Promoting Financial Inclusion through Innovative Policies

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Summary of Proceedings

I: Overview

(i) Introduction

This workshop on "Promoting Financial Inclusion through Innovative Policies" was jointly organized by the ADBI, Asia Pacific Economic Cooperation (APEC), APEC Business Advisory Council (ABAC), and the Alliance for Financial Inclusion, in collaboration with the Foundation for Development Cooperation (FDC), the Inter-American Development Bank (IDB), and the International Finance Corporation (IFC). The event included a half-day field trip to the Japan Finance Corporation Micro Business and Individual Unit, Toyota Tsusho Corporation and PlaNet Finance Japan.

Since around 60% of Asian households do not have access to formal financial services, a more inclusive financial sector could play an important role in poverty reduction, the overarching goal of the ADBI and the ADB. Evidence shows that financial access supports economic efficiency, distributional equity, and even financial stability. Also, in unstable times like the present, financial inclusion can support social cohesion.

"Microfinance" is a powerful instrument for improving financial inclusion. This is why both ADBI and ADB have long been active in microfinance activities. In partnership with the Tokyo Development Learning Center, the ADBI has been offering a Microfinance Training of Trainers Course since 2005 to strengthen the institutional capacity of microfinance in the Asia-Pacific region. In addition, in recent years a number of events have been organized, including a 6th Anniversary Conference on Microfinance in Asia; a workshop on Microfinance Delivery in Asia in 2004; and a Japan Microfinance Symposium in 2007.

The ADB started its microfinance operation in 1988 with an NGO Microcredit Project in the Philippines and, in 2000, adopted its microfinance development strategy that aims to promote access to institutional financial services for the low income households and their microenterprises. The strategy focuses on i) creating a conducive policy environment, ii) developing financial infrastructure, iii) building viable institutions, iv) supporting pro-poor innovations, and v) supporting social intermediation.

Through this strategy, the ADB has been providing loans to microfinance projects and technical assistance to build microfinance capacity in many developing countries. As of last May, its total microfinance portfolio was US$1.7 billion, covering as many as 14 developing countries in the region. The ADB is also a member of the Consultative Group to Assist the Poor or CGAP and has provided some regional technical assistance to extend CGAP's outreach and played an active role in the peer reviews.

(ii) Developments in microfinance

Microfinance originated in Latin America almost 40 years ago, and the growth of the early microfinance institutions (MFIs) was funded largely by grants and soft loans from donors. The focus in these early years was on providing working capital to urban microenterprises. And while the market penetration of microfinance is small compared with potential, the microfinance industry has witnessed remarkable growth and improving profitability. This has increased microfinance's attractiveness to financial institutions and investors, and has changed views on its viability. Information technology has clearly been a key factor in the transformation of microfinance.

Today, microfinance services have expanded beyond microcredit to include also savings, insurance and money transfer. Microfinance services are not only provided by MFIs. Private commercial banks have also entered the market and started providing a growing share of the funding to the sector. They are attracted by microfinance's attractive risk/return profile and its status as socially responsible investment.

Microfinance is moving from being about specialized institutions towards being about specialized products that can be offered by many types of financial institutions. Some MFIs have been diversifying their funding sources, and others have been commercialized and integrated into the financial system.

Financial inclusion is not just an issue for developing countries. Many of the increasing number of migrants based in developed countries also suffer from lack of access to formal financial services. Financial inclusion is particularly relevant for migrants' remittances (for which the World Bank estimates the global market at $270 billion), and also for other financial services like loans, insurance and investments.

More and more countries have also developed national microfinance strategies. According to a CGAP report, 36 countries now have such strategies with two-third of them in Africa. The government can play a supporting role by providing an enabling environment, including an appropriate regulatory framework that facilitates entry into microfinance industry while maintaining proper consumer protection and fair competition among providers.

(iii) Alliance for Financial Inclusion (AFI)

With the objective of advancing the financial inclusion agenda, AFI was established in September 2008. It is managed on behalf of its members by GTZ GmbH, with funding from the Bill & Melinda Gates Foundation. AFI is a global network of policymakers in developing countries whose roles are: (i) facilitating dialogue and co-operation among policymakers in developing countries to share and develop their knowledge of cutting-edge policies; (ii) providing policymakers with grants to develop and implement their chosen solutions; (iii) connecting policymakers with the right partners across the value chain; and (iv) keeping members up to date with the latest authoritative research from around the world, supported by research commissioned by AFI and its members.

