the best ways to improve access to savings and pension schemes, especially for those in the informal sector and for older populations. Fellows from Georgia and Ghana are dealing with the issue of savings from different ends of the spectrum, whereas our fellow from Uganda is dealing with the thorny issue of data protection, especially for a new area in financial inclusion—digital credit.

While all of our fellows have researched their topics thoroughly, and have the necessary expertise and passion to implement their policies to completion, their best evidence comes from the results of trial, error, and a passion for continuous improvement. Evidence surely is required, but creativity and the ability to critically evaluate problems and solutions are crucial.

Despite these challenges, our fellows are unstoppable. We applaud the 2017 FLPFI cohort for their commitment to addressing the financial inclusion problems that their countries face. We hope that they continue to pilot, document, refine, expand, and try their ideas, and continue to apply what they have learned at FLPFI—and from each other—while passing on the torch to their peers.



Jenny Aker, Director, FLPFI

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# Consumer Protection

# Identifying Current Market Practices, Threats and Potential Policy Interventions for the Use of Personal Mobile Phone Footprints as a Key Financial Inclusion Enabler in Uganda

Abdul Musoke Nnyenje

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## Executive Summary

While mobile consumer data can provide opportunities for the design and delivery of financial services by providing identity, consumption behavior profiles and can allow for the inclusion of otherwise difficult-to-profile consumers, the access and usage of this data may potentially provide significant consumer protection and antitrust challenges.

This memo seeks to shed light on consumer data vulnerabilities resulting from current mobile data sharing practices and to propose solutions on how best to safely and competitively leverage mobile data as a financial inclusion enabler.

A competitive secondary market for consumer data, if established, may not only change behavior of new digital providers (lenders), but also the current behavior of traditional MFIs who do not have the means to access mobile consumer data.

## Problem and Context

With deepening mobile phone penetration, consumer phone records have emerged as alternative sources of information for the delivery of financial inclusion products, like digital credit. In a 2015 Focus Note, CGAP estimated that at the time there were 36 products globally focused on the use of digital data for financial services.[1]

Data protection and data usage consent rights are compromised as the urban poor in Kampala seek credit, as credit seekers must provide almost unlimited access to personal information to micro-credit providers, either through digital platforms or through MFI agent visits. This desperation for credit at such a high cost often stems from a lack of alternative financing options.

In Uganda, phone and mobile money transaction records of 1 million individuals in Uganda have been shared by a Mobile Network Operator (MNO) with a third-party bank in order to issue micro credit and deposit to these individuals.[2] This data can include: key biographical data like date of birth, National IDs, and mobile money transaction history used to enable the credit vetting of would be borrowers.[3]

While the data in question should be treated with highest level of confidentiality and consent explicitly sought for its sharing with third parties, the MNO argues that consent to use and share this data is given by the customer at the time they sign up for the mobile money service and therefore possesses unfettered access and use of this data. This ultimately makes the micro credit seekers vulnerable to abuses like fraud.

Presently, most of the information is either collected by lending agency agents (like MFIs and SACCOs) or from the mobile phone network provider of a would-be borrower.

The long-term effect of this may be personal loss ranging from embarrassment, spamming to financial loss. These may in turn lead to loss of confidence in the financial system leading to low adoption of financial services by this demographic.

For more information on consumer vulnerability and MNOs, see Annex 1.

## Potential Solutions

Noting that most of the underlying causes have not been fully explored, we shall undertake a more detailed demand and supply side study to validate the underlying drivers of consumer and supplier behavior with respect to mobile data.

If the preliminary underlying causes are validated, a three-pronged approach should be adopted addressing the need to build regulatory capacity and competences, consumer awareness, and regulatory interventions at the Mobile Network Operator level to promote safe commercial consumer data markets.

The following solutions will be considered:

1. Enhance behavioral research capacity in the consumer protection practice at the Central Bank and Communications Regulatory Authority to address consumer protection concerns with respect to issues like the framing of data requests.
2. Enhance regulatory capacity in data protection and big data supervision and oversight (Uganda Communications Commission, UCC).
3. Enhance CB/UCC antitrust oversight capacity to address antitrust gaps in the potentially nascent but important secondary market for consumer data.
4. Undertake consumer education campaigns on data privacy and data rights to empower consumers to make better decision when responding to personal data requests and consent to use/share requests.
5. Establish standards for consumer data harvesting by service providers (MNOs and data analytics firms).
6. Establish a cross agency roundtable on consumer data management (UCC/CB/IT Authority/National ID Authority, MNOs, lenders, banks etc.).
7. Establish rules for the safe and competitive sharing/sale of commercial consumer data.

## Recommended Policy Solutions

My proposed interventions fit into two solution bundles:

1. Consumer education and empowerment programs with respect to the management of personal data, including both supply and consumer-side initiatives; and
2. Developing safe and competitive rules for data harvesting and cross vendor sharing.

These two goals will be achieved by undertaking consumer education initiatives to improve understanding of personal data sharing risks, establishing rules/regulations for data harvesting, consent solicitations as well as cross vendor data sharing.

The extent of prescription is not clear at this point in time as data protection and big data oversight and data competition is a largely nascent space for both telecom and banking regulatory agencies.

In terms of fitness of the proposed interventions; consumer education fits well within the jurisdiction of the Central Bank and the UCC. It is also part of the areas of joint collaboration in the UCC—Central Bank Memorandum of Understanding. We may however be lacking in capacity to address nascent big data issues as well as behavioral research and its role in consumer

protection. The consumer education programs shall therefore include sub-programs for regulatory capacity building.

With respect to data harvesting and sharing frameworks, UCC—as a licensor of MNOs—may use regulatory leverage to get the compliance of MNOs (the biggest holders of personal data).

In addition, UCC possesses a clear antitrust mandate and leverage over MNOs that may be useful in addressing competition bottlenecks like refusal to access data and the excessive pricing of access to data in a secondary consumer data market.

With the policy interventions, I hope to limit the potential abuse of personal consumer data in the use of mobile and financial services while at the same time fostering safe and competitive mobile data access practices for financial inclusion. This may open space for the entry of analytics/rating providers like First Access in the Ugandan market place.

## Key Stakeholders and Implementation

The most important stakeholders for the two policy solutions are:

1. Director—Industry & Consumer Affairs, to champion the policy to the UCC Executive Director and Top Management Team. Their buy-in is important if we are to secure institutional resources like man-hours and funds toward the implementation of the policy initiatives.

   UCC—Central Bank standing committee on Mobile Money oversight, which has joint authorization from the Central Bank and the UCC to make regulatory proposals in the mobile financial services.
2. At this preliminary stage, the following stakeholders will be involved:
   a. National IT Authority—May have some jurisdiction in data protection and could be helpful in crafting guidelines for safe data storage and transit.
   b. Some of the International Over the Top (OTT) players—could provide good learning points on how they are collecting and safeguarding consumer interests with regard to the handling of consumer data. We shall reach out to agencies like Facebook, Google, or any other OTTs handling significant consumer information volumes.
   c. CGAP and Smart Campaign—Have shown significant interest in consumer data protection and transparency while advancing financing FI.
   d. National Identification and Registration Authority—this will be invited to the regulatory round table given the personal data validation roll they extend to MNOs in the registration of SIM cards.
   e. Ministry of Trade—Will be particularly helpful in developing interventions to promote competitive secondary markets for mobile consumer prints.
   f. Mobile Network Operators—have strong commercial interests in the potential secondary consumer data market as well as motivation to exclude downstream competition if the MNO in question has an in-house MFS service.

      In my initial contact with some MNOs, they expressed willingness and support for regulatory guidance in the commercialization of consumer digital prints before they make significant investments and commitments to commercialization efforts.
   g. Banks and independent lenders—have strong commercial interest and lobby influence and shall be helpful in understanding their digital data needs. We are considering having them in our meeting with MNOs.
   h. Independent Mobile Credit Scoring agencies

## Implementation

1. Presentation of policy memo and proposed roadmap to UCC Top Management. This pitch shall seek to obtain internal (UCC) commitment of resources (budgets and man-hours) and the permission to engage external stakeholders.
2. Subject to the UCC approval, we shall present the same policy memo to colleagues in the UCC—Central Bank Mobile Money Committee. This will aim to; aid the Central Bank team to appreciate key policy concerns, brainstorm on potential stakeholder engagements. I may also prepare concept notes for the Central Bank should they be needed to gain further approvals within the Bank.

   We would thereafter refine policy solutions and roadmap to address the policy concerns.
3. Subject to joint institutional commitment to the policy roadmap, through the UCC—Bank of Uganda inter-agency committee, we shall undertake a stakeholder mapping and invite the key stakeholders to a round table dialogue.

   Separately we shall solicit the support of the development partners (CGAP, SMART Campaign, Global OTT players like Google, Facebook) to develop big data oversight, consumer protection and data protection programs within the UCC and the Central Bank.
4. In consultation and or partnership with the various stakeholders identified we shall undertake the policy solutions proposed. These will include; consumer education and empowerment programs, rules for data harvesting as well as developing rules for safe and competitive secondary markets for consumer data.

## Notes

1. Chen, Gregory C; Faz De Los Santos, Pedro Xavier, 2015: The Potential of Digital Data; how far can it advance financial inclusion.
2. https://pctechmag.com/2016/10/mtn-mokash-reach-one-million-subscribers-milestone-after-3-months/.
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## Annex 1: Potential Causes of Consumer Vulnerability and Mobile Data Sharing and Consent Practices

1. Limited consumer awareness of potential vulnerabilities resulting from provision of and/or consent to share personal data with various service providers.

   In Part 1 of the People Centered Policy Research, I discovered that 4 out of 5 individuals interviewed (tuk-tuk riders and university students in Kampala) expressed readiness to share phone records in exchange for potential lending with credit providers.

   While the interviews may not be conclusive, this willingness by consumers may be due to low awareness about potential vulnerabilities and the less than transparent nature in which product terms and data requests are presented to target users.

   A case in point is the fact that MTN Mobile Money and MoKash terms and conditions in which the extent of data usage permissions given to the service providers are only provided to those customers online. A request for service terms through the prompt at *165*5*1*4# would only tell the terms seeker to visit www.mtn.co.ug for product terms and conditions.

   Often times many consumers simply opt-in due to the lack of Internet on their devices, may not understand the language used (English) or may not have the cognitive capacity to appreciate the terms and conditions.

2. Ease and convenience of borrowing on mobile channels compared with the stringent checks of traditional financing options like MFIs may be providing an appeal that outweighs any potential data privacy fears.

   The World Bank's Global Findex Database shows that only 16% of individuals aged 15 and above had access to formal borrowing in 2014 in Uganda in 2014. This key statistic in a nutshell explains the limited alternative financing and the appeal of mobile based credit in filling the financing gap.

3. Lack of regulatory guidance on the framing of data usage consent requests by service providers.

   Presently, neither the UCC nor the central bank has applied itself to addressing framing and transparency in marketing solicitations including the right to access or share key consumer information. This despite the broad consumer protection mandates of the UCC and the Central Bank enshrined within the Uganda Communications and Financial Institutions Act.

   This was a key fact confirmed by colleagues of the UCC—Central Bank Mobile Money Committee. In the operators' defense, the MNO interviewed highlighted that it was not in violation of any regulatory obligation as far as consent solicitation

   Resultantly, customer data requests do not have minimum disclosure and or transparency obligations in practice similar to the MNO consumer data usage terms discussed in the preceding segment.

4. Lack of clear regulatory frameworks to guide the sharing of consumer data with third parties in **a safe and competitive** manner by data harvesting providers like MNOs.

   In Uganda and many sub-Saharan markets, while upstream Mobile Network services like wholesale call termination, mast rentals and national roaming are subjected to regulation to ensure that they are offered at Obligatory Fair Reasonable and Non Discriminatory terms to other seekers, the current telecommunications antitrust regime in Uganda is silent about obligations of MNOs to seekers of data.

   Resultantly, MNOs deny access seekers access to mobile data sets either because of the fear of potential regulatory penalties in light of regulatory uncertainty, lack of regulatory obligation

to provide this key factor input for downstream providers or for the deliberate foreclosure of downstream mobile money markets in which the MNOs have active Mobile Financial Service deployments. The lack of regulatory certainty was actually pointed out by the MNO agent interviewed as a bottleneck to the commercialization of mobile data for third party data seekers in finance and other sectors.

Therefore, MNOs have the privileged position of providing this data to other seekers at their own terms and prices.

# Improving the Effectiveness of Credit Card Disclosure Requirements in Brazil

Marcelo Junqueira Angulo

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## Executive Summary

Low-income people in Brazil are facing credit card over-indebtedness. Many borrowers who earn up to three times the minimum wage have a debt service ratio over 50 percent, and revolving credit card debt is the second largest source of pressure regarding debt service. Lack of information about and understanding of credit card interest rates, risks, and consequences is a key issue. To address that, the recommended policy solution is to improve the effectiveness of credit card disclosure requirements and best practices in Brazil through consumer research and behavioral insights.

## Problem and Context

Maria goes shopping at a popular clothing store. At the register, she receives an offer: by accepting the store-branded credit card, she could pay in installments and also get a 10 percent discount. Since Maria doesn't have any formal relationship to the financial system, the newly accepted credit card is her entrance door to financial products and services. Her credit limit starts small, and as she uses the credit card and pays on time, the limit is increased by the financial institution. Her credit limit increases, until the day Maria gets financially disorganized and cannot pay the total amount of the credit card statement. Minimum payment, interest rates, and penalty fees are far from Maria's day-to-day language. She pays the minimum amount and does not exactly understand why her debt increases, month after month.

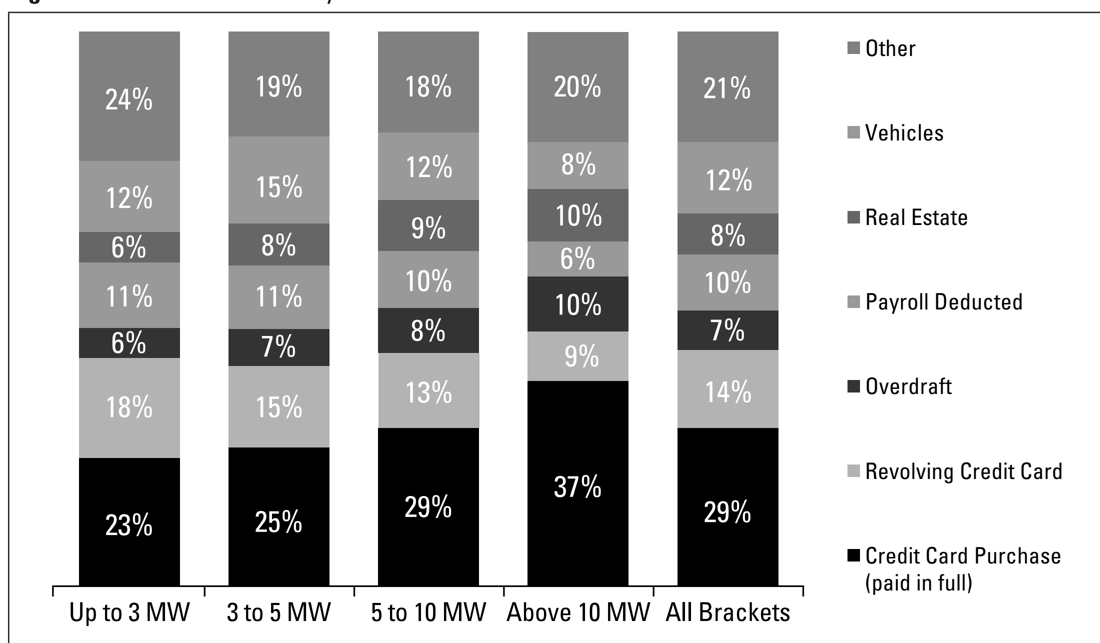
*Low-income people in Brazil are facing credit card over-indebtedness.* In Brazil, a consumer is considered over-indebted if they cannot repay their loans and bills and yet have enough resources for their basic expenses; usually the threshold is 30 percent of the household income. Approximately 43 million Brazilians (28.3%) report to have used a credit card in the past 12 months.[1] There were 85 million active credit cards in 2014.[2] Compared to other credit options, credit card debt has the highest interest rates: 490 percent[3] per year. Despite that, 11 percent of Brazilian households hold credit card debt: it is the third most used type of credit,[4] and the low-income population holds the highest ratio of credit card debt: 43 percent of the total credit card debt volume.

According to The Central Bank of Brazil's Report on Financial Inclusion, income bracket of those earning up to three times minimum wages (MW) contains the largest number of borrowers—34.4 million individuals, representing 60 percent of the total number of borrowers, and about 20 percent of the adult population in Brazil. In 2014, the up to 3MW segment showed the highest debt service ratio percentage (24.1%). **In addition, 38.2 percent of borrowers from the up to 3MW segment had a debt service ratio of above 50 percent**.

Credit card debt was the most significant type of credit in terms of debt service in 2014. The revolving credit card was the second largest source of debt service, as this type of credit has very high interest rates. In the case of the up to 3MW income segment, it reached 18 percent of the debt service.

Besides negative consequences to families, over-indebtedness affects the functionality of the financial system and consumer trust in formal financial services. This negative experience with credit cards can discourage consumers from using other financial instruments. Therefore, addressing

**Figure 1.** Debt Service Ratio by Borrower's Income Bracket – 2014




Source: BCB/SCR
Other: non payroll-deducted, overdraft, installment credit card debt, other.

credit card over-indebtedness affects consumers and the financial system in a positive way. The Central Bank of Brazil has a strategic agenda called "BC+," which highlights addressing credit card indebtedness as a major theme for improving financial citizenship in Brazil.

Credit card over-indebtedness is related to (1) lack of information and understanding about credit card interest rates, risks, and consequences; (2) lack of access and information about other credit alternatives; and (3) credit card high-interest rates, an issue that is already being addressed by the Central Bank of Brazil through regulation.

As this policy memo is going to be implemented by the Department for Financial Citizenship Promotion, it will resolve the lack of information issues, which are directly related to the Department's mandate.

Lack of information and understanding about credit cards can be seen from two perspectives: on the supply side, financial institutions can improve information offered for financial consumers' decisions; on the demand side, credit card users lack financial education.

To investigate consumers' lack of information about credit card interest rates and risks, credit card users were interviewed and explained their credit card statements. Employees responsible for credit card areas from a public bank, a private bank and a consumer finance company were interviewed. The people-centered research resulted in important insights.

**Insight 1 – Superficial knowledge: "I know, but I don't understand . . ."**
Users already know they shouldn't (over)use credit card debt (they have heard that advice on the radio/TV); however, they don't know exactly why they shouldn't do this. The consequences and the magnitude of paying interest rates of 500 percent per year are not clear. Also, they could not answer if they believed this interest rate was substantial or not.

**Insight 2 – Users are seeking additional information.**
Users carefully read their statements every month; however, statements offer a lot of information users do not understand (technical terms and interest rate types). Also, some users tried to read the contract they received with the credit card. Credit card limit is considered key information, as users monitor very often how much they can still spend by verifying their limit.

**Insight 3 – Structural problem and nudging.**
Credit card managers agree that customers don't understand how credit cards work. However, they have low expectations that customers *can* understand it better. Brazil's low education levels were mentioned by all of them. Nudging consumers into other credit alternatives may be a solution.

## Potential Solutions

Possible solutions can be described in two main bundles: (a) *Better disclosure of information* by improving the quality of information financial institutions offer for financial consumers' decisions and strong enforcement of existing disclosure requirements by the Central Bank of Brazil; and (b) *Financial education initiatives*, focusing on credit card education by covering topics such as interest rates, minimum payments, and how credit cards work. Also, tools should be available offering information on credit alternatives available to credit card debt, such as an online platform, so consumers can compare available credit options.

Financial education campaigns on how to use a credit card are already being implemented. In 2013, The Central Bank of Brazil (BCB) created a new feature for the Citizen's Calculator, helping customers to understand the risks of not paying their credit cards bills. Also, the Brazilian Credit Card Companies Association (ABECS) created a very successful short video campaign on YouTube to educate low-income customers on various topics related to credit card use. The campaign has reached millions of views.

## Recommended Policy Solution

This policy memo will focus on the disclosure bundle, since it builds on existing disclosure regulation of the Central Bank of Brazil and on the Financial Citizenship Promotion Department's mandate to offer the consumer point of view to regulation. Disclosure is a topic where the Central Bank can implement actions using its legal capabilities and power as the Brazilian financial system supervisor. Furthermore, the disclosure bundle directly addresses the issues uncovered in the people-centered research.

In Brazil, disclosure requirements state that financial institutions should provide consumers with key information for their decision-making processes, such as benefits, risks, and terms of the product. [5] The language used should be clear and comprehensible to the consumer. Also, for credit cards, the customer should be provided with a key fact sheet highlighting basic rules, risks, and procedures for application and cancellation.

According to *G20/OECD Task Force on Financial Consumer Protection,*[6] consumers can be at a particular disadvantage when purchasing financial products or services, as these are widely marketed but purchased infrequently. Behavioral finance provides insights that support the view that traditional approaches to disclosure do not always match consumers' information needs with the decisions they may need to make. Moreover, consumers' decision-making processes may be influenced or constrained by some inherent factors, which may result in poor financial choices.

CGAP produced a report called *Applying Behavioral Insights in Consumer Protection Policy,*[7] which points out that for emerging markets and developing economies' policy makers, it is important to prioritize designing and implementing disclosure rules that more effectively inform and *positively affect consumer choice*, as well as product design, marketing, and sales practices by providers.

