Innovative Financial Inclusion

Principles and Report on Innovative Financial Inclusion from the Access through Innovation Sub-Group of the G20 Financial Inclusion Experts Group

25 May, 2010

Executive Summary

At the Pittsburgh Summit in September 2009, G20 Leaders committed to improving access to financial services for poor people, through supporting the safe and sound spread of new modes of financial service delivery capable of reaching the poor.

More than two billion adults do not have access to formal or semi-formal financial services. They are the financially excluded in a world where access to financial services can mean the difference between surviving or thriving.

Innovative modes of financial services delivery can have a transformative effect on poor households. We know how greater access to even small amounts of credit can dramatically improve welfare – such as women being able to buy a sewing machine and establish a small business. Awareness is growing that access to a wider set of financial services provides poor people with capacity to increase or stabilize their income, build assets and have much greater resilience to economic shocks. Appropriate and affordable savings and credit products, payment and money transfer services (both domestic and international) as well as insurance, are all important.

One billion people with mobile phones do not have even a basic bank account. As the costs of information and communications technology shrink, the time is ripe for using technology to address financial exclusion. Technological innovation changes the cost and access equation – making it economically viable for financial service providers, often in partnership, to reach poor people, with a wider range of products and services.

Innovation also extends to new institutional approaches. Many countries are pioneering policy and regulatory responses to market innovations that open space for new approaches to the delivery of financial services. This is allowing previously excluded customers access to an increasing range of basic financial services, while at the same time protecting customers, financial institutions and the financial system from abuse and mitigating risk.

The "Principles for Innovative Financial Inclusion" provide guidance for policy and regulatory approaches to innovative financial inclusion that will: (i) foster the safe and sound adoption of innovative, adequate, low-cost financial service delivery models; (ii) help provide a framework of incentives for the various bank, insurance, and non-bank actors involved, while ensuring fair conditions of competition between all financial service players; and (iii) foster affordable financial services that respond to customer's needs in both quality and range.

Endorsement of the attached Principles represents a first step towards building a framework to improve access to a full range of financial services for poor people. Work will continue on developing practical and concrete actions for implementation of these principles. This work will be considered by Leaders at the next Summit in Seoul, Korea, in November 2010.

Principles for Innovative Financial Inclusion

Innovative financial inclusion means improving access to financial services for poor people through the safe and sound spread of new approaches. The following principles aim to help create an enabling policy and regulatory environment for innovative financial inclusion. The enabling environment will critically determine the speed at which the financial services access gap will close for the more than two billion people currently excluded. These principles for innovative financial inclusion derive from the experiences and lessons learned from policymakers throughout the world, especially leaders from developing countries.

1. **Leadership**: Cultivate a broad-based government commitment to financial inclusion to help alleviate poverty.

2. **Diversity**: Implement policy approaches that promote competition and provide market-based incentives for delivery of sustainable financial access and usage of a broad range of affordable services (savings, credit, payments and transfers, insurance) as well as a diversity of service providers.

3. **Innovation**: Promote technological and institutional innovation as a means to expand financial system access and usage, including by addressing infrastructure weaknesses.

4. **Protection**: Encourage a comprehensive approach to consumer protection that recognises the roles of government, providers and consumers.

5. **Empowerment**: Develop financial literacy and financial capability.

6. **Cooperation**: Create an institutional environment with clear lines of accountability and co-ordination within government; and also encourage partnerships and direct consultation across government, business and other stakeholders.

7. **Knowledge**: Utilize improved data to make evidence based policy, measure progress, and consider an incremental "test and learn" approach acceptable to both regulator and service provider.

8. **Proportionality**: Build a policy and regulatory framework that is proportionate with the risks and benefits involved in such innovative products and services and is based on an understanding of the gaps and barriers in existing regulation.

9. **Framework**: Consider the following in the regulatory framework, reflecting international standards, national circumstances and support for a competitive landscape: an appropriate, flexible, risk-based Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) regime; conditions for the use of agents as a customer interface; a clear regulatory regime for electronically stored value; and market-based incentives to achieve the long-term goal of broad interoperability and interconnection.

These principles are a reflection of the conditions conducive to spurring innovation for financial inclusion while protecting financial stability and consumers. They are not a rigid set of requirements but are designed to help guide policymakers in the decision making process. They are flexible enough so they can be adapted to different country contexts.

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ANNEX 2: THE AFI SURVEY ON FINANCIAL INCLUSION POLICY IN DEVELOPING COUNTRIES. AVAILABLE AT: HTTP://WWW.G24.ORG/AFISUR.PDF

Introduction

"We commit to improving access to financial services for the poor. We have agreed to support the safe and sound spread of new modes of financial service delivery capable of reaching the poor and, building on the example of micro finance, will scale up the successful models of small and medium-sized enterprise (SME) financing. Working with the Consultative Group to Assist the Poor (CGAP), the International Finance Corporation (IFC) and other international organizations, we will launch a G20 Financial Inclusion Experts Group. This group will identify lessons learned on innovative approaches to providing financial services to these groups, promote successful regulatory and policy approaches and elaborate standards on financial access, financial literacy, and consumer protection."