Knowledge of the solutions to the challenges of financial inclusion is scattered across the globe. So AFI undertook a major study which identified a number of "solutions" for facilitating greater access to financial services – agent banking, mobile banking, diversifying providers, reforming public banks, financial identification and consumer protection. These solutions were the focus of discussions of the more than one hundred workshop participants.

II Financial inclusion solutions

(i) Agent Banking (or "Branchless Banking")

Innovative policies and regulations can facilitate partnerships which enable non-bank agents to provide distribution outlets for financial services, agents like post offices, retail commercial outlets, lottery kiosks, pharmacies. To promote this scheme, regulation needs to be "proportional" to allow agent banking to progress within reasonable level of risk for the involved parties.

In **Russia,** the Russian Post earns 46 percent of its revenue from financial services through its network of 42,000 post offices -- 29,500 in rural areas and 12,000 in villages with fewer than 500 people. By contrast, the majority of bank points of service are concentrated in cities with a population of at least 50,000. Post offices are used for domestic and – to a lesser extent – international money transfers, for accepting payments and paying out pensions to people without a bank account. The Post pays out 23 million pensions (60 percent of total pension payments in Russia) with an annual volume of US$ 30 billion.

This agent banking is helping Russia overcome the legacy of central planning in terms of an underdeveloped banking infrastructure. Prior to 1990, there was no banking. Today, the share of the unbanked population is at about 45 per cent of the population. Branchless banking is proving to be a cost-efficient way of improving financial access – particularly for lower income Russians living in the country's many vast and sparsely populated areas. It is very useful at the present time as the banking sector is also being adversely affected by the financial crisis, with many branches now closing.

In **Mexico**, it is estimated that only 25 per cent of Mexico's adult population has access to financial services, and the number of branches throughout the country is below international standards and unevenly distributed around the country's states. To enhance access to financial services, banking agents are being established at about 3,000 retail outlets of various commercial store chains. This new initiative significantly increases financial services' access points and lowers transaction, particularly transportation, costs.

(ii) Mobile Banking

There are over 1 billion people in emerging markets today who do not have a bank account but do have a mobile phone. Mobile technologies and services can facilitate access to financial services, such as cash deposits and withdrawals, third-party deposits into a user account, retail purchases, over-the-air prepaid top-ups using cash in the user's account, transfer of cash or airtime credits between user accounts and bill payments. Mobile phone banking presents challenges to regulatory capacity, as it cuts across various regulatory domains including banking, telecommunications, payments systems and anti-money laundering.

Cambodia provides an inspirational mobile banking initiative in the form of "WING", a mobile phone enabled payment service that allows customers and businesses to transfer, deposit and withdraw money between each other via their mobile phones at low cost. Launched in January 2009, WING currently has more than 150 points of representation in Cambodia, and is represented in 16 of the nation's 24 provinces. Primarily focusing on the under and un-banked of Cambodia, WING customers are garment workers, and other rural customers who have traveled to Phnom Penh and other urban centers for work (approximately 80% of the Cambodian populations are in rural areas, and 35% live beneath the poverty line). WING payment service provides them with a safe, affordable and fast way to transfer money to their relatives who rely on this remittance flow for education, housing and other staples. In urban centers, WING has focused on the large student population, providing them the convenience of person-to-person transfer and airtime top-up.

One of the challenges WING faces is the low penetration rate of mobile phones. There are only about 4 million mobile phones in a country of 14 million people. This led WING to design the product in such a way that it can be used on village or shared phones in a secure manner. There are only about 500,000 bank accounts, and about 200 ATMs in the entire country. So WING decided to partner with micro-finance institutions to expand its cash-in and cash-out network.

Mobile phone banking has proved to be a powerful tool for financial inclusion in the **Philippines**, another country with a high proportion of the population without access to formal financial services. In the Philippines, the mobile phone industry serves all income groups, with more than 60% of the population having mobile phones. Smart Communications and Globe Telecom are the leading telecommunications companies in the Philippines and have respectively the following electronic money products "Smart Money" and "G-cash". There are now 8 million users of the e-money products Smart Money and G-cash, and a substantial growth in banks offering mobile banking.

The initial policy approach was to allow the market to develop, and innovations to take place, proceeding with flexibility but caution. It was also important to understand fully the operating/business models and identify all risks and necessary risk management. Developments have been monitored and the regulatory approach adopted has been based on the experience and lessons learned. While e-banking and e-money require appropriate regulation, proportionate regulation is necessary to avoid stifling innovation and to allow the market to grow.

The **Mobile Money for the Unbanked** (MMU) program is an initiative which works with mobile operators, banks, microfinance institutions, government, and development organizations to encourage the expansion of reliable, affordable mobile financial services to the unbanked. It is supporting 20 projects in Africa, Asia, and Latin America with the ultimate goal of supplying 20 million unbanked people with mobile financial services by 2011.