The current Brazilian regulation should evolve to require disclosure of information in the ***format, time, medium and volume*** that best facilitates informed decision-making by consumers.

To accomplish that, consumer research and tests are required to gain a better understanding of ***consumers' attitudes, vulnerabilities and decision-making*** processes, to provide insight and identify ways for making disclosure requirements more effective.

In addition, ***default options and nudges*** can be tested to influence consumers' decisions, as credit card users should be made aware of more affordable types of credit.

Therefore, the recommended policy solution is ***to improve the effectiveness of credit card disclosure requirements and best practices in Brazil through consumer research and behavioral insights***. Information provided by financial institutions must help consumers make better financial decisions.

## Key Stakeholders and Implementation

Transforming the recommended solution into a ***Central Bank of Brazil's corporate project*** is the first step to guarantee its implementation and institutional support. The project's main initiatives are: (1) benchmarking effective international disclosure experiences; (2) conducting consumer research and experiments through human-centered design; and (3) enforcing the newly designed disclosure documents, and promoting disclosure best practices.

The support of BCB departments are critical. The Regulation Department and the Conduct Supervision Department should be involved in the entire process as members of the corporate project executive committee. In addition, the Economic Research Department should lead the research stage.

Finally, the Brazilian Credit Card Companies Association (ABECS) and the Brazilian Federation of Banks (Febraban) should be engaged, reporting their current initiatives on the topic and highlighting the importance of effective disclosure to banks and credit card companies.

## Notes

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# SMEs

# The Financing Challenges Faced by SMEs in Zimbabwe That Inhibit Sustainable Growth and Possible Policy Interventions by the Banking Sector

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## Executive Summary

This policy memo highlights some of the major challenges faced by Small to Medium Enterprises (SMEs) in Zimbabwe in accessing formal financial services and products in order to grow their businesses sustainably and proffer possible policy initiatives. The interest in understanding and supporting this sector is driven by the fact that the Zimbabwean economy is now largely driven by SMEs, yet the sector is not receiving commensurate support from various stakeholders, including lending institutions.

## Background and Policy Problem

According to the 2014 MSME Policy and Strategy Framework developed by the Ministry of Small to Medium Enterprises & Cooperatives Development, an SME is defined as an enterprise that is "registered in terms of its legal status and employing anywhere between 6 to 100 workers." According to a SME Diagnostic Study conducted by the World Bank in 2016, the majority of SME enterprises operating in Zimbabwe employ an average of 20 employees.

Although there are quite a number of factors inhibiting growth of the SME sector in Zimbabwe, such as inappropriate working space and limited access to markets, the major cause is **limited access to funding**.

In Zimbabwe, SMEs play a significant role in the growth and development of the economy. This is according to results of the FinScope MSME Survey conducted in 2012, which determined that SMEs account for about 5.7 million jobs out of a total population of 13 million and about 60% of the country's GDP.

Meanwhile, a FinScope Consumer Survey conducted in 2014 revealed that the majority of SMEs rely on informal financial services, which is not sustainable for the growth of SME businesses.

The study noted that 23% of the Zimbabwean population had no access to financial services, the majority of whom are women entrepreneurs. The same survey observed that only 14% of SMEs use banking services and only 18% of SMEs are formally served. The figures are most likely to have worsened since the last survey; this will be confirmed during the follow up study scheduled for 2017.

The SME Diagnostic study by the World Bank in 2016 revealed that the major challenge faced by SMEs in growing their businesses is limited access to finance, which is compounded by limited financial literacy by the SMEs. Although there is high literacy in Zimbabwe, there is generally low financial literacy.

The study also revealed that access to loans is constrained by the conflicting perceptions that SMEs and banks have about the sector, resulting in banks being largely cautious and highly selective when considering applications for loans by SMEs. As of December 2016, loans to the SME sector accounted for only less than 5% of total banking sector loans and advances.

Although SMEs should meet the requirements of financial services providers when applying for loans, the SME Diagnostic Study by the World Bank also noted that the financial services providers would benefit from understanding the structure, operations and financial needs of SMEs, in order to avert some of the perceived risks.

Cognizant of the importance of financial inclusion, the Reserve Bank of Zimbabwe took the initiative to champion the development of an inclusive financial system focused on marginalized groups, including SMEs.

As such, a National Financial Inclusion Strategy was developed and launched in March 2016. The Strategy is anchored on four (4) pillars namely Innovation, Microfinance, Financial Literacy and Consumer Protection.

## Potential Policy Solutions

A number of policy solutions can be implemented to facilitate access to financial services by SMEs and grow sector sustainably. These include:

1. Facilitating capacity building programs for SMEs to better understand the requirements of financial services providers when applying for loans and other services;
2. Facilitating financial literacy programs targeted at SMEs to enable them to make better-informed decisions regarding products and services made available by financial services providers;
3. Training of SMEs to produce high quality products, which will ensure that they meet the standards of the consumers, thus creating more business and growing their enterprises;
4. Facilitating access to markets for SMEs; and
5. Capacity building of financial services providers to better understand SMEs and develop appropriate products and services to fit the needs of SMEs.

Other supporting/related solutions may include facilitating formalization of SMEs and developing financial infrastructure (i.e., establishment of a Credit Guarantee Scheme, a Credit Reference System, and a Collateral Registry).

## Priority Solution

The policy that I am proposing is to **enhance the institutional capacity of banks to better understand the operations of SMEs and design financial products that are suitable to their needs.**

Although there are multiple demand-side factors that constrain the flow of good quality credit to SMEs in Zimbabwe, it is also clear that low levels of credit to the SME sector is largely due to the reliance of most banks in Zimbabwe on traditional lending models that are highly priced and poorly matched to the needs of clients, resulting in banks being risk averse.

Banks will be required to set up dedicated SME units, which will enable them to focus on developing appropriate policies, products, and services that meet the needs of SMEs.

Through the SME units, bank staff will receive training on how to better serve SMEs. The same units could be used to provide training to SMEs on the requirements or expectations of banks when processing SME loan applications.

This policy will be implemented through the Financial Inclusion Thematic Working Group on SMEs, which comprise various stakeholders and is co-chaired by the Reserve Bank of Zimbabwe and the Ministry of Small to Medium Enterprises and Cooperatives Development.

The Reserve Bank of Zimbabwe will support other, complementary policy initiatives, such as enhancing the credit infrastructure, to incentivize lending institutions to support the SME sector.

In terms of capacity/feasibility, the Reserve Bank of Zimbabwe has oversight on the banks and microfinance institutions, which are the major providers of banking services, and is thereby in a position to influence policy on how the banking sector can support SMEs.

The Reserve Bank of Zimbabwe also collaborates closely with other financial sector regulators through the Financial Stability Committee to influence support to the SMEs sector.

Further, there is a precedent for the Reserve Bank of Zimbabwe supporting similar policies. In 2016, the Reserve Bank implemented a policy, which required banks to set up "Women Desks," to understand the financial needs of women and design products, and services that meet the needs of the women.

Out of 16 banks that are operating in the Zimbabwean banking sector, as of June 2017, 10 banks had set up these women desks and begun developing products that suit the specific needs of women. Thus, banks are receptive to the business case of paying special attention to specific underserved populations when developing financial products and services

In terms of preconditions, there is need to ensure availability of funding to support the capacity building programs.

This is my priority because all parties/stakeholders, including SMEs and financial services providers, need clarity of requirements and the expectations of each party for the SME sector to grow sustainably.

## Key Stakeholders and Implementation

Implementation of this policy will require close collaboration with various stakeholders, who can either be internal to the Reserve Bank of Zimbabwe—such as the Economic Research Department and the Public Relations Departments—or external.

External stakeholders will include relevant government ministries, such as the Ministry of Finance and the Ministry of SMEs; banks; MFIs; other financial services sector regulators; and development partners such as the World Bank and SME Associations.

I will engage these stakeholders through the Thematic Working Group on SME Finance & Development, which was constituted as part of the implementation of the National Financial Inclusion Strategy.

The tools that I intend to use include:

1. Issuing a directive to all banks through the Monetary Policy Statement, requiring all banks to establish SME units/departments that focus on supporting the sector.
2. Banks will be required to submit periodic plans, highlighting set targets for supporting the SME sector in terms of loans and other capacity building programs.
3. Development of a Financial Literacy Framework that incorporates SMEs, to enable SMEs to better understand the financial products and services available to them, as well as expectations by banks.

With my policy solution, I want to see the SME sector/enterprises grow in a sustainable manner contributing to the country's GDP and to public revenue through taxes.

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Ministry of Small to Medium Enterprises & Cooperatives Development; *MSME Policy and Strategy Framework 2014*; Government of Zimbabwe

# Informality of Micro and Small Enterprises in Costa Rica and Regulatory Challenges to Improve Their Access to Credit and Supporting Programs

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## Executive Summary

In Costa Rica, most micro and small enterprises are informal, as they do not meet all governmental requirements for participation in the formal sector, and thus can't access programs and funds available to support entrepreneurship and micro, small and medium enterprises (MSMEs). Although there is an adequate credit infrastructure offering credit and training, MSMEs are still using their own funds to operate. This policy explores the idea of modifying current regulation and the Central Bank's mandate, to improve the access to credit and promote growth for micro and small enterprises in Costa Rica.

## Background and Problem Diagnostic

Costa Rica is a small country with an estimated population of 4,890,379 inhabitants (June 2016). The overall poverty rate is 20.5 percent, with 6.3 percent living in extreme poverty. The number of employed individuals is 2.06 million, of that number 76.2 percent are wage earners.[1] The rest (490,766) work independently, of which 386,000 are informal workers, and only 50 percent of them contribute to the social security system (government pension solidary fund and health care).

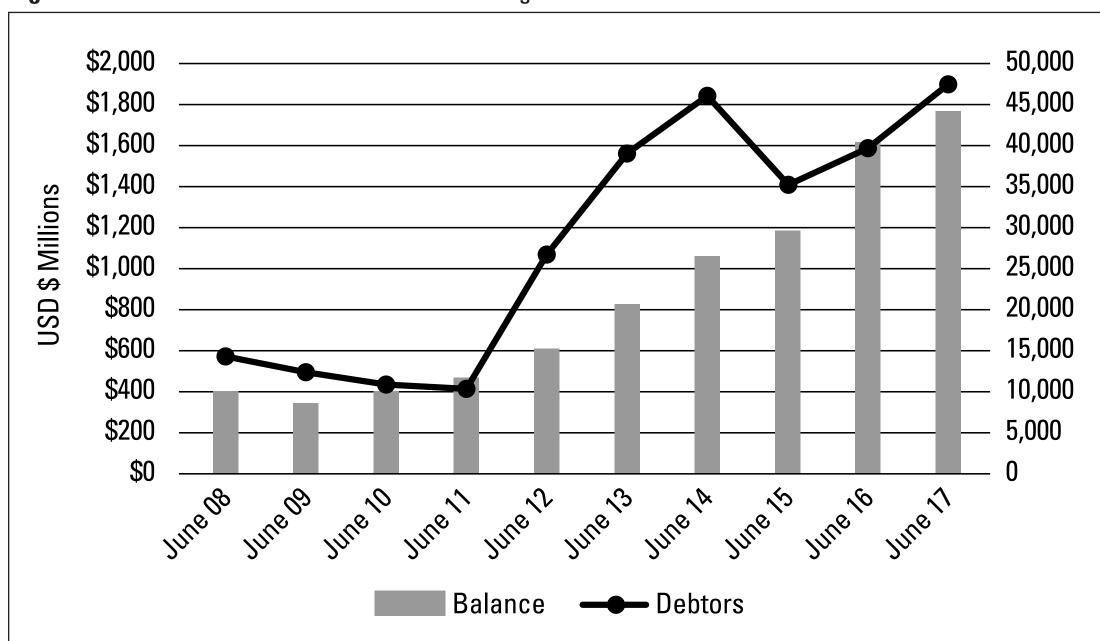
In addition, the first "National Survey of Household Producers" or Enahopro[2] (*acronym in Spanish*) registered a total of 340,000 individuals as entrepreneurs in 2014, and the Global Entrepreneurship Monitor (GEM)[3] confirmed this estimate in its 2014 report. They calculate a total of 300,000 microbusiness owners who have been working for less than 3.5 years.

Taking into consideration the above, and recognizing the importance of MSMEs in the economic development—particularly in job creation and the resultant reduction in poverty—the Costa Rican Government has established a regulatory framework to support this sector. The last two administrations passed relevant policies for this purpose[4] and several laws and funds have been created in the recent years. A complete list can be found in the notes.[5]

The Ministry of Economy Industry and Trade (MEIC) is the maximum authority and responsible for creating public policy and promoting private initiative for this sector, as well as supporting business development and promoting corporate structure facilitating the formalization of entrepreneurs and MSMEs.[6]

According to the Costa Rican Business Information System (SIEC), only 21,179 MSMEs are formally registered, and of these only 6,197 are active enterprises.[7] As a legal requirement from

**Figure 1.** Micro & Small Ent. Loan Portfolio in Regulated Financial Institutions




the Act 8262, only formally registered enterprises[8] have access to government support and the financial incentives designed for MSMEs. This could explain why up to March of 2017, the Banking System for Development[9] (SBD) only reported 23,935 active borrowers and a total balance of $410 million (73 percent to micro enterprises). Up to now, the government's efforts to register and promote MSMEs have not shown great success.

As reported by the financial entities supervised by SUGEF, at the end of June 2017 there were 47,462 debtors reported in the "micro and small business" portfolio (including SBD's borrowers) with a balance portfolio of US $1.773 million. In addition, The Economics Research Institute in the University of Costa Rica, found a much higher number of potential beneficiaries. They estimate 460,000 micro and small businesses are currently operating in Costa Rica[10] and, as a result, the SBD has only successfully provided support to 4.7 percent of all MSMEs. Obviously, large portions of MSMEs are not being served under the current system and the situation may indeed be worse than initial reports indicated.

Returning to the GEM report, the dropout rate in the early stages of entrepreneurship in Costa Rica has remained at 50 percent. Financial problems (related to the profitability of the business and access to financing) are the main reason why entrepreneurs discontinued their businesses. The GEM points out that during the three years in which the consultation took place, the main obstacles to entrepreneurship was financial support (82.9% in 2014) followed by the lack of a clear policy of support (68.6%) for new ventures, with incentives and technical assistance from public institutions.

The MSME Observatory's surveys[11] have found that the most MSMEs are self-financed (68%). Only 16.1 percent turn to financial institutions for credit. However, 40 percent of those who did not use credit believe that if they have done so, their business would have improved.

Despite the existence of financial infrastructure[12] in the country for granting credit to MSMEs and the efforts made by the authorities, the above data shows that low financing coverage remains a barrier to growth for MSMEs.

Considering all this information, I established the following problem statement:

> ***More than 90 percent of micro enterprises in Costa Rica have no access to credit, including financial and non-financial services (such as credit programs and SBD capacity building***

***programs) designed to meet the needs of MSMEs. Because of this, these enterprises struggle to grow and keep running their businesses sustainably.***

## Possible Solutions

To resolve this financing gap, SUGEF (as a regulator and policy maker) needs to incentivize MSMEs to interact with existing financial infrastructure and legitimize access of informal and semi-formal microenterprises to the SBD programs and funds. In order to comply with the above, I propose the following options:

1. Incentivize new user-friendly financial products in supervised financial institutions (Digital Financial Services could work as an option to address this challenge).
2. Improve financial education for MSME owners by implementing countrywide training programs.
3. Establish a period of amnesty by the authorities (at least one year) to encourage MSMEs to formally register their enterprises and comply with legal requirements for formalization. In this period, government would eliminate fines for the collection of back taxes, in addition to granting a tax-exempt status for the first year of formal operations.
4. Obtain a government-level commitment to lowering the cost for health care and pension fund contributions to Costa Rican Social Security Fund (CCSS) for the first years of formal operations.[13]
5. Encourage supervised financial institutions to service microenterprises reducing MSMEs requirements through regulation incentives, to attract informal or semi-formal MSMEs to the financial system.

These solutions would allow many micro-enterprises shifting their status from informal to formal, which would improve their access to credit by granting them access to existent financial infrastructure. The issuing of prudent regulation on microcredit (or by modifying the current regulation to allow for more flexibility) would also help address this problem.

## Priority Solution

My priority solution is to encourage and promote access for informal and semi-formal microenterprises to SBD programs and funds by incentivizing supervised financial institutions to engage with MSMEs. To this end, I propose:

1. Lowering reserve requirements on microloans for supervised entities, in order to make MSME-sector more attractive to the Financial Service Providers (FSP).
2. The Mandate of the Central Bank must be revised to add Financial Inclusion as another primary objective. This would also allow the Central Bank to exempt financial institutions from paying the minimum legal reserve requirements[14] on the resources they use to provide microcredit. This could work as an incentive, with the condition that financial institutions provide microloans with a fixed rate for at least 5 years (similar to what already happens with housing loans).

## Implementation

What I propose with the implementation of this policy is that informal and semi-formal microenterprises receive fair treatment in accessing credit and training from SBD, allowing them to grow in their activities and eventually becoming formal enterprises that contribute to the economic development of their families, their communities and the country.

The solution is the most feasible based on conditions in Costa Rica and the Banking System for Development Act. The agreement SUGEF 15-16: "Rules on Credit Risk Management and Assessment for the Banking for Development System," is a precondition regarding the implementation of this solution. Although some economic experts[15] believes that more time should be given to see if the "agreement 15-16" is effective, I feel more immediate action is required and, I believe the situation deserves a more urgent approach in outreach to this underrepresented sector.

The function of SUGEF is to ensure the stability of the financial system, issue prudential regulations and perform risk-based supervision. As a regulating entity, the SUGEF has evidence that current users of SBD program are mostly formal SMEs with easy access to credit in the formal system. The modification of SUGEF 15-16 or the enactment of new regulation is necessary to expedite the transformation of informal or semi-formal micro-enterprises into formal businesses. Accelerating this process will not only allow MSMEs to grow and provide more stable income for their owners, but will also improve government stability in taxes, as well social security and pensions contributions.

The specific steps to modify current regulation or to enact new ones, include:

1. Working meetings with the financial inclusion (FI) working group, the FI steering committee and the Technical Services Department (SUGEF new regulation issuers and modifiers).
2. Analyzing similar regulations and successful implementation of MSME policies in other countries.
3. Proceeding with internal consultation to the legal department and external consultation to the financial institutions that must assimilate it.
4. The Superintendent will present the regulation to SUGEF's Board members (National Council for Supervision of the Financial System or CONASSIF) for final approval, publicity and implementation.

To measure the policy impact, I propose to use a regulatory sandbox scenario monitoring indicators to be properly defined, but reachable through the INEC and OMIPYME surveys and MSME data, including the annual situation report from the MEIC.

## Notes

1. National Institute of Statistics and Censuses (www.inec.go.cr)
2. Retrieved from http://www.inec.go.cr/economia/directorio-de-empresas-y-establecimientos-0
3. Retrieved from http://catedrainnovacion.ucr.ac.cr/GEM-C4-2014.pdf
4. The Public Policy for the Promotion of SMEs and Entrepreneurship (Chinchilla Miranda Administration 2010–2014) and The Public Policy for the Promotion of Entrepreneurship of Costa Rica (Solis Rivera Administration 2014–2018)
5. Main Acts:
   - Regulation to the Law for the strengthening of small and medium-sized enterprises Law 8262 - Decree 39295 November 2015.
   - Law for the Banking for Development System - Act 8634 May 2008
   - Comprehensive Reform of the Law on the Banking System for Development - Act 9274
   - The Movable Guarantees Act 9246 May 2014
   - Regulation to the Law of the Banking System for Development - Decree 3490-MEIC-MAG).
   - Special Regulations for the Promotion of SMEs in the Purchases of Goods and Services of the Administration" (Decree 33305-MEIC-H).
   - Regulation to the special fund for the development of Micro, Small and Medium Enterprises (FODEPYME Decree 39278-MEIC).
   - Operating Regulations of the Micro, Small and Medium Enterprise Fund (FODEMIPYME), Gazette No. 84 of May 03, 2010.

- Regulations for Obtaining, Use and Application of the SME Seal - Mandatory Use Manual for the SME Seal Costa Rica: for the entrepreneur (Decree 38254).
- In addition, SUGEF has recently issued a specific regulation for credit operations granted under the SBD, SUGEF agreement 15-16 "Rules on Credit Risk Management and Assessment for the Banking for Development System" Effective as of October 2016.

Main Funds:

- PROPYME: Program of Support to Small and Medium Enterprises (acronym in Spanish).
- FODEMIPYME: Fund for the Development of Micro, Small and Medium Enterprises (acronym in Spanish).
- FINADE: National Trust for Development (acronym in Spanish).
- FOFIDE: Financing Fund for Development (acronym in Spanish).
- FCD: The Fund of Credit for Development (acronym in Spanish).
- FOMUJERES: Fund for development of women's productive activities and organizations (acronym in Spanish).

6. Additionally, the Act 8262 establishes regional support and development centers for entrepreneurs and micro-business owners, the "National Entrepreneurship Council—General Directorate of SME (DIGEPYME), the Institutional Network for Support to SMEs and Entrepreneurs (RED acronym in Spanish) and the "National Incubation and Acceleration Network (RNIA acronym in Spanish).
7. State of the SME Situation 2016 report, prepared by the General Directorate of Support to the MSMEs in the Ministry of Economy, Industry and Trade (MEIC). Retrieved from: http://reventazon.meic.go.cr/informacion/pyme/2017/informe.pdf)
8. There are three different categories of enterprises according the fulfillment of requirements (formal, semiformal and informal). Informal businesses are invisible to the institutions and the government. The formal enterprises comply all the requirements by law. In Costa Rica, Omipymes [11] research found a large group of businesses (exactly 154.158) that comply the local requirements but no the national requirements. This kind of business is called semi-formal that usually operate obtaining licenses granted by the local government (municipality). Brenes Bonilla, L., Bermúdez Mesén, L., & Bermúdez Vargas.
9. Retrieved from http://sbdcr.com/webcenter/portal/sbdprod?scrollTo=3022. The SBD includes a network of financial operators (regulated financial intermediaries and MFIs) that channel the resources available to MSMEs and was established since its creation as . . . "a mechanism to finance and promote productive, viable projects, in accordance with the development model of the country in relation to the social mobility of the subjects covered by this Law." Thus, the SBD is an instrument of financial inclusion with the capacity to encourage the creation of companies, the strengthening of these, the generation of employment, the increase in competitiveness, as well as the creation and development of markets.
10. Retrieved from http://www.nacion.com/economia/politica-economica/SBD-insuficiente-demanda-hacen-pymes_0_1610039016.html
11. Observatory of Micro, Small and Medium Enterprises (OMIPYMES) is an initiative from the State Distance University of Costa Rica (Universidad Estatal a Distancia de Costa Rica, UNED acronym in Spanish) in tandem with the other public universities: University of Costa Rica, the Technological Institute of Costa Rica, and the National University of Costa Rica. Its main goal is to generate information and strategic knowledge to inform the decision-making process and the design of public policy that foster competitiveness in Costa Rican MSMEs.
12. Infrastructure for credit granting include:
    - High geographic coverage of banking agencies of the state-owned dominant banks throughout the country and commercial banks (SBD operators).
    - The movable guarantees act and the public registry.
    - The risk information center in SUGEF (CIC acronym in Spanish) that generates a credit scoring for all debtors and a risk qualification according to their historical behavior of payment based on information of the formal financial system.
    - At least three private credit bureaus with extensive positive and negative information from the unsupervised financial market.
    - The credit guarantee schemes from the National Trust for Development from SBD (Finade acronym in Spanish) for MSMEs with no collateral.

13. Since 2015, two projects have been presented to the congress in this regard, the number 19,729 Law for the Promotion of the Entrepreneurial Person and the 19,805 Law to temporarily exempt the employer's contribution to the Fund for Social Development and Family Allowances and the Joint Institute of Assistance Social, to the microenterprises in the condition of informality. None has been approved. However, the CCSS has sufficient autonomy to generate such modifications.
14. The reserve is also a liquidity requirement and represents a 15% of current deposits from the public (in savings and check accounts) that financial intermediaries must maintain at the Central Bank.
15. II Report of the Evaluating Commission of the banking system for development, 2016. Retrieved from http://www.cpcecr.com/documentos/desarrollo-profesional/InformeIIComisiondelSBD.pdf

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# Challenges for Small Enterprises to Sustainably Run Their Businesses — The Case in Ethiopia

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## Summary

Small enterprises[1] in Ethiopia have been challenged to sustainably run their businesses, primarily due to lack of credit and technical capacity[1] and an inability to raise working capital from their own sources. Improving the credit infrastructure, such as the movable collateral registry system and Credit Reference Bureau (CRB), and providing need-based and tailored training on entrepreneurship, risk management and basic accounting would build small enterprises' capacity in business management. Furthermore, this would inspire confidence for banks and MFIs to offer the necessary credit to small enterprises, thereby giving them the means and opportunities to run their business sustainably.

## Context

Ethiopia is a country with a population size of around 94 million, with 70 percent of the population below the age of 30.[2] This indicates high current and future demand for jobs in the economy that is mainly dependent on agriculture. The Government of Ethiopia has been working to transform some of the economy into manufacturing-based in the medium-term and then to industrialize, following the Growth and Transformation Plan (GTP).[3] Given this context, and from the perspective of job creation and supporting the development agenda of the Country, expanding and enabling small enterprises to sustainably run their business is critically essential.

The Growth and Transformation Plan (GTP) envisages creating a total of three million Micro and Small-Scale Enterprises (MSEs) by 2020.[4] In 2016, the number of small enterprises reached 190,587, with a total credit of around ETB 5.4 billion and creating 1.7 million job opportunities.[5] The average credit stood at ETB 28,000 (around USD $1,200), which may not be high enough to ensure sustainable growth and expansion of the enterprises.

A National Financial Inclusion Strategy (NFIS) was formulated and ratified by the Council of Ministers in January 2017. It has a vision of universal access to quality and affordable financial products and services, mainly targeting marginalized people and small enterprises. NFIS seeks to implement this through the execution of four strategic pillars, namely: Financial Infrastructure, Products and Services, Consumers Protection and Capability. Furthermore, recognizing the current state of conditions and the future prospect of small and medium enterprises (SMEs), the Government of Ethiopia has allocated ETB 10 billion (around USD 450 million) to be disbursed over five years where small enterprises are expected to benefit a lot from the scheme.

## Challenges

***Approximately 88 percent of small enterprises in Ethiopia face challenges to sustainably run their business.***

The root causes for the challenge are the following:

1. Small enterprises, by their nature, raise low level of capital from their own sources.
2. Banks and MFIs are not willing to provide credit to small enterprises due to lack of credit information and fixed nature collateral. According to the World Bank Group's Enterprise

Survey of 2011, 88 percent of small enterprises reported that their application for loan was rejected as compared to 57 percent of micro-enterprises. This indicates the need for financing services better tailored to small enterprises.[6]

3. Lack of technical capacity of the enterprises mainly due to the absence of training on entrepreneurship, risk management and basic accounting. Under these circumstances, banks and MFIs also lack confidence to offer credit that resulted in a serious challenge for small enterprises to sustainably run their business.

## Potential Policy Solutions

Potential solutions to the causes of the problems are:

1. Strengthening the capacity of small enterprises to enable them to raise working capital from their own sources, through the use of advantageous conditions around them, such as cheap labor and potential increase in productivity. This would help them to grow and mature relatively faster and accumulate and raise working capital from their own sources;
2. Improving credit infrastructures such as Movable Collateral Registry and Credit Reference Bureau (CRB). Introducing a new registry for movable collateral has benefits for small firms, which are often more constrained in their access to finance and do not have many fixed assets that can serve as collateral.[7] Expanding credit information system would also create a more conducive environment for banks and MFIs to extend the necessary credit to small enterprises; and
3. Providing training to small enterprises on entrepreneurship, risk management and basic accounting, to build their capacity in business management and give banks and MFIs the confidence to offer the necessary credit.

## Priority Solutions

Among the proposed three potential policy solutions, I have chosen to work simultaneously on two of them as priority solutions: improving credit infrastructure such as Movable Collateral Registry and Credit Reference Bureau (CRB) and building the technical capacity of small enterprises through providing training.

The first priority solution was chosen due to its feasibility and pre-condition.[8] Currently, the Credit Reference Bureau (CRB), which only serves the banking sector, is run and administered by the National Bank of Ethiopia (NBE). As Head of the Financial Inclusion Secretariat (FIS) within the NBE, I have the responsibility to propose and coordinate the expansion of the bureau, to enable it accommodate credit information of the MFIs and leasing companies. The NBE has the capacity and interest to expand the database and is required to do so under the financial inclusion framework. With respect to Movable Collateral Registry law, the National Financial Inclusion Strategy has given a mandate to FIS to draft the necessary law that promotes financial inclusion. I will, therefore, draft the law and put the registry in place in collaboration with key stakeholders such as banks, MFIs and leasing companies.

The second priority was also chosen because of its feasibility and pre-condition. The National Bank of Ethiopia has an institute called Ethiopian Institute of Financial Study (EIFS) where the Director/Expert will have a seat in the working group of the Financial Education. I will identify need based training to small enterprises in collaboration with the Institute and Federal Micro and Small Enterprises Agency (FMSEDA), which is responsible for the development and expansion of small enterprises, and organize delivery of the proposed training through EIFS.

In sum, the policies I am proposing are aiming to **promote easier access to credit for small enterprises by building the necessary credit infrastructure and strengthening the enterprises'**

**technical capacity by providing training primarily on risk management, entrepreneurship and basic accounting**.

## Key Stakeholders and the Next Steps

### Key Stakeholders

As stipulated in the National Financial Inclusion Strategy, the Financial Inclusion Secretariat (FIS) has the mandate to set up a working group that specifically deals with the challenges of small enterprisers. Members of the working group would mainly comprise selected experts from Federal Micro and Small Enterprises Agency (FMSEDA), banks and microfinance institutions, Ethiopian Institute of Financial Study (EIFS), Bank Supervision Directorate (BSD), Microfinance Institutions Supervision Directorate (MFISD) and Legal Service Directorate (LSD). FIS would engage and invite them all to bring their perspective on resolving the challenges and enabling small enterprises to run their business sustainably. The National Council for Financial Inclusion (NCFI) will provide authorization and decision to proceed with the implementation of the proposed policy priorities. In this process, FMSEDA will lead the agenda and FIS would coordinate, monitor and evaluate efforts of the key stakeholders toward resolving the challenges of small enterprises.

### The Next Steps to Execute the Priority Policy Solutions

The next steps for expanding the Credit Reference Bureau are: (1) I will organize the working group to discuss the policy priority and to secure buy-in to the agenda; (2) if the matter can be resolved through internal capacity of experts from Information System Directorates of the National Bank of Ethiopia, the expansion work will be started straight away; (3) if the matter requires further technical capacity (in terms of hardware and software and human resources), the working group and I will forward proposal to be approved by the Governor; and (4) the expansion work will be carried out.

In the case of the Moveable Collateral Registry Law, a working group will be formed and will start reviewing the draft law, taking into consideration the current state of relevant conditions and contexts. Thereafter, a workshop will be organized to deliberate on the draft law and get feedback from key stakeholders. Then the final draft will be sent to the Council of Ministers and then to the Parliament for ratification and issuance. Subsequently, the collateral registry unit will be setup and the system will be in place. As Head of the FIS, I will coordinate the entire process.

With respect to technical capacity building, I will team up with EIFS and FMSEDA to identify need based trainings for small enterprises. Then, a workshop will be organized for key stakeholders to get feedback on the proposed training materials. Once approved, FIS and FMSEDA will continue the coordination and the training will be delivered by EIFS as a series of learning events.

## Monitoring and Evaluation

The goal of the policy proposals is to improve the lives of people in the small enterprises sector by enabling them to sustainably run their business, mainly by means of resolving their credit and technical capacity challenges. As banks and MFIs provide the necessary credit, small enterprises will sustainably run their business and increase earnings and profits over time, which will improve the lives of people dependent on the sector. To monitor and evaluate the progress, survey will be conducted to gather demand side data by Central Statistic Agency (CSA) and secondary data will be collected quarterly from FMSEDA, Bank and Microfinance Supervision Directorates.

## Notes

1. Small enterprises are defined as having 5–19 workers.
2. Technical capacity in this context includes entrepreneurship, access to market and business information, competiveness, managerial skills, among others.
3. Central Statistics Agency (2013). *Population Projection for 2007–2037*.
4. Growth and Transformation Plan is formulated by the Government of Ethiopia to transform the economy to manufacturing in the medium term and then to industrialization with the view to realizing the national vision of becoming a low middle-income country by 2025.
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7. National Bank of Ethiopia (2017). National Financial Inclusion Strategy.
8. Inessa Love, Sole Martínez Pería and Sandeep Singh (2013). *Collateral Registries for Movable Assets: Does their Introduction Spur Firms' Access to Finance?* Retrieved from http://siteresources.worldbank.org/EXTGLOBALFINREPORT/Resources/8816096-1361888425203/9062080-1361888442321/Collateral_Registries_for_Movable_Assets_Presentation.pdf.
9. Refers to the capacity to implement the proposed policy and ensuing the existence of necessary condition to proceed with the execution.

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# Formal Finance

# Making Affordable and Simple Microinsurance Service Accessible to Low-Income Urban Ethiopians

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## Executive Summary

Ethiopia is the second most populous country in Africa with over 90 million people, of which about 20% is urban. As of 2011, 14% of Ethiopia's poor (about 3.5 million people)[1] live in urban areas. According to a 2011 Welfare Monitoring Survey, 26.9% of urban respondents reported that they have experienced at least one shock, such as death of household member, illness, drought, flood, price shocks, job loss, livestock shocks, theft, fire, and loss of house or land. In response to these shocks, about half of urban households use their own cash to cope, 26% take loan from relatives and non relatives, 6% of respondents sell animals and 6% withdraw from bank to raise Birr 200,[2] even if raising Birr 200 is not fully protective from large shocks. As formal financial services, particularly, insurance products, for coping with such shocks are not available, this initiative aims to promote micro insurance as a viable tool to help urban poor to withstand such shocks and thereby lead a better life.

## Problem and Context

Low-income urban Ethiopians are highly vulnerable to health, death and other shocks. As data on loss incidents or occurrence of shocks particularly relating to the urban poor are not available, other data will be used to provide context. For example, the actual level of insurance penetration in Ethiopia is only about 0.45% of GDP.[3] Compared to some other African countries such as, Kenya (2.94%), Uganda (0.86%), Tanzania (0.9%), Zambia (1.12%), and Ghana (1.02%), the uptake of insurance in Ethiopia is very low.[4] Besides, about 95% of the premiums come from the general insurance business. Long term contracts, including life insurance, are at their infancy. As the mainstream insurance business is focused on auto insurance and other classes of insurance, such as marine, engineering and property insurance for the well off, the majority of the population has no insurance whatsoever. While there are already attempts on a fragmented way to provide micro crop and livestock insurance for smallholder farmers and for the pastoralists who are highly susceptible to climatic changes by different agencies, there has been little focus on insurance to support the urban low-income population, which is growing by number from time to time.

In the event of drastic shocks, the urban poor cannot easily withstand the financial consequences and return to normal life. They have to either take loans from relatives or through other informal networks, sell assets or spend their savings in the face of accidental shocks. This vulnerability to shocks is mainly caused by insufficient and informal saving, volatility of income, absence or inadequacy of social guarantee schemes, absence of suitable insurance products, and inadequacy of policy or regulatory intervention to promote suitable financial services.

## Potential Solutions

There are a number of ways to assist the urban poor in coping with accidental shocks. The primary policy objective is to put in place the necessary infrastructure for the promotion and expansion of micro insurance business. This includes strengthening the regulator's capacity in terms of creating awareness about the role it plays in promoting inclusive financial services, and in terms of

designing proportionate regulatory framework for the supervision and regulation of micro insurance; issuing consumer protection regulations for insurance businesses in general and to micro insurance consumers in particular, in order to enhance consumers' confidence in the products; assisting insurers in building their internal capacity to provide micro insurance; and facilitating the development and effective roll out of suitable and affordable micro insurance products.

Other proposed potential solutions are to focus on improving social services such as education, family planning, health services and housing; to promote financial literacy that includes income and expenditure management; and to abolish harmful practices and provision of premium subsidies in micro insurance businesses.

## Recommended Policy Solutions

My priority solution is **putting in place necessary legal and market infrastructure for the promotion and expansion of micro insurance**. This includes strengthening the capacity of the regulator (the Insurance Supervision Directorate of the National Bank of Ethiopia) to promote the expansion of micro insurance to include those who have historically been excluded from this market, like the urban poor. Moreover, the regulator should focus on putting in place appropriate and proportionate regulation for the registration and supervision of micro insurance business for the urban poor. Relevant legal infrastructure includes the issuance of consumer protection regulations pertaining to micro insurance clients and issuing directives for the registration and monitoring of micro insurance intermediaries. The National Bank of Ethiopia will assist the insurance industry in building capacity to carry on micro insurance business by engaging them in the inclusive insurance project, which the Bank has already launched in collaboration with the World Bank. Furthermore, the Bank will work with interested insurance companies in the process of development and piloting of suitable and affordable micro insurance products for the urban poor.

The ultimate objective is to utilize micro insurance services to help the urban poor withstand financial shocks, and grow the fledgling insurance industry within the Ethiopian market.

Successful implementation of this policy requires the participation of various internal and external stakeholders. The internal stakeholders include the Board of Directors of the National Bank of Ethiopia, the Governor, and Vice Governor for Financial Institutions Supervision, and various Directorates, including the Insurance Supervision Directorate. External stakeholders mainly include the members of the Association of Ethiopian Insurers, the World Bank, Reinsurance Companies and other government agencies.

I will work with members of Insurance Supervision Directorate and all concerned parties within the National Bank. In my capacity as head of the Insurance Supervision Directorate, I will also work with the members of my directorate, World Bank consultants, the Legal Services Directorate and the Financial Inclusion Secretariat on the formulation and issuance of regulations. We will work with all insurers, public and private, on crafting the necessary regulations, and to ensure that they have participated in the process and that any concerns are properly addressed. We will provide support for insurers in the form of seminars and trainings relating to micro insurance business. We will also facilitate the development of micro insurance products in collaboration with our partners, particularly the World Bank and insurers themselves, accessible to those who are interested in participating in the micro insurance market. We will issue necessary regulations for the registration and regulation of micro insurance business and for consumer protection.

The key policy instruments will involve issuing directives on consumer protection, registration and supervision of micro insurance business, and licensing of intermediaries. Other policy considerations are working on micro insurance product development, based on feedback from surveys to interested insurers and microfinance institutions (MFIs), and the successful roll out

of these services, which, at the moment, is the key deficiency of the market. Prototype products and the proposed delivery system will be developed and pilot tested through interested insurers before the final products are rolled out.

There is already infrastructure that will assist in the development and roll out of these services. The National Bank of Ethiopia, as a sole financial sector regulatory agency, carries the necessary mandate and responsibility to support these endeavors, particularly because this policy initiative corresponds to the core responsibility of the Bank to develop the finance sector and the promote financial inclusion. More importantly, there are already different initiatives within the National Bank for addressing the issue of inclusive insurance (micro insurance), setting a precedent for this sort of policy adoption.

Microinsurance and other financial services have played an important role in improving the conditions of low-income people in countries such as Philippines, Mexico and Kenya. For instance, out of the 49 million Filipinos who have life insurance in 2014, 31 million were insured by micro insurers.[5] In addition, the Philippines was ranked first in terms of micro insurance coverage ratio registering a ratio of 21%.[6] According to the Insurance Commission of Philippines, in 2015, 50% of the 162 insurance products approved are micro insurance products, and 50% of registered insurers provide micro insurance products. I have a strong belief that this can be replicated in many places, including Ethiopia.

## Key Stakeholders Implementation

The key internal stakeholders are the Vice Governors including the V/governor for the supervision of financial institutions, the Governor, the National Bank's board, Directorates entrusted with the supervision of banks, MFIs and insurance within the National Bank and the Secretariat of the National Financial Inclusion Strategy. The key external stakeholders include the private and public insurance companies, the Association of Ethiopian Insurers, insurance intermediaries, Trade Competition and Consumer Protection Agency, the World Bank and MFIs and insurance intermediaries.

## Notes

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# Extending Pension Coverage to the Informal Sector and the Self-Employed in Nigeria

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## Executive Summary

The informal sector and the self-employed (ISSE) in Nigeria are not covered by any form of retirement benefits program and there is no social security arrangement that provides old age income for them. The National Pension Commission (Commission) has developed the concept of Micro Pension Scheme (MPS) to provide sustainable retirement income for the ISSE. However, lack of requisite subsidiary legislation and a lack of distribution channels inhibit the execution of this strategy. This memo, therefore, provides a policy path in addressing these constraints toward the successful implementation of the MPS.

## Analysis of the Problem

According to the National Bureau of Statistics, the size of working population in Nigeria is estimated at 109 million (aged 15–64)[1] and has a labor force of 81.2 million.[2] However, about 19.7% of the labor force work in both the public and private formal sectors, while 80.3% work exclusively in the informal sector. Currently, provision of pension for old age income is largely restricted to the formal sector only. Indeed, according to a bi-annual survey conducted by an NGO, Enhancing Financial Innovation and Access (EFInA), in 2014, only 45.4 million adults were financially included. The report for 2016 showed a decline of about 15% in the proportion of Nigerians that were financially included, including those that had pension accounts. In fact, pension coverage was just about 7% of the working population as at the end of 2016.

According to the World Bank, Nigeria ranked third on the world poverty index as of 2014.[3] In addition, an EFInA 2016 report[4] showed increasing levels of poverty and less employment/income-generating opportunities among the ISSE. The report further showed that majority of the ISSE are primarily focused on survival and informal economic activities. Indeed, formal financial access is not their priority due to lack of understanding and trust, short-terminism and a preference for accessing their money as is familiar to them under informal methods of savings.

The Pension Reform Act (PRA) of 2014 allows voluntary contributions under the Contributory Pension Scheme (CPS). The ISSE could, thus, have sustainable old age income under the CPS on voluntary basis if these challenges are addressed.

## Key Challenges

In Nigeria, pension historically has been the exclusive privilege of those working in the formal sector. Although Section 2(3) of the PRA 2014 has entitled the ISSE to participate in the CPS, the Commission has yet to issue the enabling subsidiary legislation to extend pension coverage to them. This is largely due to the need to further understand the preferences of the informal sector (including SMEs) and the self-employed in regards to savings and savings for pension (old age income); and lack of clear scope and deliverables on the proposed channels for account services.