(iii) Diversifying Providers.

Regulatory reform can lower barriers for start-up institutions and the development of various financial products geared to low-income clients. Policy instruments must be designed to promote new entrants without distorting the market.

Following several stages of regulatory reform, the **Ugandan** microfinance industry is now well integrated into the financial sector. Within about 20 years, clientele has increased from below 300,000 to over 3.5 million. Adaptation of international best practices and stakeholder cohesion, including through the Association of Microfinance Institutions in Uganda (AMFIU), have mutually reinforced each other to accelerate industry growth. Since 2002, government withdrew from being a direct provider of microfinance and has been providing enabling environment for private sector microfinance to grow.

Microfinance retailers in Uganda currently range from commercial banks to Tier 2 credit institutions, micro deposit-taking institutions, savings and credit co-operatives, NGOs and private companies. While the challenges of modest outreach, limited product variety and high pricing/costs remain, the microfinance industry continues to facilitate access to financial services for the low income people in a significant way.

In **Indonesia**, deregulation has opened opportunities for microfinance, a necessary development in a country where most households and microenterprises have only limited access to financial services. The Indonesia microfinance sector is characterized by a very large number of providers from banks to non-banks like savings and loan cooperatives, pawnshops, multifinance/leasing companies, non-bank co-operatives and money lenders. A key element of the government's microfinance strategy is rural bank development based on regulation and supervision improvement, human resources capacity building and infrastructure building. The objective is to enhance rural banks to become stronger and more efficient supported by sufficient capital to give better and broader services.

In **Cambodia**, microfinance is perceived as the most powerful tool against poverty and in support of development in rural areas. It has developed rapidly, with mobile banking doing better than ATMs and Internet banking. As discussed above, Wing created a mobile banking operation in Cambodia, whose main focus are low income households. The Financial Sector Development Plan for 2001-2010 focuses on rural finance in light of the inability of commercial banks to reach the rural poor and the need for financial services to improve living conditions in rural areas.

Microinsurance can help low-income people manage their risks effectively. If mircocredit provides the poor their present financial needs, microinsurance will provide their unexpected and future financial requirements. However, according to the Microinsurance Centre, only 3% of the world's low income population is covered by formal microinsurance. Regulators and supervisors in emerging market jurisdictions have little experience or empirical data to support their role in creating an "inclusive" insurance market that works effectively for the upper as well as the lower income segments. Increasingly, however, supervisors and other microinsurance promoters (such as insurers, governments, donors, consumer lobbies) in many of these jurisdictions realize that a more conducive and enabling regulatory environment is required for the development of microinsurance. Many initiatives are aimed at adapting laws and regulations which support the evolution of more inclusive insurance systems by encouraging existing insurers to serve low-income segments or by allowing microinsurers to evolve and integrate with the formal insurance sector.

In the **Philippines**, the government's National Strategy for Microfinance highlighted the need for microinsurance, allowed the formalization of group-based insurance institutions (mutuals/cooperatives), and provided the regulator with the flexibility and leeway to adjust regulations to market changes, thereby creating space for innovations. The Philippines is now working with the Japan Fund for Poverty Reduction and the ADB to improve the regulatory framework, strengthen the capacity of government regulators and microinsurance providers, and promote financial literacy on microinsurance. Complementary technical assistance with GTZ is beginning in May 2009.

(iv) Reforming Public Banks to improve access to finance.

State banks can be reformed and managed such that they contribute to financial inclusion, but through commercially sustainable financial services.

Over half of the population in India is financially excluded from the formal banking sector. Since 1969, when the Indian government nationalized banks, a number of policy initiatives by the Indian government and Reserve Bank of India made it possible for Indian public banks to reach out to the poorer sections of the society to promote inclusive banking. Following the liberalization measures launched since 1991, public banks have continued with financial inclusion initiatives by adopting technology and innovative product developments. Microfinance institutions are being encouraged, and public banks have now been allowed to finance MFIs/NGOs to extend the reach of financial inclusion. The National Payments Corporation of India, a PPP initiative, has been established in 2008 to create a robust retail payment infrastructure in the country. The government has announced an initiative to issue national identification cards to all resident Indians. This will be in the form of a financial identity card.

In the context of these reforms, the **Union Bank of India** has undertaken a number of initiatives to promote financial inclusion, particularly through issuance of financial identity cards to i) milk pourers of the National Dairy Development Board for payments and credit; ii) urban hawkers for savings, credit, remittance and micro-insurance; iii) over a million daily wage earners under the government's National Rural Employment Guarantee Scheme for payment of wages. Other initiatives include setting up village knowledge centres to disseminate knowledge and fro counseling; and training/incubation centres for rural youth with the National Small Industries Corporation.