The MPS was introduced as a platform to extend pension coverage to the ISSE. An integral part to the implementation of the MPS is the channel for delivery of account services, which is not currently available. The channel will provide the platform for registration, contribution

collection, complaints resolution, and benefits payments. It is important to note that mobile payment system is well established in Nigeria, but currently does not cover the pension sector.

Most Nigerians live day by day without any proper arrangement for savings toward old age income. This problem is compounded by an inability to adjust consumption patterns in retirement, due to the old family value system where aged parents are the financial responsibility of their children. This is exacerbated by negative economic conditions, low level of education and lack of adequate financial knowledge.

## A Policy Path

To address the challenge of providing sustainable retirement income to the ISSE through the MPS, the following policy solutions were considered:

1. Finalize the development of, and issue the subsidiary legislation on MPS.
2. Design and develop the relevant channels for pension account services.
3. Develop appropriate incentives including investment instruments that satisfy the appetite of the ISSE.
4. Design and implement mass awareness campaigns on the MPS.
5. Design and implement financial literacy programs for secondary schools and tertiary institutions with particular emphasis on savings and pension.

Indeed, all the five policy solutions are key integral components of a robust roadmap to implement the MPS in Nigeria. However, the priority solution *is the development and issuance of the subsidiary legislation* as it defines the overall framework upon which the other four policies can be achieved. On the other hand, the subsidiary legislation would require the channels and awareness campaigns for its successful implementation. Thus, these solutions will be simultaneously implemented alongside the priority solution.

## Implementation Steps

- Finalize the development of, and issue subsidiary legislation.
  - Conduct a survey to fully understand the behavior of the ISSE regarding their savings and savings for pensions. This will cover the workings of the informal savings schemes that are well developed in Nigeria and how the ISSE are effectively using them. Survey results would be used in updating the draft legislation.
  - Consult comparable implementations. A study of the Indian and Kenyan Pension Systems was conducted on how they extended coverage to the ISSE. It is interesting to note that both allow use of mobile money for transactions, but the Indian model allows more flexibility in contribution remittance, such as accepting registration through an agent or via an online form. In Kenya, access to pension commences at age 50, while in both countries, the concept of 2-tier accounts was implemented. They also implemented a minimum contribution rate to ensure that reasonable account balance is built at retirement. These concepts would be considered in defining the scope of the subsidiary legislation and delivery channels for account services.
  - A pilot run of the MPS would be conducted to provide an opportunity for the legislation to be tested and adjusted. In particular, Pension Fund Administrators (PFAs) and Custodians (PFCs) would be engaged in test-running and modifying their processes and infrastructure on general administration, investment and custody of the MPS assets.
  - The Board of the Commission would approve the legislation once finalized.

- Design and develop the relevant channels for pension account services.
- Conclude the definition of deliverables to allow for clarity on the registration, contribution collection, consumer protection and benefits administration models to allow telecos develop the necessary supporting infrastructure.
- Continue engagement with the National Communications Commission and the telcos for the development of the supporting platform that would enable use of mobile phones for pension account services.
- Mobile telcos in Nigeria, Association of Licensed Mobile Payment Operators and Nigeria Interbank Settlement System would be engaged to design appropriate mobile money platform and supporting infrastructure for the implementation of the MPS.

- Awareness campaigns.
  - Constitute a media team comprising staff of the Commission and pension operators (PFAs and PFCs) to handle all awareness campaigns.
  - Develop a communications strategy for the mass awareness campaigns.
  - Design all the relevant awareness campaign materials on legislation and channels for print, electronic and social media.
  - Select and engage media houses for the effective implementation of the strategy.
  - Engage trade unions and associations as well as National and State Chambers of Commerce to obtain buy-in and build working relationships for the effectiveness of the campaigns.

## Efforts with Key Stakeholders

Already, the Financial Inclusion Secretariat (FIS) has been established at the Central Bank and is coordinating all financial inclusion activities in Nigeria. All financial regulatory agencies, operators, mobile phone regulator, telcos, and some key Ministries and Departments are represented in the Technical Committee and in the Working Groups established to develop products, channels, literacy and mass awareness as well as special interventions. There is a commitment by all the agencies on the Financial Inclusion Technical Committee to support the implementation of the MPS as a driver for financial inclusion in Nigeria.

The Commission established the Micro Pension Department and participated in the development of financial literacy curriculum for primary and secondary schools in Nigeria, which was coordinated by the FIS. The curriculum has been adopted for basic and senior secondary schools by the National Council on Education. Similarly, engagements have commenced with the National Council on Information for the development and implementation of financial literacy mass sensitization plan. When these plans are implemented, financial literacy levels would be significantly raised across all age groups and educational levels in Nigeria. This is expected to raise coverage levels by substantial proportions including on pensions.

## Notes

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# Introducing a Long-term Saving Scheme for Rwandans Working for the Informal Sector

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## Background

Rwanda is a relatively small country, with nearly half of its population under the age of 15 years. The Fourth Population and Housing Census expects Rwanda's elderly population (60+) to double, from roughly 510,000 in 2012 to approximately 1,096,000 individuals by 2032. This is due to a combination of reduced fertility rates and improvements in life expectancy. This aging population creates a public policy challenge for the Government to be addressed by a comprehensive social security coverage, backed by long-term savings. Rwanda's current pension scheme barely covers 10 percent of Rwanda's workforce, focusing largely on public and private sector salaried employees. The excluded 90% of the workforce (mostly working in the informal sector) is not covered by a pension scheme.

## Problem and Context

*Mr. Burakari (65 years old) calls and visits friends and family and requests financial assistance to meet basic needs (food, medical costs, and transportation). He formerly worked in the informal sector and earned irregular income. While he was employed, there was no scheme in place that targeted people working in the informal sector. Besides that, he had a low level of financial education and had little access to formal or informal financial services providers for advice on financial matters. He admits that he faces a tough time ahead and agrees that young Rwandans should be helped to save for old age. His situation reflects the findings of a 2012 financial capability survey, which reported that when it comes to saving and planning for the future (including old age)* ***"59 percent say they save only if [they] have money left after expenses, only 38 percent say they are somewhat or very knowledgeable about planning and budgeting for daily expenses."***

According to Rwanda's Institute of Statistics, 35 percent of elderly Rwandans struggle to meet their basic needs in retirement. This has not only affected the elderly Rwandans but also the country at large, with a social protection spending that today stand at $15,671,733 and low levels of savings as a percentage of GDP (averaging 11 percent for the last 20 years).

It is important to mention that 90% of the Rwandan working population is concentrated in the informal sector, working as farmers, transporters, artisans, metal and wood workers, etc. These workers earn irregular incomes and remain excluded from voluntary savings schemes, since these programs are not designed to suit the needs of this segment of the population.

Beyond of the absence of a scheme designed for people working in the informal sector, there is no law to establish a long-term savings scheme and govern its organization in the informal sector. The absence of this law was due to other development priorities for Rwanda, which has been rebuilding itself after the 1994 genocide against the Tutsi; these priorities focused primarily on job creation and income earning. *The Integrated Household Living Conditions Survey* showed that over 140,000 jobs have been created annually since 2011, to meet the 200,000 target every year across all sectors.

As more Rwandans are given an opportunity to earn incomes and save money, the need for a savings scheme that addresses the needs of workers in the informal sector becomes more pressing.

## Potential Solutions

To address the above problems, there are numerous potential solutions.

1. Enact a new law establishing a long-term savings scheme and governing its organization, which requires Rwandans working for the informal sector to save for old age.
2. Introduce a new inclusive and attractive long-term savings scheme for all Rwandans.
3. Prepare and implement a national financial education and consumer protection campaign and also effectively prepare and implement a robust awareness retirement campaign.
4. Introduce new affordable tools and infrastructure (mobile, digital and electronic) to support scheme. This infrastructure will be connected with MNOs and all financial institutions to enable all segments of the population save where ever they are.
5. Pilot the new inclusive and attractive long-term savings scheme in at least four districts for lessons and Launch the Scheme in January 2018.

## Recommended Policy Solution

I propose designing and implementing an attractive and inclusive long-term saving/retirement scheme for the informal sector by putting in place a policy, which establishes the conditions for a suitable long-term savings scheme for workers in the informal sector and provisions for governing its organization.

This policy option stands out among others because it will address the deficit in voluntary savings schemes flexible enough for Rwandans working for the informal sector, as well as the lack of legal guidance to oversee such a scheme.

The existing law and schemes only are suitable for defined benefits schemes designed for salaried people who earn regular incomes. The new policy should be flexible enough for the irregular earners of the informal sector, by allowing them to make flexible contributions throughout the year. In a bid to attract savers, the **Government of Rwanda** should match the savings of people in the lower quintiles of the population, and offer tax exemption on earnings to the savings for those in the higher income quintile.

Implementing this policy solution will call for constituting a National Steering Committee and working group of stakeholders to provide **guidance and mobilization support**. All stakeholders—including donors, the Rwandan Parliament, members of civil society, financial service providers, the National Identity Card Office, Ministry of Finance, the Central Bank of Rwanda and the people working in the informal sector—will also guide a feasibility study for designing, piloting and implementing the new scheme.

As the Ministry of Finance and Economic Planning's financial sector development department leads the implementation, **the Ministry of Finance and Economic Plannin**g will ensure that the policy environment (introduction of tax incentives for the savers and matching their savings, massive education and continuous monitoring and periodic evaluation of the scheme) continue to be favorable.

To establish a precedent for this sort of implementation, a team from Rwanda visited India (www.pinboxsolutions.com) and found a similar project that is working well, and a feasibility study in Rwanda will be conducted to adapt the project to the informal sector's needs. A pre-feasibility study and people-centered research has been carried out and indicated that 51 percent of people working in the informal sector desire such a scheme. It is also mentioned that 49 percent need it but also requested to be educated on this subject, demonstrating a need for capacity building and financial literacy education.

The Rwandan government will mobilize the necessary funds to hire a team to carry out the feasibility study, design and later support the rollout and is willing to support the designing and roll out a new inclusive and attractive long-term retirement scheme targeting Rwandans working for the informal sector. The funds will also support the designing of the core IT pension system to support and manage the savings collections.

For more information on implementation, please see Annex 1 and Annex 2.

## Conclusion

The financial capability survey 2012 reported that 91 percent of Rwandans disagree with the statements that "they don't worry about saving money for the future," and 82 percent disagree with the statement that "they don't worry about the future and let tomorrow take care of itself." Generally, people in Rwanda are willing to save even with the lack of attractive long-term savings products. A new inclusive and attractive long-term saving/retirement scheme in place should be piloted and launched to address the financial insecurity faced by those who work in the informal sector. The uncertain future should positively influence people to save and guarantee their future (retirement) consumptions. It is worth mentioning that every retiring Rwandan deserves a dignified life, and there is great social importance in implementing this proposed scheme. However, the greatest impact will be financial empowerment and stability for the aging population of Rwanda, regardless of whether they worked in the formal or informal sectors of the country.

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## Annex 1. Implementation Plan

| Activities | 2017 | | 2018 | | | | 2019 | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| Recruit and establish technical assistance (International Experts) | x | | | | | | | | | |
| Recruit and establish PMU (Technical and Administrative staff) | | x | | | | | | | | |
| Procure and establish IT platform customization and integration | | x | x | x | | | | | | |
| Publishing Law governing long-term savings scheme | | | x | | | | | | | |
| Publishing Prime Minister's Order determines the institution in charge of administering the long-term savings scheme | | | x | | | | | | | |
| Publishing Ministerial Order of long-term savings scheme | | | x | | | | | | | |
| Establishing central record-keeping, Helpline and other protocols of long-term savings scheme | | | x | x | | | | | | |
| Establishment of long-term savings scheme regulator, trust and other services providers | | | | x | x | | | | | |
| Launch of demand and supply side surveys | | | | x | x | | | | | |
| Test proposed product and features and channels | | | | | | x | | | | |
| Define pricing strategies, guidelines and benefits | | | | | | x | | | | |
| Design awareness campaigns plan and toolkits | | | | | | | x | | | |
| Training of intermediaries (Banks, MFIs, SACCOs, and MNOs etc.) | | | | | | | x | | | |
| National public awareness campaign and financial literacy campaign | | | | | | | | x | x | x |
| Launch long-term savings scheme pilot in the selected districts | | | | | | | | | x | |
| Ongoing M&E | | | | | | | | | | x |

## Annex 2. Key Stakeholders

We plan to engage the institution below through a formed working group with experts representing each of the institutions below. Without a strong sense of interest and ownership of a project from inception, successful implementation remains affected. Negotiation and persuasion should start at an early stage and every relevant institution should be brought on board.

| No. | Stakeholder | Key Steps from Your Theory of Change or Implementation and Responsibilities | Assumptions |
|---|---|---|---|
| 1 | Ministry of Finance and Economic Planning (MINECOFIN) | • Lead the carrying out of the feasibility study on this scheme<br>• Convene and constitute a stakeholder to discuss and validate the findings of the feasibility study<br>• Design the scheme and enact a law on the scheme<br>• Mobilize the needed budget.<br>• Lead stakeholder during the piloting and later roll out of the scheme | As a lead institution, MINECOFIN should be equipped technically and financially to successful implement such a project. |
| 2 | National Bank of Rwanda | Support the drafting of a Law on a retirement scheme for the informal sector and enforce it. | Without a strong legal framework in place, this scheme would struggle. |
| 3 | Rwanda Lower and higher chamber of deputies | Study and pass all necessary legal tools | The Legislators are the representatives of people and they have to ensure that the Laws worth changing the lives of the people without putting a lot of burden. The laws should not crowd out financial inclusion. |
| 4 | National Identity card (NID) office | Provide identification of the savers | Citizens Bio-data that is hosted at the NID is needed for the designing of the scheme. Mainly for identification. The scheme infrastructure should be linked to the NID systems. |
| 5 | Ministry of Local Government | Mobilize Rwandans | Without an institution that daily work with and mobilize local citizens the scheme enrollment would be negatively impacted |
| 6 | Mobile Network operators | There branch networks to support the collection of savings | The current level of mobile penetration will be leveraged on during collection of savings. A collaboration should be in place and MNOs should take a center stage for collections and remittance of pensions. |
| 7 | Financial services providers (Banks, MFIs, Insurers and SACCOs) | The FSPs branch networks to support the collection of savings | FSPs branches and agents will always remain key to collection and remittance of savings and a relation/collaboration framework has to be agreed in time. The assumption is that they should give low cost services to people who intend to save or withdraw their savings. |
| 8 | Donors | Advise and Fund the project | This project will be an expensive undertaking therefore mobilization of financial support from donors should be considered. Without donor support implementing such a project would be a challenge. |
| 9 | Rwanda Social Security Board (RSSB) | Administrator of the Fund | The assumption is that without a strong administrator for such a scheme, collapsing or failure would be expected. RSSB should be brought on board at this stage to understand and own the project and then finally the scheme. |
| 10 | Rwanda Civil Society | Mobilization and marketing | Both these scheme are recognized as strong institution to mobilize citizens and they should be part of the project from the start. |
| 11 | Rwanda Cooperatives Agency | Mobilization and marketing | |

# Boosting Rural Morocco's Resilience to Agricultural Shocks

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## Introduction

Morocco is a developing country where agriculture is a key driver of economic growth. This sector is the largest employer in the country and contributes to almost 15 percent of Morocco's GDP.[1] Despite the many policies and programs undertaken by the government to promote the sector's growth and its resilience to exogenous shocks, several challenges remain in relationship with the outstanding inequalities between large and small farmers, drought and soil erosion.

This policy memo brings to light the main reasons for Moroccan rural households' vulnerability to agricultural shocks and proposes measures to smooth their consumptions and enhance the quality of their life through access to adequate and sustainable financial services.

## Problem and Context

In Morocco, rural areas harbor 40 percent of the population[2] of which 22 percent live below the poverty line.[3] As the main employment sector in these areas is agriculture, the earnings of rural population are volatile due to climatic variations that can lead to a lack of income, particularly during drought season or a poor harvest.

Moreover, the rural population's vulnerability to agricultural shocks is worsened by a lack of infrastructure. According to the supply side indicators[4], by the end of 2016, only 24 percent of rural localities had an access point to banking services, with only 1 access point for 13,163 adults. This is due to the high costs of implementing financial institutions' branches in rural areas,[5] especially in remote ones, compared to the high level of risk and small potential transactions amounts. Thus, informal providers have become major players in financial services provision, often without regulation.

The lack of access points to financial services in addition to the limited financial skills and illiteracy lead to a low rate of usage of formal financial services in rural areas. According to the "financial capability survey,"[6] only 19 percent of rural adults use a formal financial product and only 20 percent of them are familiar with insurance products. In addition, the survey revealed that this group has the lowest financial capability scores compared to urban dwellers, especially in terms of saving, budgeting and planning for unexpected expenses.

Furthermore, the limited role of women in the economy is another factor that affects the living standards of rural populations. Indeed, Morocco is one of the countries with the lowest index of women's participations in the economy: according to global gender gap report of 2016, Morocco's ranking is 139 out of 144 countries.

These observations were further underlined by some interviews with families from the rural area of "Benslimane," a small city in west of Morocco, as well as with senior representatives from financial service providers (FSPs) who pointed out that farmers, especially small ones, don't have the required expertise to utilize their properties in an optimal way.

In conclusion, the **rural population in Morocco is vulnerable to agricultural shocks**; people have volatile and unsustainable revenues with no plan to face shocks as (1) they don't have enough access points for adequate, sustainable and regulated financial services, (2) they have

low financial skills, (3) they are illiterate, and (4) women don't contribute enough in the households' revenues. These conditions may imply dangerous social impacts, mainly: low living standards, early employment of children and migration to urban areas.

## Potential Solutions

According to CGAP's article "*The Role of Financial Services in Building Household Resilience,*"[7] resilience to shocks can be supported by affordable access to a range of financial services: mainly saving, credit and insurance in order to guard against shocks due to illness or poor harvests, for example. The article mentions "*financial services help households anticipate, adapt to, and/or recover from the effects of shocks in a manner that protects their livelihoods, reduces chronic vulnerability, and facilitates growth.*" However, this can be possible only if the affected person has good financial skills.

Thus, building on a detailed analysis of rural financial exclusion causes in Morocco, three different but complementary solutions should be implemented:

- **Implementing branchless financial access points**: Rural Morocco needs an affordable channel of adequate formal financial services to meet the population needs. Indeed, **banking agents and innovation in financial channels** represent a great alternative to reach this segment and provide affordable and tailored financial services.

  This solution will be supported by targeted financial education programs and transparent consumer protection framework.

- **Reviewing the microcredit law for adequate and tailored Microfinance services**: Rural populations need opportunities to create income-generating activities, alongside saving and insurance. Unfortunately, in Morocco neither the current legal status of microcredit institutions nor their scope allow to meet the rural population's financial needs. In other words, the Moroccan legal and regulatory framework does not allow microcredit institutions to collect funds or provide by themselves insurance products except if they operate as an intermediaries of banks or insurance companies. These binding conditions impede the microcredit sector growth at the expense of the vulnerable population needs. For this reason, legal adjustments are necessary to give rise to an **enabling Microfinance law that offers more flexibility and encourages innovation**.

  This solution will include non-financial services in the MFI's products.

- **Empowering women who are a powerful workforce in rural Morocco**: As is the case in several Middle Eastern countries, women in rural Morocco are, in general, dominated by men who are culturally expected to support their families financially. However, gender-based discrimination leads to poverty and vulnerability. **Empowering women by providing them with a comprehensive financial ecosystem** will unlock new opportunities, increase the resilience of rural households and bridge the gender gap.

  This ecosystem will include adequate collateral provisions, financial education action plan, expertise and assistance programs in addition to tailored formal financial services (credit, saving and insurance).

## Recommendation

Rural financial inclusion requires actions on the key dimensions (access, usage and quality) in order to achieve the ultimate goal. For this purpose, Bank al-Maghrib (BAM) should work together with the potential stakeholders on all the above-mentioned solutions. However, the

priority solution should **focus on developing an adequate financial ecosystem for rural women** combined with **microfinance reform.**

Indeed, as the first solution depends on the strategic orientation of the payment institutions'[8] business plans and their interest in rural areas, the recommended policy solution seems to be the most feasible given the national context and the commitment of BAM to promote women's financial inclusion as well as the good experience of microcredit institutions with women.

In Morocco, the context is positive for the implementation of gender oriented policies. Indeed, as part of the financial sector sustainable development roadmap, BAM succeeded last year to include as one of the sector's commitment "Bridging the gender gap." In this respect, the recommended policy will be an important opportunity to push the main potential stakeholders to work together in order to achieve a preexistent goal of closing the gender gap. Moreover, this national orientation is aligned with the priorities of international institutions, which will make it easier for BAM to bring external stakeholders around the same table to move toward the same target.

Furthermore, given the fact that Microfinance is a useful tool to emerge from poverty,[9] BAM and the Ministry of Economy and Finance (MEF) should pursue efforts toward reshaping the microfinance framework to overcome the constraints of the current microcredit law and to expand and strengthen its support to rural poor women. To do so, the targeted framework should focus more on the non-financial services of MFIs based on awareness programs, training about entrepreneurial skills, assistance and regular meeting with their clients to ensure proper usage of loans, saving and insurance. The framework should be supported by tax exemption or advantages for rural women.

Microfinance services will be an important component of the ecosystem and a driver of social and economic development by which women can be empowered to earn and contribute to the family expenses and improve the living standards of rural world.

In Morocco, some FSPs (like Microcredit institutions and Crédit Agricole Bank) have experiences related to providing their clients with packages that include financial services and assistance (including financial education programs, literacy programs, and advisory services) that can be considered as a pilot experience. The proposed solutions can build on the lessons learned from the above mentioned FSPs and set up a national network that enables sharing of practices and knowledge.

## Key Stakeholders and Implementation

The implementation of the policy involves a strong collaboration between several actors, within the central bank (BAM) and with external actors mainly: MEF, Ministry of Agriculture, Ministry of Handicraft, micro-credit institutions, banks, insurance companies, the insurance regulator and the Moroccan Foundation for Financial Education. In addition, international organizations will have an important role to play, especially for technical assistance.

As a first step, BAM and the MEF have joined their efforts and created a working group in charge of discussing financial inclusion issues and proposing solutions. Within this framework, BAM (particularly the Banking Supervision Department and the Payment Systems and Instruments Oversight and Financial Inclusion Department) and the MEF have already started their work on the microfinance reform.

Moreover, as designing an effective policy entails further quantitative and qualitative data collection, BAM collaborated with the World Bank and GIZ to conduct a national survey, that accounts for rural and gender considerations, and a benchmark study in order to get further insights about the policy's needs. The results should be available by the end of 2017.

The potential FSPs, especially MFIs and "Credit Agricole," will be involved in the whole process in order to:

- Learn from each other's experiences;
- Raise their awareness about the best practices and evaluate their needs in terms of capacity building; and
- Enable them to develop human centered products by organizing focus groups with women from different rural areas.

Building on the results of the survey, the study, the interactions with FSPs as well as the national and international experiences, the stakeholders will be able to implement an adequate ecosystem for rural women.

Moreover, the action plan will be supported by a clear monitoring framework that will be defined and shared with the key stakeholders including key indicators:

- **Monitoring the progress made by the working groups:** they will be asked to share with the central bank, periodically, their achievements and their next steps.
- **Pilot experience and sandbox:** with relevant indicators such as the evolution of saving by the woman beneficiaries from the program, access to credit for investment, insurance subscription by the beneficiaries, and other social indicators through surveys.

## Notes

1. The World Bank in Morocco (accessed April 05, 2017); available from http://www.worldbank.org/en/country/morocco/overview
2. National census conducted in 2014: 13.42 million people live in rural areas while the global population is 33.84 million.
3. Source: Unicef
4. Source: Central Bank's database
5. Urban areas have a coverage rate of 95% with 1 access point for 1 572 adults.
6. Conducted in 2013 by Bank Al-Maghrib with the collaboration of the World Bank.
7. CGAP, "The Role of Financial Services in Building Household Resilience." Accessed April 20, 2016. Available from http://www.cgap.org/publications/role-financial-services-building-household-resilience
8. "Payment institutions" have been created by the most recent banking law, number 103-12, as a means to take into account the development of new means of payment. Indeed, according to Art. 16 of this law, payment institutions can carry out payment services, including "the execution of payment transactions" using a mobile device.
9. Dr. Ashwin G. Modi, Mr. Kiran J. Patel and Kundan M. Patel, "Impact of Microfinance Services on Rural Women Empowerment: An Empirical Study," November 2014.

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Law N°18-97 in Microcredit.

# Easing Access to Financial Services to the Most Needy in Mozambique

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## Executive Summary

Today, only 35.7 percent of the adult population in Mozambique have access to bank accounts. This means that most Mozambicans are excluded from formal financial services such as: the means to transfer money from one bank account to another in order to pay for services and products; receiving credit to invest in valuable businesses and products that can improve their economic and social lives; access to saving products and services; and sophisticated saving products as investment in stocks or private pensions (Baxter and Allright, 2015).

This memo recommends implementing regulation to increase ease of access to bank accounts for low-income people in Mozambique. This can help low-income people in Mozambique to enjoy access to financial services that will ease the burden of unexpected financial shocks.

## Problem Context

**Financial inclusion in Mozambique is extremely low, particularly among the poor in rural and remote areas, and among micro, small and medium enterprises (SMEs).** Within this segment of people, some have never opened a bank account. For those who do have a bank account, charges and fees are relatively high for their economic status, and the fees are the same for all users, from individuals to big businesses.

According to Baxter and Allright (2015), high costs and fees are most likely due to a lack of competition in the market, as well as underdeveloped physical and institutional financial infrastructure. The World Bank identified other key causes in Table 1.[1]

**Table 1.** Reasons for Not Having a Formal Bank Account in Rural and Urban Areas

| | Too expensive | Having not enough money | Too far away | Do not know how | No trust | Lack of documents | Other |
|---|---|---|---|---|---|---|---|
| **Urban areas** | 14% | 31% | 14% | 11% | 8% | 11% | 11% |
| **Rural areas** | 20% | 19% | 19% | 14% | 12% | 11% | 5% |

Source: The World Bank (2014)

Another difficulty is a current lack of technological innovation for providing financial services to the rural poor, although some technology is in development. Nevertheless, the government of Mozambique is engaged in promoting financial inclusion, and its National Financial Inclusion Strategy (NFIS) has prioritized the expansion of access to financial services and increasing the number of users of these services, mainly through stimulation of bank and mobile money accounts and their effective use.

Recent statistics, produced by Bank of Mozambique reveal significant progress in Financial Inclusion and in bank accounts ownership in particular, as shown in Table 2.[2]

**Table 2.** Some Financial Inclusion Indicators of Mozambique

| | 2015 | 2016 |
|---|---|---|
| **BA** | 4,405,157 | 5,213,411 |
| **Mobile accounts (from mobile operators)** | 4,059,612 | 5,602,891 |
| **Adult Population with BA (15 years on)** | 31.1% (total of adult population 14,178,492) | 35.7% (total of adult population 14,606,766) |
| **POS and ATMs in each 100,000 adults** | 174.1 and 11.5 | 148.8 and 11.4 |
| **Mobile Money Agents and Bank branches in 100,000 adults** | 129.7 and 4.6 | 171.6 and 4.4 |
| **POS and ATMs in 10,000km2** | 256.2 and 19.2 | 318.1 and 21.1 |
| **Mobile Money Agents and Bank branches in 10,000km2** | 223.4 and 7.7 | 313.5 and 8.1 |

Source: Banco de Moçambique (2017)

In terms of bank accounts and mobile money accounts, the figures represent a proxy number, given that a person may have more than one account (both types). This implies that there are fewer people with bank or mobile money accounts than represented in this table. Therefore, my aim is to increase the number of people with bank accounts, to promote access to saving products and services and to receive credit to invest in valuable businesses and products. Currently, mobile money accounts only permit very small financial transactions and do not offer significant credit and savings opportunities, but they can play a great role in financial inclusion and ease of access to services.

## Proposed Solutions

The lack of bank account usage by Mozambicans can be resolved in many ways. However, this memo will focus on solutions under the aegis of Central Bank that can be implemented quickly. Possible solutions are presented as follows:

1. ***Building banking Infrastructure (branches, ATMs) in rural and remote areas*** resolves the problem of long distances to access financial services. However, it involves coordination of stakeholders, resources, long-term and costly projects.
2. ***Lessen the requirements for opening and using bank accounts and typifying them*** would entail eliminating and reducing the number of requirements that hinder a specific segment of people from opening and using bank accounts.
3. ***Expanding financial education activities*** to motivate people to open and use bank accounts and enjoy related financial services. Additionally, it solves the issue of people not knowing the procedures on how to open a bank account.
4. ***Promoting technological innovation and sandboxes*** to bring technological solutions to rural and remote areas where conventional banks do not currently offer financial services.

## Recommended Solution and Implementation Plan

This policy memo recommends lessening the requirements for opening and using bank accounts and typifying them to diminish the burden people experience when opening a bank account and accessing formal financial services. It presents the fewest constraints in terms of budgetary issues, stakeholders involved, and complexity.

My solution is divided into parts:

1. Create a policy that facilitates opening bank accounts for the people who currently do not have access to formal financial services. For instance, banks should not ask for more than one

type of ID or proof of residence; they should reduce the age requirement to 16 years old to open a bank account;
2. Reduce bank fees; and
3. Offer services that meet the needs of low-income customers.

To address the first consideration, we can look to comparable precedents. India, Brazil, Portugal, and Angola have gone through experiences of opening basic accounts. In 2014, India launched a Financial Inclusion goal to bank every household, as national priority. A census showed an increase from 58.7 percent in 2011 to 99 percent in 2016 of banked population (Datwani 2017). In terms of preconditions, the fact that there is a NFIS aiming to improve financial inclusion, the willingness and "go ahead" are already in place for facilitating access to basic accounts in Mozambique.

To implement the reduction of fees for low-income customers opening bank accounts, internal departments of the Central Bank (namely the Payment Systems, Market Conduct, Risk Management and Regulation and Licensing Department) will be engaged in a round table discussion. External entities, such as consultants will be included to provide technical support and commercial banks, to increase buy-in the idea and find a balanced solution that will not reduce their profit.

I lead a working group that addressed the final points: to provide services tailored to the current unbanked populations of Mozambique. The relevant regulation was approved by the board members in late May 2017. In its essence, this solution harmonizes bank fees across the commercial banks, standardizes the names of services, obligates banks to disclose prices and fees of services and products in a very clear way and gives fee exemptions for some bank services, including opening and closing banks account, accessing balance sheet of current accounts, depositing physical money or checks in any currency, obtaining a first debit card, SMS alerts within the country, canceling a check, transfers between accounts, and credit simulation.

The Ministry of Justice, Interior and Tax Authority will be invited in for some meetings in order to sensitize them with other related issues under their aegis. These external stakeholders are also referred in the NFIS, and its implementation will lay the foundation for a similar roll out of this policy.

The success of NFIS and an internal focus on providing better services to promote consumer wellness are integral to the participation of internal stakeholders. These participants will be essential to getting approval and drafting a new regulation proposal to start discussing it internally and with external stakeholders. A survey will also be conducted for the purpose of updating the study on the reasons for not possessing a bank account.

While this proposed policy is under the aegis of the Central Bank, this solution continues to pose challenges that will call for the consideration of other institutions. For example, there are issues not yet solved such as a lack of an electronic National ID information system that is opened for the use of all government institutions and weak interoperability between electronic information systems from banking, mobile money, financial and government sectors.

## Notes

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# Enhancing Georgian Households' Financial Resilience by Fostering Savings and Financial Education

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## Executive Summary

Lack of financial resilience, driven principally by low levels of financial literacy, a lack of disposable income and insufficient savings, constitutes one of the major challenges for Georgian households. To address this problem, policymakers and private sector stakeholders should focus on enhancing household financial capabilities by providing financial education, and, additionally, by encouraging the uptake and use of accounts that help households save and reduce vulnerability to shocks.

## Policy Problem

Despite the fact that the level of access to formal finance is not low in Georgia, the majority of Georgian households lack financial resilience. According to the National Bank of Georgia's 2016 Financial Literacy and Financial Inclusion Study, supported by the Development Facility of the European Fund for Southeast Europe (EFSE DF), 75 percent of the households are not adequately prepared for unexpected financial challenges, such as loss of employment.[1]

According to the Australian Centre for Social Impact, financial resilience means the "ability to access and draw on internal capabilities and appropriate, acceptable and accessible external resources and supports in times of financial adversity."[2] Financially resilient households have the knowledge and capacity to manage daily finances, plan for anticipated and unexpected expenses, and use financial services (savings, credit, insurance) wisely. Financial resilience, in turn, supports financial inclusion, and sustainable and safe financial market. Therefore, this policy concern is significant for NBG from multiple perspectives.

## Background and Analysis

Inadequate financial resilience, largely driven by low levels of financial literacy (especially rurally), lack of disposable income and insufficient saving, is one of the leading challenges for Georgian households

Georgia is a lower middle-income country in the South Caucasus with a well-developed financial sector. There are 16 commercial banks, over 80 microfinance institutions (MFIs) and 8 credit unions, with banks holding roughly 90 percent of the sector's assets.[3] Most of the population has access to basic formal financial services; according to IMF's 2016 Financial Access Survey, there are 1578 deposit and 942 loan accounts with commercial banks per 1000 adults.[4]

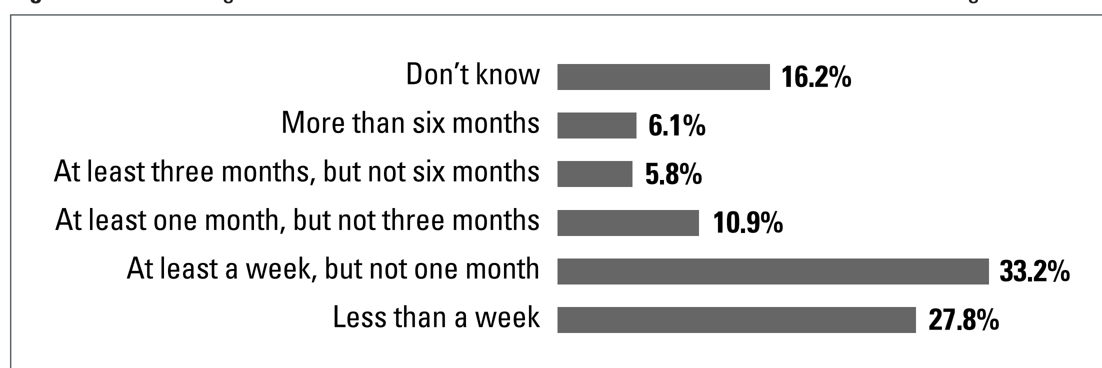
However, access to formal finance alone seems insufficient for building households' financial resilience. Households experience vulnerabilities to financial shocks: 75 percent of households are unprepared for unexpected financial challenges; further, 62 percent of Georgians faced a shortfall of income during the last year, and 45 percent borrowed to make ends meet, revealing absence of emergency planning.[5] Lack of planning is illustrated by other, relatively recent surveys too: according to 2011 ACT/SBFIC Saving Behavior Assessment Survey, only 14 percent of the population put money aside from monthly income, 76 percent faced unforeseen expenses, and 32 percent spent without making savings, relying on borrowing until payday—an

unsustainable emergency-management tool.[6] To note, NBG and the World Bank are currently working on Household Overindebtedness Study to better dissect household debt levels and its impact on financial resilience as well.

Household saving behavior is particularly alarming: over 60 percent of the population did not save last year.[7] Lack of savings, in turn, has been linked to irregular spending and lack of disposable income.[8] Most households save at home, which, as the consumer interviews conducted during the Fletcher Leadership Program for Financial Inclusion revealed, could be due to the importance of the accessibility of funds at all times—pointing to the abundance of emergencies, and lack of predictability.

Saving has proven to enhance households' resilience to financial shocks.[9] Those who save, longer withstand income shocks without borrowing.[10] However, the majority of Georgian households can do this for less than 1 month:

**Figure 1.** Time During Which a Household Can Withstand Income Shock Without Borrowing




Source: National Bank of Georgia

Unsurprisingly, saving at banks increases with the improvement of income and education levels.[11] Conversely, lack of financial literacy can lead to investing in unregulated, non-transparent companies, increasing risks of losing savings.[12]

Lastly, setting financial goals is uncommon for 41 percent of Georgians and only 29 percent feel somewhat prepared for retirement.[13] Further, goal-setters are mostly concerned with meeting immediate expenses, demonstrated by the list of the most widespread financial goals: covering loans (28%), buying food (25%), and paying for utilities (24%).[14] Again, those with higher financial literacy are more likely to set financial goals.

## From Causes to Solutions

As discussed above, the leading causes for the lack of household financial resilience are low financial literacy (especially rurally), insufficient savings, and lack of disposable income. Potential solutions can thus be grouped into following categories:

1. *Establish financial education centers (FLCs) country-wide,*, with programs addressing saving, risk mitigation, and other key aspects of household money management;
2. *Establish strategic partnerships with the private sector* (e.g., through working groups with commercial banks and fintechs) to encourage innovative solutions that help vulnerable households save and reduce exposure to shocks;
3. *Introduce/reform systems that enhance household financial resilience*, including, (i) introduction of deposit protection system to encourage financial stability, consumer trust, and growth in formal savings, and (ii) reforming the pension system to foster household preparedness and reduce retirement poverty;

4. *Introduce policies for alleviating poverty and increasing income levels* by fostering employment and entrepreneurship, among others.

Currently, the Government of Georgia, with the involvement of NBG, is working on developing Deposit Insurance system, and reforming the pension system.[15] However, lack of household income, and hence, the policies in , falls outside of NBG's authority.

Thus, this policy document advances as a priority solution.

However, to maximize FLC effectiveness, as a complementary policy, it is recommended for NBG to consider establishing private sector partnerships to encourage innovative solutions that help particularly vulnerable households save more and reduce exposure to shocks.

## Recommended Policy Solution: Financial Literacy Centers

This policy memo recommends establishing financial literacy centers (FLCs) countrywide to address the lack of financial literacy and resilience. FLCs with effective, targeted programs have improved financial knowledge and capabilities globally, and this experience can be replicated in Georgia.[16, 17]

As the financial supervisor, and leader of the National Strategy for Financial Education (NEFE),[18] NBG is well positioned to advance policies in financial consumer protection and education; in 2016, NBG amended financial consumer protection regulations,[19] and highlighted financial education as an integral part of a comprehensive consumer protection framework. Timing is also convenient: FLCs will complement other policies for financial resilience currently in development.

FLC programs that focus on saving, risk mitigation, budgeting, borrowing, consumer rights and other topics of household money management, must consider differences (including, socio-economic) between target audiences.[20] Further, while financial education interventions have demonstrated positive change in consumer knowledge, preferences, and actions, linking long-term behavioral change to financial education remains somewhat challenging.[21] Thus, to ensure FLCs' sustainable positive impact on household decision-making and behavior, it is recommended to use behavioral economics tools during research and development of programs.

Lastly, at FLCs, financial education (preemptive measure) can be offered in combination with debt counseling (corrective measure), since many households borrow during financial shocks, exacerbating financial pressures.

## Roadmap for Implementation

Firstly, NBG's Consumer Protection and Financial Education team should discuss FLC project internally with and gain support from relevant departments.

Next, to ensure support from relevant stakeholders and timely implementation, NBG should propose the project to the Steering Committee for NEFE—the most effective platform for launching FLCs. The Committee unites commercial banks, Ministry of Education, universities, and other private, public, and civil sector stakeholders, and NBG Governor is its Chairperson.

Establishment of FLCs entails: a) conducting research with human-centered design on household financial behaviors; b) developing operational guidelines and educational materials; c) training trainers; d) implementing M&E tools. Based on the discussions within the Committee, the Committee Secretary will draft an action plan, outlining each step, along with pilot project timeline, stakeholder roles, and budget.

FLCs do not require establishing new infrastructure, and can be built on existing systems, such as regional community centers. Thus, it is important to engage from the outset relevant stakeholders from outside of the Committee—local municipalities, universities and research centers, pertinent ministries—to ensure smooth implementation.

## Complementary Policies

Financial education alone may not be sufficient for promoting positive changes; it is also crucial to ensure access to low-cost savings accounts with design and marketing features that help overcome psychological barriers to saving, increase account take-up and use, and thus, improve financial well-being.[22] In Georgia, low-cost savings accounts are already vastly accessible for consumers; thus, as the next step, NBG is recommended to form partnerships with banks and fintechs to encourage private sector innovations for better take-up and use of saving accounts, especially by vulnerable populations. Working group activities can take form of hackathons, and NBG should bear in mind that implementation of innovative solutions may necessitate regulatory sandboxes.

Lastly, for better protecting household savings, authorities may consider policies restricting "pyramid schemes," and regulating all entities that attract funds from larger population. Further, although insurance falls outside of NBG's authority, it is recommended to research the possibilities for encouraging the use of insurance products against risks affecting household income and, ultimately, financial resilience (e.g., unemployment risks for salary recipients, or risks of natural disasters for agricultural households).

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7. At the moment, commercial banks and credit unions are the only licensed deposit-taking institutions in Georgia, and credit unions hold a negligible part of total savings.
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10. The National Bank of Georgia, the European Fund for Southeast Europe Development Facility, 27.
11. Ibid., 25.
12. In 2016, one Georgian company, not regulated by NBG, which was attracting funds from large segments of population and had an non-transparent business model, went bankrupt, leading many households to the loss of savings. The latter story once again highlights the importance of educating consumers about safe saving methods.
13. The National Bank of Georgia, the European Fund for Southeast Europe Development Facility, 33.
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16. Financial Literacy Centers developed in India with the support from the Reserve Bank of India and GIZ are an interesting example of such initiative.
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# Improving Savings Rate Among Poor Urban South Sudanese Through Enactment of Regulations for Microfinance Deposit-Taking Institutions

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## Executive Summary

South Sudan is the world's youngest country, which gained independence in 2011. The country underwent brutal war for decades that precluded the development of key infrastructure necessary for laying a solid foundation for a prosperous country. The financial sector is in its earlier stages of development and, therefore, access to financial services is very limited. The savings rate is one of the lowest in the region, due to a lack of appropriate financial regulations and a highly illiterate population, with only 27 percent who can read and write (Census, 2008).

***Many of the urban poor in South Sudan do not have access to appropriate and affordable financial services, making them vulnerable when faced with shocks like unemployment, medical care, and displacement due to conflict.*** The current financial institutions focus on providing financial services to high-income earners, with no appropriate financial products for most the population: the poor.