The **Khan Bank of Mongolia** is an example of a former public bank which has ultimately been reformed into a model of financial inclusion. Today, it is Mongolia's largest and most profitable bank, and has offices in every village and neighborhood. It is used by some 80 per cent of Mongolian households, and by many domestic and international corporations active in Mongolia.

In the days of central planning days, it was a Soviet style monobank. While it was privatized in 1991 as the Agricultural Bank of Mongolia, it was not separated from the government and there was no real change in its operations. The bank failed in 1996. It was recapitalized by donors, but, since there was no change in its operation, was placed in receivership in 1999. For major donors, the bank was impossible to turn around and should be closed. For the government, it was the only bank in rural Mongolia and politically impossible to close. So, a compromise remediation plan was agreed upon under the World Bank Financial Sector Adjustment Credit (FSAC) program where the government re-acquired 100% ownership but the bank was run by external management, Development Alternatives, Inc. – DAI, and supervised by an independent Board. The bank was renamed "Khan Bank". Being the only bank in the remote markets, it kept its branches and was able to turn them around with all new policies and procedures and intensive training of existing staff who were tactically excellent and loyal.

After generating its first profit in 2001, the Bank was sold to Japan's HS Securities in 2003 but DAI was retained as manager. HS Securities resold 40% to Mongolian partners and another 13% to DAI and IFC in 2004.

The successful privatization has resulted in experienced owners, access to capital, access to expertise and technology, full transparency, strong corporate governance, and international strategic alliances. Restructuring a state bank for high performance requires among other things independent management, the ability to say no, international support, clean beginning balance sheet and adequate funding.

(v) Financial Identification.

Many people lack a "financial identity" which constrains their access to formal financial services. Many poor people even lack personal identity, such as having no birth record. In Asia, some 60% of births are not registered on their birthday and many never at all.

Financial identity can be created by drawing on people's transaction history into a financial asset. Various options were discussed for developing identity, taking advantage of IT innovations and statistical analysis. Regulatory frameworks would need to adopt a flexible approach to supporting the generation of financial identity, facilitating information sharing in the initial stages of development and introducing protective measures during the later stages that involve large-scale information processing.

Biometric automatic teller machines are a new innovation for targeting the unbanked population. Using thumbprint and voice guidance in ATMs reduces literacy requirements to a considerable extent. Thus, establishing the identity of a rural depositor through biometrics makes it possible for illiterate or barely literate people to have access to formal financial services. A simplified menu on ATMs coupled with possible audio guidance in local language enables easy use for rural masses. Though identification can be via face, voice, retina or iris, fingerprinting has the advantage of being a familiar concept worldwide. Some banks have started implementing biometric applications in retail branch applications for officer authentication.

The Bank of Indonesia has launched an initiative to increase the country's "unbanked" by developing financial identities. It is estimated that some 58 per cent of the Indonesian population do not have a bank account. One of the factors limiting access to finance is the lack of adequate information on the financial capacity of the unbanked. In order to improve access to the unbanked in the banking sector, financial identity is needed to identify and monitor the financial track record.

While financial identity is important for obtaining access to formal financial services, identity theft is a quickly rising crime in industrialized countries like the US and UK. Personal information must be legally protected as privacy breaches may pose a threat to confidence in the banking sector. Other privacy breaches include disclosure of personal information to unauthorized third parties, and profitable sale of personal information on the black market. Another issue is purpose diversion with personal data which is collected for one purpose being used for another purpose without the consent of the data subject.

(vi) Consumer Protection.

Consumer protection policies are necessary to address technical and delivery security, reduce predatory lending and increase disclosure of information, facilitate efficient dispute settlement, enhance data protection and improve comparability of offers. The key elements are transparency, fairness, responsibility and fair recovery practices. But financial literacy is low in all developing countries (and many developed countries), which means that financial education must also be pursued in parallel to consumer protection.

In **Malaysia**, the central bank "Bank Negara" is responsible inter alia for ensuring the fair and equitable treatment of consumers and well-informed and empowered consumers. To this end, it undertakes a wide range of initiatives in the following areas: market conduct regulation, fair treatment of consumers and market integrity; access to financial products and services; enhancing financial capability; avenues to seek redress and help; deposit insurance; and credit information database. Dynamic and pro-active implementation of these initiatives has proved to be successful. At the same time, a challenge is striking a balance between protecting consumers versus innovation and competition, and the competing expectations and pressures from various stakeholders.