Evidence from multiple programs across multiple regions demonstrate that access to inclusive financial services benefits the poor. Financial inclusion enables borrowers to attain higher household incomes, increase savings rate, smooth consumption pattern over their lifetime and finally can diversify their sources of income generation. "Access to financial services also translates to greater social benefits, including improved health (better nutrition, better living conditions and preventive health practices, higher immunization rates); increased educational participation (children of microfinance clients are more likely to go to school, drop-out rates of these students are lower than average" (Murdoch et al. 2003).

This memo examines various possible policy options that could be instituted to make financial institutions provide saving products for the urban poor; the recommended policy is the enactment of regulations for microfinance deposit-taking institutions. This policy will compel microfinance institutions to provide key products like savings, micro insurance and money transfers, which currently are not necessarily offered by these kinds of institutions. The policy will inevitably allow many poor people access to savings products and therefore increase the national savings rate.

## Problem Statement

The urban dwelling poor are vulnerable to shocks due to a lack of financial inclusion in South Sudan.

## Context

Although the country has a total number of 23 registered commercial banks in operation, the financial system is South Sudan is relatively underdeveloped, with only 2.2 percent of the population having a bank account (Bank of South Sudan, 2015). The Gross Domestic Savings as a percentage of the GDP was estimated to be only 5.6 percent in 2015, with a slight improvement in 2016 to 17 percent (UNCTAD, 2016). This major jump could be attributed to the eruption of

the conflict in July 2016, which may have led to many people to reduce their investment plans and instead put their money in savings.

Household savings are important because they provide the funds to finance capital investment and serve as a buffer against shocks. Understandably, many countries with traditionally low saving rates are interested incentivizing growth in this sector. For example, Vision 2030, created by the Kenyan government, "encourages savings and investment by strengthening existing economic structures and instruments" (Vision 2030). "Governments, such as those of the Philippines and South Africa, are also actively promoting a strong savings culture in their countries"(Cronje' and Roux 2010).

The government of South Sudan does not have a clear policy on financial inclusion or on lifting a majority of the people out of poverty. Access to financial services is limited to urban areas, which leaves a majority of the people living in rural areas (84%) without access to vital financial services (Census 2008). This problem is compounded by the fact that non-bank financial institutions are not allowed to conduct money transfer services and microfinance institutions are not allowed to take deposits from the public.

Lack of appropriate savings products designed for low-income earners is also a major hindrance to the urban poor trying to access affordable and appropriate financial services. Many rural and urban poor are now forming informal saving groups to help them save and have a revolving fund that they can use to meet their emergency needs. However, they continue to lack the basic skills to operate these groups effectively, and, despite the fact that several NGOs have tried to address this knowledge gap, a lack of financial education persists.

Furthermore, the current political crisis in the country has caused a huge displacement of the population; many South Sudanese have crossed the borders to neighboring countries, while others are internally displaced. This has led to a contracting economy and caused huge rural-urban migration, putting pressure on employment opportunities in urban centers. In response, financial institutions have primarily concentrated their operations in the main city of Juba, leaving many other urban centers without any access points.

According to Guarcello et al. (2011), "Unemployment rate in South Sudan urban centers is 11.8% and 12.9% in rural areas. Unemployment is high among female in urban centers at 13.7% compared to males at 11.6%." This high prevalence of unemployment could partly be the reason why many people are not able to save—they do not have enough income. When people are unemployed, they cannot pay rent, school fees for their children, or even meet emergency medical fees in case of illness. South Sudan does not have a welfare program to address unemployment.

In addition, banks require every person opening a bank account to have a national identification card, regardless of the type of account one is opening. This has excluded a huge number of people from the banking services, as the issuing of national identification is centralized in the national capital, and traveling to obtain an ID card is cost prohibitive for a majority of the population.

Unfortunately, there are no studies done in South Sudan to unquestionably ascertain exactly why the urban poor do not use formal financial services. Most of these reasons mentioned here are speculative, based on my people-centered market research. I therefore intend to make further study to inform this policy.

## Potential Solutions

There are several potential solutions to help protect the urban poor against financial shocks, such as a loss of employment. The major challenge, the inability of the urban poor to save, can be improved via the enactment of microfinance deposit-taking regulation. In addition, there

is a need to enforce the current banking regulations so that commercial banks pay interest on savings on all savings accounts; this could incentivize the use of formal savings programs.

## Recommended Policy Solution

To improve the saving rates among the urban poor, ***this memo recommends new regulation for microfinance deposit-taking institutions.*** New regulations should allow the formation of low-tiered deposit taking financial institutions, which will target small business owners and people with low income as clients. The regulations will advocate for the use of other forms of identification than the national ID, as well as the use of biometrics for the clients of the microfinance deposit-taking institutions. Prior to finalizing the details of the regulations, a demand-side survey will be conducted among poor urban South Sudanese, to better understand why they rarely access and use formal financial services.

At South Sudan Microfinance Development Facility, we have the capacity to undertake this policy initiative as we have done before in preparing the South Sudan national Microfinance Policy (2012) and the South Sudan Microfinance Deposit Taking Bill (2011). The existence of a microfinance deposit-taking law and associated policies will bolster our efforts and ability to marshal the support of key stakeholders to come up with regulations for microfinance deposit-taking institutions.

## Key Stakeholders and Implementation

The South Sudan Microfinance Development Facility shall work in collaboration with key other stakeholders in the financial system, both in the public and private sector, as regulating a financial sector requires a robust consultation with all that will be affected by the proposed regulation. The South Sudan Microfinance Development Facility will also design and implement the demand-side survey to better understand why poor urban South Sudanese rarely access and use formal financial services today.

The Bank of South Sudan (BSS) will form the microfinance regulation committee and take lead in reviewing both the initial and final drafts of the regulations. The Governor of the Bank of South Sudan will sign the regulations. The Central Bank will be a partner in advancing this policy, as it is in the interest of the Bank that access to financial services is expanded for all South Sudanese.

The Microfinance Association of South Sudan (MASS), the association of all microfinance institutions in the country, will provide input for the regulation, shaping how the regulations will transfer MFIs into deposit taking institutions. They will also be consulted to determine best practices for implementing these regulations.

The Ministry of Justice will provide legal oversight in this process. This will ensure that the regulations are anchored within the existing legal frameworks and in tandem with other banking regulations.

Once we circulate the memo, we shall call for a stakeholder workshop that will discuss the need to regulate the Microfinance sector. We shall invite all the above-mentioned stakeholders as well as the donors and NGOs that are supporting financial inclusion initiatives in the country.

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# Promoting Savings and Credit Cooperatives for Rural Development in Mongolia

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## Executive Summary

Savings and Credit Cooperatives (SCCs) are non-profit financial institutions that fulfill the social and financial needs of their members through democratic management and collective decision-making. In rural Mongolia, virtually all businesses are small and medium enterprises (SMEs). The development of SMEs is crucial for achieving wider social-economic objectives, including poverty alleviation (Government of Mongolia, 2014). There is an absolute necessity to create a model to provide inclusive financial services by creating sustainable working environment for SMEs with the support of SCCs. Unfortunately, there aren't many SCCs operating in rural areas due to lack of policy support and inadequate SCC legislation. Thus, there is a need to request a policy grant for creating a savings and credit cooperatives model in order to reduce transaction cost of SMEs operating in rural areas and provide sustainable services related with financial inclusion. Implementing this policy would require revising the SCC's legislation, facilitating financial literacy programs for rural-area populations and employing capacity building program for SCCs in cooperation with international financial organizations such as World Bank.

The financial system will be established by issuing loans to SMEs through savings and credit cooperative, granting credit collateral guarantee to SCCs, supporting SMEs through their members, and accelerating SCCs growth in this sector. This will have an indirect positive effect on the rural development by increasing employment and improving the living standards of rural households.

## Background

Mongolia is the 18th largest and the most sparsely populated fully sovereign country in the world, and consists of *21 provinces*, 329 districts (soums) and 1568 baghs, or small administrative units. A typical "bagh" has a population of about 500–800 people. On average, each district administers a territory of 4,200 km$^2$ with about 5,000 inhabitants, primarily nomadic herders. Around half of the total population lives in rural areas.

The economic diversification of Mongolia is very narrow, with the mining and animal husbandry sectors contributing more than 70 percent to the GDP. Poverty levels in Mongolia are about 46 percent for the rural and 27 percent for the urban areas.

Over the last 10 years, the banking, mining and construction sectors developed rapidly. However, the growth didn't last long and faced a downturn. At the moment, banking sector dominates Mongolian financial sector with the 95 percent and the other institutions only with five percent. In 2016, the GDP was approximately 12–13 billion dollar (Mongol Bank, 2016).

## Problem

Even though 14 commercial banks operate in the country, only two of these banks have branches in all districts. There is no single bank that has branches in baghs. Due to issues related to the lack of financial literacy of rural Mongolians, lack of collateral, and also lack of fixed income, people have a tendency not to sustain their basic financial needs. ***In particular, nomadic and***

***low-income households remain vulnerable to harsh weather conditions in rural areas, which in turn cause significant financial hardship*** (FRC 2015).

## Underlying Issues

Why are rural families "poor" when they have a large number of livestock? There are a few reasons.

1. Animal husbandry in Mongolia is nomadic and solely based on extensive grazing under open pasture. As such, livestock production is highly dependent on weather and climate, and herders are reliant on the productivity of pasture land.
2. Rural populations are not formally educated in finance. Their understanding and knowledge of financial market and even private finance matters are very limited (FRC, 2016).
3. There are low rates of financial inclusion in Mongolia, especially in rural areas. In 2012, International Finance Corporation (IFC), a member of the World Bank group, commissioned market research to analyze enabling environment, and supply and demand prospects for SMEs in Mongolia. The study revealed that the financial inclusion is inadequate in Mongolia, despite the fact that financial inclusion indicators in Mongolia are high (IFC 2012). Savings and credit cooperatives(SCC)are the primary financial institution and play a vital role in increasing financial inclusion of low and middle-income individuals and resolving their social issues. However, while 280 registered SCCs operate in Mongolia, over 80 percent operate in the cities, leaving rural populations financially vulnerable. For more information on financial inclusion in Mongolia, please see Annex.

## Proposed Solutions

There are two potential mutually supporting solutions to address the above problem and underlying causes. First solution is to roll out improved financial infrastructure in rural areas via SCCs; and second one is to provide financial education to poor and low-income Mongolians in rural areas through SSCs. Because SCCs are vital non-profit, co-operative institutions that deliver financial and social services at the same time, they could be utilized to improve financial education and deliver fast financial services to the rural poor.

To do so, we do need to support and nurture newly created SCCs in rural areas. This could be achieved through policy support and opening up legislative environment to SCC input and participation. SCCSs should also be involved in the development of farming and SMAs. As the government of Mongolia has received loans from donor countries and international organisations, sizable parts of the loans could be allocated to ensure coverage of the herders or rural population through SCCs.

## Stakeholders

In Mongolia, there are three relevant state institutions, namely, the Ministry of Finance, the Central Bank of Mongolia and the Financial Regulatory Commission (FRC). These three institutions collectively regulate and coordinate the financial sector. The main objectives of FRC are to ensure financial stability, regulate financial services, enforce applicable legislation, protect the rights and interests of investors and customers, and maintain fair, orderly, and efficient market.

The Financial Regulatory Commission currently regulates over 2000 legal entities, except commercial banks. The FRC and The Department of SCCs are working with domestic and foreign experts on the SCC sustainability fund and determining how to create savings insurance structure.

The Central Bank, the Ministry of Finance, and the Ministry of Food, Agriculture and Light Industry will also be imperative in the development and roll out of a program to promote financial inclusion in rural areas, as well as in securing the approval of Parliament to secure the financing budget as soon as possible.

## Next Steps

Recently, the Government of Mongolia has approved an Agriculture sector development plan, as part of the domestic industry development plan. But the financing for this plan is still not clear yet. In the interim, SCCs could prove to be helpful in delivering positive results to issue employment support project and program loans.

Among the key next steps, I propose to:

1. Conduct a study and develop a report on making amendments to laws and regulations related to issuing loans through commercial banks to SMEs from a special fund.
2. Establish a model of savings and credit cooperatives in five regions of Mongolia, which will work to support SMEs and providing inclusive financial services.
3. The FRC will consider the opinions of stakeholders through discussions in the proposed amendment to SCC legislation. The goal is to have the approval of Parliament and the implementation of the revised legislation by 2018.
4. Establish SCCs in local provinces to reduce poverty, and to make contributions to the social and economic development of the province in the following ways:
   - Poverty and unemployment levels will be reduced;
   - Residents of each soum will have a mutual financial organization established by themselves;
   - It will be a good model to reduce poverty in other provinces;
   - Living standards of soum residents will be increased and improved;
   - Number of people engaged in SMEs will increase;
   - Citizens' social activity will improve;
   - Budget income of the province will grow; and
   - Positive thinking will be created.

The ultimate goal of this policy will be to reduce the vulnerability of those who depend on the animal husbandry sector to severe weather shocks and to improve productivity and security in rural Mongolia by enabling households to access formal financial services and accumulate savings. Savings are, in fact, the real determinant of financial inclusion.

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# Annex

**Financial Inclusion of Mongolia**

| No. | | Account | Formal Saving | Formal Borrowing |
|---|---|---|---|---|
| REGION AND COUNTRY | | | | |
| 1 | East Asia & Pacific | 69% | 36% | 11% |
| 2 | Europe & Central Asia | 51% | 8% | 12% |
| 3 | South Asia | 46% | 13% | 6% |
| 4 | Mongolia | **92%** | **33%** | **36%** |
| INCOME GROUP AND COUNTRY | | | | |
| 1 | High income | 91% | 47% | 17% |
| 2 | Upper-middle income | 70% | 32% | 10% |
| 3 | Lower-middle income | 43% | 15% | 8% |
| 4 | Low income | 28% | 10% | 9% |
| 5 | Mongolia (Lower-middle income) | **92%** | **33%** | **36%** |

Source: World Bank

# Agent Banking

# Agency Banking: Extending the Frontiers of Financial Services from Informal to the Formal: The Case of Savings Groups in Ghana

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## Executive Summary

The promotion of agency banking in Ghana with the issuance of Agent Guidelines in 2015 has not seen the envisaged benefits, which included, among other things, deepening financial inclusion and extension of financial services beyond the traditional branch-based channels to financial services agents. To date, only five banks out of 34 banks and one savings and loans company out of 37 have ventured into that space. The guidelines have been subjected to review, yet no significant changes were recommended. Banks have always stated that the economic returns of opening branches in remote locations are not justified. In the early 2000s, the Bank of Ghana tried to address this with a policy that required banks seeking to open a branch in the urban center to tie in a branch/agency in a rural area, but that unfortunately was not successful.

## Problem

Savings groups ("SGs") are an important informal financial mechanism used throughout the world, including in Ghana. A 2017 survey of savings groups in Ghana suggested that there are over 10,000 savings groups operating in the country, with over 261,000 members, a savings of over $2.7 million and loans of over $1.8 million (Table 1, SAVIX 2017). Fidelity Bank has been able to link only 375 savings groups (3.68%) out of the total savings groups reporting on the SAVIX. The share of other participating financial institutions have not been available. The lack of accessibility of formal financial services remains a significant barrier for savings groups in Ghana, as bank branches remain remote to the rural poor.

Despite the importance of savings groups for the rural poor, the sector faces some key challenges. Key learnings from a collaborative study by Barclays, CARE, and Plan International (2015) in Ghana, Kenya, Tanzania, Uganda and Zambia suggest that many savings groups want to link with the formal financial sector in order to access more credit, but are unable to given difficult access (i.e., distance from a bank branch), complicated products, or products that are not suitable for savings groups. In addition to these issues, the report noted several other constraints to and potential benefits of linking savings groups with the formal financial sector.

As per SAVIX, an information exchange portal funded by the Bill & Melinda Gates Foundation where the savings groups in developing countries across the globe voluntarily post financial and operational data; Ghana's reported data as at mid June, 2017 are as follows:

**Table 1**

| Item | Amount |
|---|---|
| No. Savings Groups reporting | 10,172 |
| Total membership of reporting SGs (households) | 261,417 |
| Total savings of SGs (US$) | 2,707,344.50 |
| Total Loans Outstanding (US$) | 1,799,500.23 |

In Ghana there are 42 different projects in respect of savings groups that report on the SAVIX exchange and these savings groups are facilitated by NGOs such as CARE International, Plan International and World Vision who also act as implementing agencies or collaborate with local partners.

## Potential Policy Solutions

Our proposed policy solution seeks to help link savings groups with financial institutions, so that they can: 1) be monitored by the formal sector; 2) gain access to additional loanable funds, which enables members' smooth consumption and to meet fees payment in between share outs without having to wait for share outs, and 3) better secure their funds.

In order to support savings groups' linkage with the formal financial sector in Ghana, there are several potential solutions, including:

- The promotion of innovative but less costly agency banking business models with service providers
- The orientation and capacity building for financial service providers to enable them design suitable products and services that properly align to the peculiar needs of savings groups
- Financial literacy and awareness programs for self managed savings groups that would also bring out the benefits of linking groups to service providers
- Continuous capacity building support in the management of the savings groups
- The promotion of viable business models for the savings groups sector to enable them be sustainable with or without donor support
- The development of proportionate regulatory and supervisory framework to guide the operations of savings groups.

## Proposed Policy Solution

To build on the existing enabling regulatory framework to effectively promote linkage to the formal financial ecosystem a bundle of solutions is proposed:

1. Orientation and capacity building for financial services providers to enable them design suitable products and services that properly align to the peculiar needs of members of the savings groups,
2. Promoting viable business models for savings groups sector to ensure sustainability with or without donor intervention or support.

## Modalities for Policy Implementation

- Technical Committee on National Financial inclusion Strategy (NFIS) will initiate and promote policy on linking savings groups at the launch of the Strategy and remain the major sponsor/facilitator for this agenda. This is because savings groups are considered an important vehicle to drive financial inclusion in the national strategy
- Financial services providers, through their association bodies, will institute measures to promote the national agenda in collaboration with the central bank
- These bodies will receive capacity building and training from donor/implementing agencies (CARE, Plan, World Vision) as well as other development partners such as the UNCDF and UNDP to enable them understand the operations of the savings groups to enable them design and align the financial needs appropriately
- Alongside, there will be a national financial literacy and awareness of the existence of savings groups, their operations and they role they role. This is to give assurance to the market and

allay any fears, inhibitions, mistrust they may have regarding the torchlight on their operations, as well as toward formal financial institutions

- Lessons learned from a possible study tour of Mexico will be modified and implemented to suit the local environment where necessary
- Once services providers have been adequately equipped through awareness and training, they in turn will be required to build capacity of the groups
- Service providers after being equipped through capacity building with the operations of savings groups and their peculiar needs should be ready now to reach out to the savings groups their agent network, providing total support to ensure sustainability of savings groups operations
- Once linked, these savings groups would have access to a full range of financial services beyond savings and loans, such as micro-insurance, and micro-investments (small value investments in government securities, pension schemes for small savers, etc.) for the benefit of its members

## Stakeholders

### Internal

- Supervision department responsible for microfinance institutions (MFIs);
- Financial Stability Department – has responsibility for market conduct;
- Payment Systems Department;
- Banking Supervision Department

Internal engagement will bring to the fore the activities and important role of SGs as one of the key drivers of financial inclusion and will help to collectively develop an in-house strategy on the best way to link savings groups to the formal sector to achieve a win-win situation. We shall brainstorm, looking at the existing regulatory environment, current challenges in the MFI sector against the Bank's objective in deepening financial inclusion and take a position on how to engage the external stakeholders.

### External

- Ministry of Finance (Financial Sector Division)
- National Insurance Commission
- National Pensions Regulatory Authority
- Securities & Exchange Commission
- Ghana Microfinance Institutions Network (GHAMFIN)
- Implementing agencies and facilitating agencies of savings groups
- Ghana Association of Banks
- ARB Apex Bank
- inCharge Global Access Network
- Mobile Money Operators
- Telcos
- Development partners interested in savings groups

For the external engagements, most of the proposed stakeholders are already members of the technical committee drafting the National Financial Inclusion Strategy so the plan is to leverage on that platform as they are aware of government's agenda on financial inclusion. This external engagement therefore is to partner with them for the successful promotion and implementation of the proposed policy solution to ensure a total industry-wide buy-in for the compliment of a full array of affordable and suitable financial products and services to the end consumer in savings groups in the poor communities. This is considered necessary for the implementation of the proposed NFIS when launched.

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Video presentations on SGs in Ghana by CARE International in collaboration with local banks (Fidelity Bank and GN and the Ministry of Finance)

# Promoting Branchless Banking and the Use of Agent Banking in the Rural Areas of Namibia

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## Executive Summary

Poor and low-income people living in rural areas of Namibia do not have access to formal financial services that are convenient, a situation that can be devastating in the face of shocks. This is largely because they are dependent on irregular and unstable income from subsistence agriculture. Even in cases where their children and relatives working in urban areas send them remittances to supplement their income and reduce vulnerabilities, subsistence farmers do not have easy access to necessary cash-in and cash-out facilities and cannot use mobile wallets to buy goods or pay for services. This proposal considers the promotion of branchless and agent banking in rural areas that can provide basic financial services to the rural poor as a potential solution.

## Problem and Context

One of the goals of the Namibia Financial Sector Strategy 2011–2021 is to promote improved access to financial services and products by all Namibians. As with many developing countries, the Namibian population can be divided between urban communities—comprised of fairly educated and high income earning individuals, who amongst other things enjoy relatively good banking, telecommunication and road infrastructures—and rural poor communities, usually characterized by dependence on irregular and volatile income from subsistence agricultural produce, lower literacy levels, poor education and less access to basic infrastructure.

FinScope Namibia 2011 found that 23% of surveyed households list farming as their only source of income. It further indicates that 76% of those households are engaged in subsistence farming on communal land. The dependence on subsistence agricultural yields irregular and volatile income, which affects the livelihood of rural people and renders them vulnerable to climate and health shocks, among ***others.*** According to the World Health Organization (WTO),[1] difficult access to health services, especially for the severely poor detract from Namibia's ability to reach the MDGs. Andongo and Deen-Swarray (2006) also identified dry climate as among the factors that have resulted in decreasing per capita revenues for the rural population.

***FinScope Namibia 2011 also found that rural households do not have access to formal financial services, including savings, loans and remittance services that are convenient, a situation that can be devastating in the face of shocks.*** The survey reports that the rate of financially exclusion is higher in the rural area than in the urban area and that 39% of the rural population is not financially served. Furthermore, many of the surveyed households also indicated that they had to travel between 1 and 3 hours to reach certain access points, including cash-in–cash-out points, demonstrating that necessary access facilities are not easily accessible to rural households.

The use of mobile money is possible in Namibia, given the existence of an enabling regulation (the E-money Regulation introduced by the Central Bank in 2012) and the fact that four operators are currently providing mobile money services, according to the Fourth Quarter 2016 Oversight Report of the Bank of Namibia. The country also boasts a high coverage rate of mobile telecommunication, which could be an enhancer of access to financial services for Namibians, including rural households. Budde research[2] analyzed market penetration rates in

Namibia's telecommunication sector and found a high level of access to communications technology, especially access and use of mobile phones, with mobile SIM population estimated at 102% in 2016.

Despite a high coverage of mobile telecommunication in the country, only urban-based citizens who are close to financial infrastructures can currently derive full benefits from the mobile money service. Often, rural low-income and poor people may have relatives working in towns, who can send them money to complement their income, but they themselves do not have easy access to necessary facilities, i.e., they have to travel long distances to reach cash-in-cash-out facilities. They also cannot use mobile money wallets to buy goods or pay for services, as this functionality is not currently available in Namibia. Agent banking is also not always possible in rural areas, as most rural traders (where they are available)[3] are not able to meet regulatory qualifying criteria. For example, entities that are mostly found in remote rural areas, such as faith-based and not-for-profit entities and NGOs (often the only types available), are not eligible to participate as agents.

Another factor adding to the complexity of extending financial services in rural areas is the confession by some mobile money providers, spoken to by the author, that financial service providers do not always consider the lower end of the market as their target market, given the lower margins involved. In fact, it is often believed that there is no money in rural markets, which creates a lack of interest on the side of service providers to serve those areas. This, in addition to other limitations discussed above, calls for the development of a customized and appropriate financial services strategy for rural areas, if Namibia is to achieve its objective of improving access to financial services and products for all its citizens.

## Potential Solutions to the Problem

Potential solutions to the above-identified problem are as follows:

1. ***Promote branchless banking in the rural area, especially the use of agent banking, through regulation that considers rural conditions and the specific set-up of rural areas.***

   The lack of access to basic infrastructure creates logistical challenges for banks and other financial service providers to operate in rural areas. Currently, mobile money providers tend to center their focus mainly on urban areas, as these areas are likely to be more profitable, i.e., these services are primarily targeting customers who are likely to have access to ATMs, as well as a wide range of proper retail outlets. This type of infrastructure is either non-existent in rural areas or located far from rural communities.

   The issue of infrastructure and location can be resolved with the use of agent banking as per the lessons from other countries, such as Kenya (Frydrych and Aschim, 2014), which demonstrates that even in areas where a lack of retailers is observed, other innovative ways of forming distribution partnerships that could play the role of agents could still be possible in rural communities. To do this in Namibia will require first reviewing the current regulatory guidelines and possibly amending them to accommodate the conditions and realities of rural areas, particularly in terms of available structures that can be used as agents. This may spark the interest of service providers to explore and tailor services for rural communities. A report by Standard Chartered on reaching the unbanked published in 2014 quotes the World Bank that one of the main reasons why Kenya is a success story is because the central bank allowed regulation to follow innovation by choosing not to impose onerous requirements on money agents entering into that business while ensuring oversight of the businesses at the same time.

2. ***Promote the use of mobile wallets to pay for services and buy goods in rural areas***

   Promoting and enabling the use of mobile wallets (without requiring cash) to pay for services and buy goods is a service that should be explored for the rural areas, as it will also mitigate the problem of rural people traveling long distances to reach the nearest cash-in-cash-out facilities.

   Effective promotion of this service to potential service providers will require improved availability of necessary information, including a compelling value proposition for serving rural areas. There is therefore a need to examine the behavior of rural consumers to understand how they earn their income and how they save and spend their money. This will assist financial service provider to tailor products for rural communities.

3. ***Promoting and supporting alternative (non-agricultural) employment activities in rural areas***

   A complementary policy that could add to the value proposition of serving rural households is the promotion of alternative, nonagricultural employment activities in rural areas to mitigate the effects of irregular and volatile income from subsistence agriculture.

   While Namibia has implemented a number of employment creation initiatives as part of its developmental agenda, the majority of these initiatives has been in urban areas. Rural areas (especially remote villages) have remained dependent on subsistence agriculture. There is a need for deliberate efforts by the country to develop rural areas by introducing initiatives offering alternative employment opportunities and enabling rural communities to have multiple sources of income. This will not only enable them to have more regular and stable income and be in a position to withstand shocks and improve their livelihood, but the increased economic activity would also stimulate the interest of financial service providers to serve them.

## Recommended Policy Solution

While all of the above proposed potential solutions are necessary and complementary, ***my priority solution is the promotion of branchless and agent banking in rural areas, via regulation that reconsiders requirements for rural setup given the type of available structures.*** This is mainly because this solution meets the following criteria:

**Capacity/feasibility**: The Bank of Namibia is the custodian of the regulation in question, and as such, it can amend regulation to reflect the proposed solution.

**Preconditions**: The regulation on branchless banking and agent banking exists already, while related activities are also already ongoing in urban areas. The only adjustment required is to cater regulation to rural conditions, particularly in regards to which entities can participate as agents.

**Evidence**: Elsewhere in countries like Kenya, branchless banking has proven to facilitate access to financial services, including access to remittances and other types of financial access, through innovations such as the M-PESA. Kenya has used a network of agents in this process (Standard Chartered, 2014). India is another country that employed formation of distribution partnerships where mobile money providers could team up with community business owners and other individuals as agents and where progress in serving rural communities is reported (Frydrych and Aschim, 2014). While there is also evidence that mobile money has not worked as effectively in some other countries, the intention of this proposed policy solution is to help rural households in Namibia get access to agent banking as a first step to encourage resilience in the face of shocks. This policy should ultimately pave the way for access to other types of financial services in future.

## Key Stakeholders and Implementation

Implementing this policy requires the involvement of relevant stakeholders, both within the Central Bank and externally. First, will be to raise awareness with relevant internal stakeholders to ensure buy-in into the proposed project so that it is included on the business agenda of the Central Bank. The buy-in from especially the Payment Systems and Banking Supervision Departments is particularly crucial in this process, as it will facilitate faster approval by the Management Committee of the Bank. An internal committee with these departments will thus be set up to work on appropriate modalities, including the exercise of reviewing the existing regulation and sell this as a package to the Management Committee for approval.

The Bank will also have to engage with different external stakeholders relevant to branchless and agent banking, to better understand why they are not developing agent banking networks in rural areas under the existing regulation. This feedback would shape the reviewed regulation as well as efforts toward awareness raising, buy-in, and partnerships with compatible external stakeholders. Relevant stakeholders include existing mobile money operators, other financial service providers, telecommunications regulatory authority, financial industry associations, the Ministry of Finance, and the targeted group (rural households and rural establishments that are potential banking agents). Other groups, such as consumer organizations, the media and regional councils, will also be engaged to help advocate for the policy.

The Bank will implement a baseline survey to understand the exact current situation and needs of the targeted population. It is proposed that the implementation of the policy be piloted first before rolling it out. The Bank will then monitor progress throughout the implementation process, using an appropriate monitoring tool. It will then do an evaluation after a year or two years to gauge the impact made by the policy.

## Notes

1. Accesses at http://www.aho.afro.who.int/profiles_information/index.php/Namibia:Issues_and_challenges_-_Progress_on_the_Health-Related_MDGs on 19 July 2017.
2. Accessed at https://www.budde.com.au/Research/Namibia-Telecoms-Mobile-and-Broadband-Statistics-and-Analyses on 28 June 2017.
3. There is sometimes a lack of trade centers in some remote villages.

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# Getting Money Transfer Services Closer to the Rural Zambian

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## Introduction

This policy memo looks at challenges faced by financial service providers in providing easier access to money transfer services for people living in rural Zambia. People in rural areas in Zambia often walk long distances to access money transfer services in order to obtain funds to smooth their consumption or address financial shocks. Zambia has a total population of about 15.5 million people[1] with 8.1 million people being classified as adults. According to the Fin-Scope survey carried out in Zambia in 2015, a majority (54.8%) of adults in Zambia live in rural areas. This means that a significant portion of the adult population in Zambia have insufficient access to the much needed formal financial services, primarily due to the physical remoteness of access points.

## Background

Most people in rural areas come from low-income households that have seasonal income, mainly from agricultural activities. These households are vulnerable to shocks such as sickness, funeral costs, and sometimes even hunger. In this regard, people in these areas often need immediate access to money transfer services to receive funds to address shocks or to smooth consumption. Despite the necessity of these services, people in the rural areas in Zambia (as in many other developing countries) do not have close access to formal money transfer services and often have to walk long distances to access them.

According to the FinScope Survey, while financial inclusion in Zambia has grown considerably, from 37.3 percent in 2009 to 59.3 percent in 2015, rural areas experienced less growth in comparison to urban areas. Further, a survey carried out by the Zambia Information Communication Technology Authority (ZICTA)[2] showed that "insufficient spread of pay points lead[s] to users having to travel long distances to access the services." The centralization of these services in urban areas has contributed to lower levels of access and usage of digital financial services in rural Zambia.

Given that close to 60 percent of the adult population resides in rural areas, there is a high demand for these services to improve financial inclusion in Zambia. It is against this background that this policy memo seeks to address the issue of the relatively lower levels of access points in the rural areas.

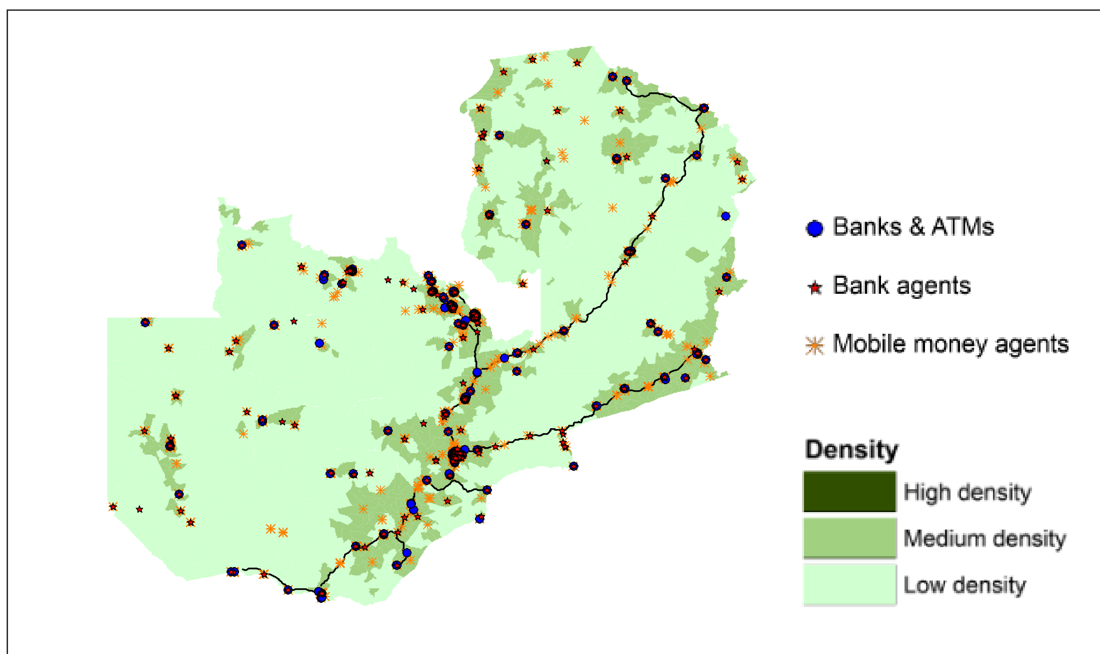
## Problems and Challenges

The Financial Sector Deepening Zambia (FSDZ), with United Nations Capital Development Fund (UNCDF), MIX Market and other stakeholders in 2015, made efforts to gather supply-side data on financial services in Zambia and made the following observations:[3]

- Most of the financial services were mainly along the main roads and the line of rail (urban areas);
- Mobile money agents had started penetrating the low-density areas; and
- Approximately 45 percent of all access points in Zambia are mobile money agents, and there was at least one mobile money agent in 75 of the 106 districts.

### Access points – Banks, ATMs, bank agents and mobile money agents[4]

The map below shows the spread of access points for Banks, ATMs, bank agents and mobile money agents.




This map reflects many primary challenges to financial inclusion for rural Zambians:

- **Low infrastructure development**
  One of the main challenges with providing more access points in rural areas is that of lack of infrastructure development in rural areas, due to associated costs.

- **Lack of national switch**
  Further, a lack of a national switch to facilitate interoperability has restricted access and usage of formal financial services. In contrast, countries such as Peru and Jordan have reported increased innovation and access to financial services through the implementation of national switches.

- **High cost of providing financial services in rural areas**
  The FinScope Survey of 2015 highlighted that "the reason for the low financial inclusion is the high cost of providing financial services, particularly in rural areas and to poorer populations. Furthermore, servicing poorer communities generally resulted in lower revenue for financial service providers given that poor households have limited investment opportunities and small transaction amounts."

- **Lack of mobile money agent access points (networks)**
  The mobile money service providers (MMSP) have struggled to create strong agent networks in rural areas, despite the current regulations having no restrictions on who can be an agent. The supply-side survey carried out by FSDZ, UNCDF and other partners highlighted that the mobile money agents sighted the following as challenges:
  - Low commissions – 40.3 percent of the agents
  - Lack of float – 32.4 percent of the agents
  - Lack of support from MNO – 20.4 percent of the agents

Similarly, an Agent Network Accelerator Survey[5] revealed that 63 percent of the mobile money agents were in urban areas, while 37 percent were in rural areas. The survey also highlighted the main barriers/challenges that agents face as follows (in order of priority):

- Lack of resources to buy enough float
- Lack of awareness of service among potential customers
- Irregular demand for services

- **High levels of agent exclusivity**
According to the survey carried out by the Helix Institute of Digital Finance/Microsave, Zambia has high levels of agent exclusivity (91 percent) compared to other countries in Africa. The report highlights that "high levels of exclusivity in a nascent market, especially when combined with dedication, put a lot of pressure on the provider and agents to achieve a critical mass of customers and transactions respectively."

- **Irregular/Low demand for services**
As highlighted in the survey carried out by Helix and Microsave, demand in the rural areas in many cases is seasonal/irregular. This has been compounded by the fact that the Zambian Government currently has not included mobile money as a form of payment for pensions, social welfare disbursements, health care and education service. These are services that are prominently used or accessed by people in rural areas.

## Potential Solutions

A number of solutions are possible as outline below.

- **Infrastructure development** – The country should increase mobile network coverage in the rural areas. The communications authority in Zambia is working to address this and is committed to putting up more towers.[6]
- Zambia is currency implementing a **national financial switch** to facilitate for interoperability, increased access to financial services and lower transaction costs. The national switch will include a module for mobile money services that will facilitate for interoperability between the MMSP as well as with the banks.
- **Incentives for financial service providers** – Offer incentives to financial service providers that offer financial service in rural areas.
- **Improve commissions for the agents** – the Central Bank should engage the MMSP on revisiting their commission structures and look at the possibilities of providing incentives for both agents and customers aimed at increasing the value and volumes of transactions.
- **Provide financial resources for agents** – provide resources for agents for their startup costs and their working electronic float. One service provider in Zambia has managed to build a strong agent network partly due to providing their agents with interest free support/facilities for startup costs and electronic float.[7] This is mostly done through external/donor funding.
- **Agent support by the MNOs** – MNOs should give the Agents the necessary support (training, branding, etc.) for them to run their businesses successfully. The central bank will be reviewing the electronic money directives in 2017 and should include a provision for agent support by the MNOs.
- **Increase awareness of service among potential customers** – increase awareness of services. The central bank has embarked on country-wide sensitization campaigns for the promotion of DFS. The campaigns began in 2016 and will continue up to 2019. Some of the campaigns will be carried out in conjunction with the MMSP.
- **Address high levels of agent exclusivity.** According to the Helix/Microsave report, MMSP should adopt a shared agent model, as this will increase the revenue and perhaps the motivation for agents. This will be particularly important for the agents in the rural areas. The electronic money directives issued by the central bank has a provision that prohibits exclusivity. The central bank should enforce this provision especially in rural areas so as to achieve critical mass for the agents.

- **Increase demand for services.** Demand in the rural areas may be seasonal/irregular. This can be cured through government adopting services such as mobile money for making pension and social welfare payments. Government should also allow for include mobile money to be used as a payment method for services such as for health and education.

## Recommended Policy Solutions

While all the potential solutions are important, ***my proposed priority solution is that of providing financial support for the setup of agent networks in rural areas.*** This financial support for agents in rural areas should come in the form of providing interest free facilities for startup costs and working capital. In the absence of donor funding, my proposal therefore is that the service providers be allowed to use the interest earned on the "trust accounts" to extend interest free facilities to agents in rural areas to help with the startup costs and working capital.

This has worked successfully with one service provider and can be replicated with the other mobile money service providers. The interest free facility will also act as an incentive for both the agents and the mobile money service providers to set up agents in rural areas, as it will reduce costs of providing these service in these areas. This should be done on a pilot basis before being rolled out to other areas once successful.

Currently the Central Bank determines how the funds on the interest account are used through directives (under the National Payment Systems Act of 2007) that were issued in June 2015. The directives require that the interest earned on the "trust accounts" be kept in a separate account and only be used on financial education activities that benefit the customer. However, it is more beneficial for customers at this particular time in Zambia to have increased access to financial services for people in the rural areas.

The Central Bank should therefore revise the directives to allow for interest earned on the "trust" accounts to be used for setting up agents in rural areas. The mobile money service providers and the banks that hold the "trust accounts" should extend and manage the proposed facilities. The central bank will prescribe how these funds will be accessed and paid back by the service providers but will not require all the service providers to access/extend the facility.

Further, the revised directives should require service providers to provide increased agent support. The service providers should also be encouraged to review their agent commission structure, with greater incentives for agents that set up in the rural areas.

The Central Bank should also enforce the non-exclusivity clause in the electronic money directives, especially for agents in the rural areas. This will allow for these agents to reach critical mass and also allow them to earn more commission.

Lastly, the Central Bank should work with Government and other stakeholders to increase demand for mobile money service by making pension and social welfare payments mobile. Government should also allow for mobile money to be included as a payment method for services such as for health and education.

## Key Stakeholders and Implementation

In the priority solution, the central bank will need to work with various key stakeholders by putting in place a working group comprised of the following:

- **The service providers –** do presentations and workshops with them to brainstorm on how to implement the recommended solution. Include the feedback into policy document.
- **Banks –** presentations and workshops to brainstorm on how the facility can be extended to the Agents.

- **Mobile Money Agents –** presentations and workshops to better understand their challenges and how the facility can be implemented
- **Customers –** survey, interviews to better understand their needs
- **ZICTA –** have a meeting to understand the network coverage in certain rural areas and the challenges faced.
- **Government –** Get buy in from the central bank executive for mobile money to be used for some government payments. The Executive should then lobby Government through meetings and presentations for it to adopt mobile money as a form of payment for some of its services.
- **Central bank –** who will be the drivers of the process. Approval by the executive will have to be obtained for the directives and policy to be implemented. This will be achieved through finalizing and presenting the policy document to the Supervisory Policy Technical Committee for their feedback after which the paper will be presented the Supervisory Policy Main Committee for consideration and approval.

## Notes

1. Population and demographic projections 2011–2035, Central Statistics Office of Zambia, July 2013
2. https://www.zicta.zm/Views/Publications/2015ICTSURVEYREPORT.pdf
3. http://finclusionlab.com/market-insights/zambia
4. MIX Market, Finclusionlab
5. http://www.helix-institute.com/sites/default/files/Publications/160126%20Zambia%20Country%20Report%20UNCDF%20Helix%20FINAL%20(1)_0.pdf
6. http://www.itwebafrica.com/telecommunications/155-zambia/233979-report-finds-fault-with-zambias-communication-towers
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# Cutting the Distance and Lowering Expenditures to the Access of Formal Financial Services in Rural Areas of Tajikistan

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## Executive Summary

This policy memo considers the lack of access to formal financial services for low-income populations in rural areas of Tajikistan, who face high travel expenditures to get remittances from formal financial institutions. As remittances start to play a substantial role in the economy of Tajikistan, the affordable and cost effective delivery of these services should remain accessible for a large portion of the rural population. Ipso facto, the governmental regulative body of the banking sector of the country must implement sound and reliable coverage policies to face people's needs, as remittance delivery is currently carried out only through formal banking institutions.