In **South Africa**, consumer protection is managed by the National Credit Regulator under the National Credit Act the key objective of which is to combat reckless lending and improve transparency and fairness. The role of the Regulator is to monitor the conduct of all registered entities. Loan agreements are frequently complex and difficult to understand, with many fees and obligations hidden in the fine print.

Consumers must accept responsibility for their actions and must resist the growing trend of acquiring goods that they cannot afford, and then seeking to escape responsibility of paying for their obligations. But the credit industry has been too willing to participate in the race and pushing credit and credit limits where the clients cannot afford the repayments. It is necessary to develop a market where consumers can benefit from access to credit, without being damaged by it. It is a priority for the Regulator to engage with banks in order to establish a constructive and effective working relationship. Any real concerns and practical implementation problems must be raised with the Regulator's office formally – or through the Association – or the informal monthly meetings between the Regulator and the bank's legal advisors.

In **Peru**, the Superintendency of Banking, Insurance and Private Pension Funds is responsible for consumer protection. It does not solve consumer complaints, but regulates and supervises the policies and procedures followed by financial institutions in order to receive, manage and properly solve complaints presented by dissatisfied users. It follows a preventative approach by regulating and supervising the policies, procedures and operations in financial institutions in order to reduce the probability for users to feel offended by a financial institution's product or service, decreasing in turn the probability for complaints to generate in the first place.

In this context, the Superintendency undertakes the following actions regarding consumer protection: regulation approval, supervision activities, information campaigns, financial literacy projects and consumer orientation and inquiry-solving processes. The main lessons leaned by the Superintendency in its activities are:

- The most cost-effective way of protecting consumers is through ex-ante activities, not in solving complaints directly;
- Regulations and overseeing activities are supervisor's key tools and channels in the protection of consumers, not only for capital adequacy examination purposes;
- Extending financial services to more users through non-traditional channels requires not only adequate operational requirements, but consumer protection rules in order for the public to trust and adopt them;
- Transparency and disclosure to consumers (both current and potential) is not a natural process in a complex market and this should be a regulatory requirement;
- Financial literacy is an efficient way of empowering consumers; and
- Partnership with educational authorities and mass media is essential.

The "**Global Financial Education Program**" is very active in promoting financial education for consumer protection. Financial education communicates the knowledge, skills and attitudes that people need to adopt good money management practices for earning, spending, saving, borrowing and investing. It develops curriculum targeted to low income households and trains a broad range of service organizations to use it. The Program now focuses on three main activities: 1) disseminating its curriculum around the globe through training of trainers events and technical assistance; 2) developing new curricula; and 3) measuring outcomes of financial education programs.

III. The role of regional capacity-building and public-private partnerships in promoting financial inclusion

There is much scope to improve the efficiency of microfinance institutions (MFIs). For example, around 45% of existing MFIs still track and record their operations and accounting in excel sheets or even completely manually. This costs a massive amount of time and resources, leaves room for error, prevents them from growing quickly, and undermines their ability to manage risk.

Thus, IBM has been developing **Microfinance Processing Hubs** to meet the information technology needs of MFIs. They provide a shared infrastructure and software platform with a centralized core banking system, data center, operations management, and transaction processing. The Processing Hubs include the following applications: accounting, customer management, payroll, collections and recoveries, risk management, liquidity management, agent/reseller operations, and core banking. They also help create a more efficient and vibrant financial ecosystem by integrating MFIs with other key participants from across the economy like international payments networks, regulators, credit bureaus, telecom companies, banks, NGOs and donors.

Finally, the workshop concluded with the discussion on the role of government, private sector, civil society, development institutions, and regional cooperation in enhancing financial inclusion. It was noted that over 200 players are involved, and there is an urgent need for them to work together. For example, in the Asia-Pacific region there are: Pacific regional microfinance network – Microfinance Pasifika Network; Asian regional microfinance network – Banking with the Poor Network; Latin American regional microfinance networks; Consortium of National-Level Microfinance Networks drawn from each APEC developing country; Asian Bankers Association, Asia Pacific Rural and Agricultural Credit Association, Association of Development Financing Institutions in the Pacific, Multilaterals (ADB, APEC, IDB, IFC, UNCDF, World Bank); and also international and domestic private sector companies.

It was suggested that what is needed is a broad-based, high-level operational committee for APEC financial inclusion. In this context, the APEC Business Advisory Council is working very closely with the APEC finance ministers' process to propose a possible APEC financial inclusion initiative. This would focus on the legal, policy and regulatory enabling environment, and involve activities like research, policy dialogue and capacity-building.