## Background and Policy Problem

Tajikistan is a post-Soviet Union, mountainous country located in the Central Asia Region with a population of 8.2 million, with 6.2 million people living in rural areas.

After the USSR collapsed, the country was faced with long-standing civil war that ended in 1997. The civil war negatively influenced social and economic growth and created high rates of unemployment. As a result, many people in rural Tajikistan started to seek jobs abroad. As of 2015, there are about 1 million Tajiks working abroad, mainly in Russia, who send remittance to their families. As a vast majority of the population (73.6 percent) lives in rural areas, remittance recipients are primarily rural Tajiks, located far from central financial infrastructure. In order to get remittances, people in rural areas have to travel to reach nearest banking institution's service point.

Over the past twenty years, Tajikistan's annual economic growth rate has stood at 7.0 percent, and the poverty rate decreased from 81 percent in 1999 to 31.5 percent in 2015. Labor migrants' remittances, and state capital investments, were the major sources of economic growth in the country. Other data further suggests that remittances are the primary source of income for low-income people in rural areas of Tajikistan.

Yet despite the importance of remittances for low-income populations, gaining access to these remittances can be challenging. According to World Bank Diagnostic Review of Consumer Protection and Financial Literacy in Tajikistan, physical access to financial services may be difficult, especially in rural areas, and consumer choice is limited or absent.

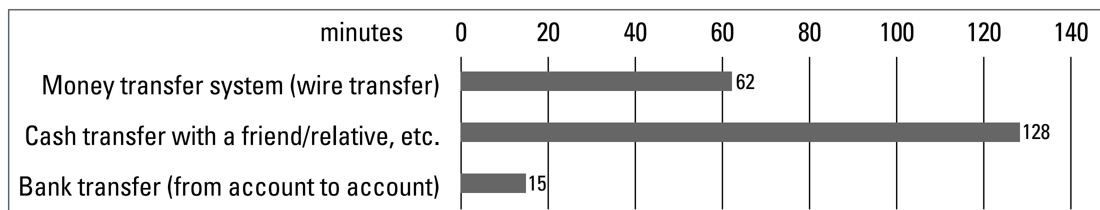
A survey by the Asian Development Bank shows that in order to get remittances, low-income people in rural areas face an average cost of travel to and from a bank of around $4.20, which represents 4 percent of real remittance income in rural areas.

One of the potential reasons for the high transactional costs is regulation. Due to regulation in Tajikistan, both international and domestic remittance may be delivered only through licensed banking institutions, which creates higher costs in rural areas. For example, a 2014 survey on Mobile Money Market Research in Tajikistan by Z-Analytics found that there are no facilities to make purchases, bill payments or receive remittances in rural areas of Tajikistan. To access these financial services, people in rural areas have to travel to the center of the district, spending extra money and time.

Another challenge is limited access to satisfactory banking services. The survey also found that only 41 percent of respondents were satisfied by banking services, whereas one-third indicated that the ATM or bank branch network was too small, and 28 percent noted that there is often no money in the ATMs. The survey also found that respondents' concern on cash withdrawal was not related to security (i.e., the risk of being assaulted while carrying cash) but rather to access to ATMs, bank branches or other points. This lack of access is significant, as, according to this survey, almost all families (98 percent) received money by using the money transfer system (wire transfer), 1 percent by cash transfer through a friend or relative, and another 1 percent through bank transfer. Nobody used mutual settlement or hawala and postal transfer.

The time cost of these various types of transactions is demonstrated in Figure 1.

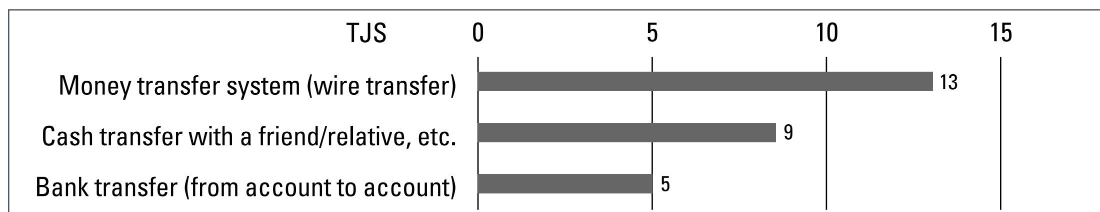
**Figure 1.** How much time do you devote to receive transfer? (Minutes)




(Mobile Money Market Research, Tajikistan, 2014. Study Report, Z-Analytics)

A recipient, on average, spends 13 TJS to receive money sent by wire transfer method, and 9 TJS if money is sent in cash with a friend or relative. The respondents from Khujand City (the 2nd largest city) reported that they have an experience in transferring money through banks with 2–3 percent fee.

**Figure 2.** How much do you usually pay to get the money (all expenditures)? TJS




(Mobile Money Market Research, Tajikistan, 2014. Study Report, Z-Analytics)

Figure 2 shows the percentage of additional costs relative to amount of money received. Again here respondents didn't consider the fees paid by sender or withdrawn from the amount: 33 percent stated that they have no extra costs to get money.

The research above suggests that, in rural areas of Tajikistan, the cost of financial services—especially for remittances—is high, primarily due to limited access to financial services. There is also a lack of financial literacy, as demonstrated by respondents' failure to consider hidden fees and other costs.

## Potential Solutions

There are several potential solutions to mitigate the hardship people face in rural areas of Tajikistan while receiving and sending remittances, to provide affordable access to basic financial services, to make social and municipal payments easy through payment channels and to motivate people start to use formal financial services provided by banking/financial institutions in the country.

- ***Introduce agent-banking service by guidance provision***, which allows banking institutions to incorporate with private sectors, such as entrepreneurships, small shops, and mobile

operators' service points in rural areas. This incorporation could enhance accessibility to formal financial services and cut the distance faced by people in rural areas and decrease operational costs for banking institutions incentivizing them expand their services;

- ***Strengthen consumer protection framework and promote financial literacy program,*** thus enhancing consumers' confidence in the financial services industry (banking system), increasing awareness of financial services, and promoting financial stability, growth and innovation.
- ***Introduce Mobile Money Services (MMS) by guidance provision***. Because Tajikistan has a high mobile sim card penetration, an MMS service in which the mobile phone is used to access financial services can be deployed rapidly across emerging markets as a key tool to further the goal of financial inclusion. MMS would provide opportunity to use a mobile phone in order to transfer funds between banks or accounts, deposit or withdraw funds, or pay bills.

## Priority Policy Solutions

In the context of the described problem to facilitate delivery of remittance in rural areas of Tajikistan, ***the recommended policy solution is the introduction of Agent Banking Services Guidance for banking institutions in the Republic of Tajikistan.*** This would require private to private partnership (P2P) between banking institutions that provide financial services, including remittance delivery services, and private institutions with networks of service points in rural areas (such as post offices, mobile operator's service points, and pharmacies).

Agent banking services is the latest innovation in banking services available in emerging countries and aims to provide formal banking services to the unbanked, including populations that have traditionally been inaccessible. Agent banking services must be provided by authorized banking agents. These agent points are much smaller than bank branches and are equipped with point of sales (POS) devices, mobile phones, barcode scanners, computers, and biometric devices. Agents also may be able to play a role in a services such as account opening, cash-in and cash-out services (including cash disbursement of bank-approved loans and repayment collection), payment and transfer services (including international remittances and person-to-person domestic transfers), and perhaps even credit underwriting. By reducing the overhead required to set up a bank branch and through its use of technology, agent banking allows financial institutions to reach underserved segments of the population, particularly in rural and remote areas, in a more cost effective way.

The Agent Banking Service provision would also help financial institutions to enhance awareness for usage of their financial services and products in rural areas, and improve country financial depth indicators, since it remains the lowest, with only more than 11% of adults having an account with at least one formal financial institution.

Hitherto, the primary challenge to implementing agent banking service in Tajikistan was the lack of legal framework. Fortunately, The National Bank of Tajikistan has developed the draft Law of the Republic of Tajikistan "on payment services and payment system" that was adopted by the parliament in 2017. This law was in accordance with the National Strategy for the Development of the Payment System of the Republic of Tajikistan for 2015–2025, which prioritized the creation of favorable conditions for the development of payment systems for financial inclusion.

There is a precedent for this type of policy implementation. The World Bank's 2017 study of the reforms and actions undertaken by Malaysia to drive financial inclusion highlighted Malaysia's experience with "agent banking," which leverages technology to provide financial services to under-served population.

## Implementation

As an authorized governmental regulative body of banking systems in Tajikistan, it is the National Bank of Tajikistan's (NBT) responsibility to promote financial inclusion in the country, and will thereby be instrumental in the implementation of this policy. According to the article 14.5 of The Law "On Payment Services and the Payment System," The National Bank of Tajikistan determines the rules of the payment system and organizes and monitors their compliance by payment system participants and payment infrastructure service providers. The next step is for the NBT to formulate the guidance for the agent banking services that will provide clear rules for the private sector on how to implement agent banking services in the country.

This should be achieved by conducting internal working group of stakeholders from related departments of NBT, the Departments of Payment Systems and Banking Supervision. External stakeholders should include identified donors like World Bank, IFC, and EBRD, who have ongoing projects within the National Bank of Tajikistan and can support best practices with the provision of consultancy services and running pilot projects. Once the internal and external stakeholders have reached consensus, the project should be presented to the Board of Directors of the National Bank of Tajikistan and registered in the Ministry of Justice to obtain a legal status.

For a model of implementation from Indonesia, see Annex.

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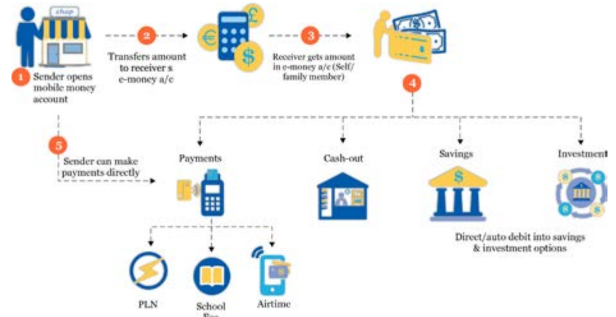
# Annex

## Examples of models that are tailored to the Indonesian context

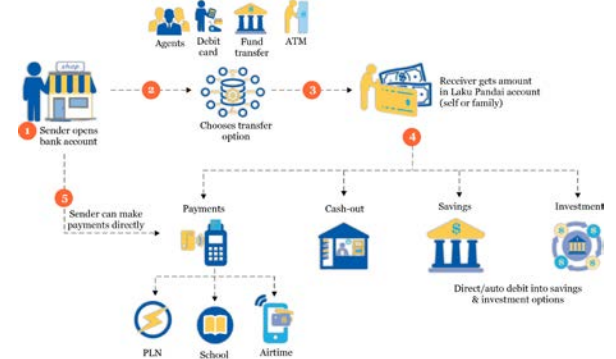
**1. Cross border Remittances Through E-money:**

First model enables the sender to remit money through mobile/e-money services. Both sender and receiver need to open a mobile/e-money account. Upon successful account opening, sender is able to remit money directly to receiver's e-money account. This model requires bi-lateral agreements between the operators within the remittance corridors. Telecom operators in West and East Africa have successfully demonstrated this model.




**2. Bank led International Remittance Model:**

The second model requires the sender to open a bank account and the receiver to open a Laku Pandai account (branchless banking account) to facilitate the remittance activity. This model offers a degree of flexibility by proposing several channels for the transfer: agents, debit card, fund transfer, or ATM.




**3. Direct Deposit to E-money or Branchless Banking A/c:**

The third model involves money transfer operators, Laku Pandai providers and a hub to link these two entities. This model maximizes synergies between providers in the remittance value chain. Unlike the first and second model, this model allows senders to remit cash through any of the existing agents of money transfer operator(s). Upon concluding the transfer, sender receives a money transfer code that is passed on to the receiver.

**4. P2P International Remittances:**

Requires senders to open a bank account and receivers to open a Laku Pandai account to enable the remittance facility. Just like model 2, sender has the freedom to choose medium of transfer through designated agents, debit card, fund transfer or ATM. TransferWise—a good example of this model– matches senders between two countries through its online remittance platform, without the need for money to cross borders.

These models have the potential to stimulate economic development of migrant communities, which is one of the key objectives of the Government of Indonesia. If implemented well, these models can lead to annual savings of USD 230 million for Indonesian migrant workers. Clearly, a win-win proposition that requires unified effort from all stakeholders.

Source: https://www.linkedin.com/pulse/unleashing-international-remittances-technology-driven-mohammad

# Infrastructure

# An Interoperable Payment Infrastructure: A Way Forward for Financial Inclusion

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## Executive Summary

Pakistan is a country of 200 million people living within an area of 796,095 $km^2$. Although 60 percent of the population lives in rural areas, the banking sector in the country is centered around urban areas, while rural areas are neglected. The tele-density in the country has improved gradually, currently standing at 73 percent[1], but the cost of operating brick and mortar structures in rural areas is very high, due to frequent electricity outages, a lack of road access, and the current law and order situation. While a bare minimum financial infrastructure is available to the rural poor, the existing system cannot serve the need of such a big population. Due to this non-availability of adequate payment infrastructure, the cost of financial transactions is very high.

This policy memo highlights the existing inadequate payment infrastructure in the country and proposes a central interoperable infrastructure that will connect existing payment systems. The regulator will take the leading role in directing the banking sector toward adopting an interconnected payment infrastructure to promote cost-effective payments. This can be achieved through increase in the electronic government and private sector payments, hence reducing the cost of transaction by achieving economies of scale.

## Problem and Context

The people in Pakistan using financial services, particularly the rural poor, incur high transaction costs for financial transactions, primarily due to limited access to financial infrastructure.

Within Pakistan, there are 42 banks[2] and 11 microfinance banks that provide financial services across country. According to the Findex Data of Pakistan for 2014, only 13 percent of Pakistani adults have a formal bank account, and less than 5 percent of women are included in the formal financial sector (compared to South Asia's average of 37 percent). More than 100 million Pakistanis are unbanked, accounting for 5% of the world's unbanked population. In addition, 27.5 million of Pakistani adults mention distance as a barrier to opening a financial account with a financial institution.

The State Bank of Pakistan's (SBP) Branchless Banking Regulations[3] in 2008 paved the way for non-bank agents to provide the banking services to customers, but the payment infrastructure is so inadequate that the branchless agents cannot adequately meet the needs of rural Pakistanis. Similarly, the use of digital financial instruments is also very low. For instance, only 2.9 percent of adults in Pakistan have a debit card and only 1 percent of adults use them to make payments, whereas neighboring countries' averages stands at 8.5 percent and 9.6 percent respectively. Moreover, only 1.4 percent of adults use an account to receive wages and 1.8 percent of adults use it to receive government transfers in 2014. The reason may be attributed to the high KYC requirements for bank based accounts, like debit and credit cards.

Low KYC accounts in Pakistan help to address some of the disparities in financial access, as Pakistan is a regional leader in the adoption of low KYC accounts. For instance, 6 percent of Pakistani adults have mobile accounts, compared to South Asia's average of less than 2.6 percent.

Due to non-availability of adequate infrastructure in the form of acceptance points for Mobile Accounts (m-wallets), the only recourse is using the OTC for the purpose of transfer and cash-out, as is seen below (Table 1).

**Table 1.** Payment Infrastructure[4] in Pakistan

| Description | 2017[5] |
|---|---|
| Number of Agents | 368,738 |
| No of Bank Branches | 13,9263 |
| No of ATMs | 12, 515 |
| POS Machines | 52,854 |
| Cellular Subscriber (millions) | 1341 |
| 3/4G users (millions) | 361 |
| Plastic Cards (millions) | 37 |

The central bank is currently working on National Financial Inclusion Strategy[6] (NFIS) 2015, developed in coordination with the World Bank. The strategy leverages on the existing infrastructure, currently operating in silos, but which have the capacity to interconnect with other systems and build a financial ecosystem. Adapting existent infrastructure is pivotal, as the development of new infrastructure is currently cost-prohibitive.

Countries like Jordan,[7] Peru,[8] and Tanzania[9] have leveraged their existing infrastructures by creating interconnectivity among various systems and to increase the ubiquity of infrastructure, which ultimately reduced transactional costs for the customer. In the case of implementation of JoMoPay in Jordan, centralized infrastructure operated by the central bank will interconnect the ATM Switch, POS Switch and bill presentment, paving the way for a new digital ecosystem.

The Hawala[10] literature also highlights that the remittance system is dominating the conventional banking system, primarily due to the high transaction costs of formal banking when compared to the informal banking structures.

## Possible Solutions

1. Develop Centralized Interoperable Payment Infrastructure
   The development of modern and robust payment infrastructure is one of the major strategic goal of SBP Vision 2020.[11] The State Bank of Pakistan has already implemented a high value payment system (Real Time Gross Settlement System – RTGS) since 2008 and thus already has the capacity to develop and run such infrastructure. There are few infrastructures being operated by the private sector in the country already like 1LINK (*ATM Switch*) and NIFT (*clearing house*).

   A centralized infrastructure, if developed, will interconnect existing and future Payment System Operator (PSO) and Payment Service Provider (PSP), such as ATM Switch, POS Switch, E-Commerce Gateways, and the branchless banking agents, while complying with international standards and best practices so that the centralized infrastructure is scalable to cater to the future needs of transactions. The new centralized infrastructure will also enable Government to Person (G2P) and Person to Government (P2G) payments, thereby increasing the annual tax revenue and help push up tax to GDP ratio. This will also enable interconnectivity with regional switches (GCCNET Consortium of five Arab countries where a significant Pakistani population works and sends remittances)[12] for regular remittance transfers in cost effective ways, thereby discouraging Hawala.

   The proposed centralized infrastructure can be built, operated and then transferred to the private sector at a later stage once it achieves maturity. Further, the buy-in from relevant stakeholders (including the central bank, commercial banks, microfinance banks, Telco service providers, and other relevant regulatory authorities) is also required to make it a success. The stakeholders are already involved with the State Bank of Pakistan under NFIS implementation, through various working committees.

2. Develop E-Money Framework (for non-banks)
   Introduce regulatory changes to allow non-banks (E-Money) to provide financial services, thereby increasing competition among existing financial service providers (commercial banks and microfinance banks).

3. Develop Consumer Focused Product
   Encourage financial institutions to develop products, including savings, insurance, and investment services, to incentivize people to keep their money in the system, rather than immediately cashing out and increasing digital liquidity in the system.

4. Create Awareness/Financial Literacy
   Develop financial literacy among masses for using wallets rather than OTC for transactions thereby increasing digital liquidity.

## Recommendations

The author proposes to achieve reduction in financial transactions through deploying a central hub of interoperable infrastructure that will interconnect various payment systems, such as ATM switch, POS switch, E-Commerce Gateway, and Remittance Gateway. This will increase the interconnectivity among systems that otherwise are operating in silos, including branchless banking agents, and will increase access points, such as ATMs, POS, Internet connection points, and branchless banking agents, for general public that will facilitate financial transactions among disparate systems. The usage of such systems, which are otherwise underutilized, will provide economies of scale through the increased number of transactions, thereby reducing per-transaction cost and providing convenience and cost effectiveness to the rural poor of Pakistan.

Legal changes will not be required to deploy the centralized infrastructure, as Payment Systems and Electronic Fund Transfer Act[13] (PSEFT Act 2007) gives broader powers so that SBP "may generally in respect of this Act, or in respect of any particular provision of this Act, or generally in respect of payment systems, the conduct of all or any of the Service Providers, Operators of Payment Systems or issuers of Payment Instruments, issue such rules, guidelines, circulars, bye-laws, standards or directions as it may consider appropriate" The policy will be enabling in the start whereby all the stakeholders will be encouraged to join the initiative. To establish the proposed interoperable infrastructure, a policy forum will be established to take onboard the relevant entities who can contribute toward the development of an interoperable infrastructure. The central bank will take the lead to facilitate the dialogue among the stakeholders. Moreover, the central bank will also create an enabling environment and also consider the regulatory changes, if required.

However, if the desired goals are not achieved, the other course of action may include mandatory participation by the banking industry in the initiative and the regulation may be prescriptive.

The key stakeholders initially will include SBP internal departments, existing Payment System Operators/Payment Service Providers (PSO/PSPs), commercial banks, microfinance banks, Telco service providers, Pakistan Telecommunication Authority (PTA). A few more relevant parties may be identified during the course of implementation.

## Implementation

The implementation of the central interoperable infrastructure will be initiated with the development of proposed Guidelines/Regulations/Framework for centralized interconnectivity switch. The concerns on the framework of all the relevant stakeholders will be addressed through joint task force. Once approved, the proposed recommendations will be communicated to the stakeholders formally through series of Circulars and Guidelines from the central bank.

The implementation of deploying centralized infrastructure is going to be a multi phase project. The business feasibility (business requirements, functional specification) will be developed while incorporating the feedback obtained from the relevant stakeholders. The technical implementation will follow once business feasibility is finalized.

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