(Excerpt from the G20 Leaders' Statement, The Pittsburgh Summit, 24 – 25 September 2009)

Against the backdrop of the global financial crisis and economic downturn, G20 summit agendas have focused on securing financial stability and rebuilding the trust of economic agents, especially consumers. The establishment of the Financial Inclusion Experts Group (FIEG), and its two sub-groups on Small and Medium-sized Enterprise Finance and Access through Innovation, at the Pittsburgh Summit in September 2009 recognised the mutually reinforcing policy objectives of financial stability, financial inclusion and consumer protection. G20 Leaders committed to improving access to financial services for the poor by supporting the safe and sound spread of new modes of financial service delivery capable of reaching the poor.[1]

The G20 commitment recognises the over two billion adults around the world who do not have access to formal or semi-formal financial services – nearly 90 per cent of whom live in Africa, Latin America, Asia and the Middle East.[2] Most people are already aware of how greater access to basic financial services through microfinance can transform lives and improve welfare. Awareness is growing that access to a wider set of financial tools, such as savings products, payment services (both domestic and through international remittances) and insurance (including micro-insurance directed at the needs of the poor), provides poor people with much greater capacity to increase or stabilize their income, build assets, and become more resilient to economic shocks.[3]

Barriers for poor people to access appropriate financial services include socio-economic factors (e.g., education, gender and age, low and irregular income and geography), regulatory factors (e.g. provision of identity documentation) and product design factors (e.g., minimum account balances).[4] Some major barriers financial service providers experience when expanding appropriate services to poor people are the cost of providing those services and finding the regulatory space to innovate. As a general rule, transaction costs do not vary in direct proportion to a transaction's size. Thus serving the poor with small value services is simply not viable using conventional retail banking or insurance approaches.

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[1] G20 Leaders Statement (2009).

[2] Chaia et al (2009).

[3] Helms (2006).

[4] For example: Johnson and Nino-Zarazua (2009)

The focus of the Access through Innovation Subgroup (ATISG) is on innovative methods to improve access to financial services. A key source of innovation is the capacity of technology to reduce costs and overcome other barriers to the provision of sustainable financial services to the excluded. With nearly three billion mobile phones currently in use around the world, and numbers growing rapidly,[5] the costs of communications and information technology are shrinking. This presents an unprecedented opportunity to use technology to address financial exclusion. Technological innovation can change the cost and access equation, making it economically viable for financial service providers to reach poor and isolated individuals and communities.

Financial sector policy and regulation is critical to the use of technology to promote financial inclusion. Increasing numbers of countries with large excluded populations are pioneering policy and regulatory innovations that open space for financial inclusion and similar new approaches to the delivery of formal financial services. This is allowing previously excluded customers access to an increasing range of basic financial services.

Innovation in delivery and design of financial services targeting the poor and the excluded presents challenging policy and regulatory issues. Global awareness of the challenges and barriers and hands-on experience with policy, regulation and supervision is limited. Industry innovation has thus far frequently outpaced the capacity of policymakers to respond. Policy and regulatory responses therefore need to focus on articulating flexible approaches that can accommodate further innovation and multiple and competing objectives.

The G20 FIEG Sub-Group on Access through Innovation is focusing on innovations that have the potential to reduce transaction costs and reach the excluded. In particular, the Sub-Group has explored policy and regulatory approaches aimed at: (i) fostering the safe and sound adoption of innovative, low-cost financial service delivery models; (ii) helping provide a framework of incentives for the various bank, insurance and non-bank actors involved, while ensuring fair conditions of competition between all financial service players; and (iii) fostering affordable financial services that respond to customer's needs in both quality and range.

The first phase of the Sub-Group's work through to June 2010 has focused on analysis of recent experience and lessons learned, as well as the preliminary identification of general principles. The outputs of this first phase of work are incorporated in this synthesis report, including the one page statement of recommended "Principles for Innovative Financial Inclusion" for consideration at the Toronto Summit. The second phase of the Sub-Group's work will continue through to the G20 Leaders' Summit in Korea. This work will promote successful regulatory and policy approaches through the further development and implementation of the general principles identified in the first phase, keeping in mind the distinct country conditions.

The ATISG sees the role of the G20 in this space as being a catalyst for the wide range of ongoing work to reach the financially excluded. By highlighting the importance of financial inclusion, G20 leaders will inject additional energy and commitment into the drive to increase access to financial services for poor people.

Structure of the ATISG Report

The nine 'Principles for Innovative Financial Inclusion' are the heart of the ATISG's work to date. These principles are a reflection of the conditions conducive to spurring innovation while protecting stability and

[5] Roodman (2009).

consumers. They are not a rigid set of requirements but are designed to help guide policymakers in the decision making process. They are flexible enough so they can be adapted to different country contexts.

The principles have been carefully distilled from the comprehensive survey of the members of the Alliance for Financial Inclusion and the in-depth regulatory diagnostic studies undertaken by CGAP in countries exhibiting leadership on financial inclusion (attached in Annexes 1 and 2). Each principle is illustrated by short case studies from countries in the aforementioned studies that exemplify the principle, to give policy makers confidence that others have put the principle into action and have found it important.[6] There has been a wide process of consultation and endorsement as is outlined in Appendix 1 and the reports of three of the key consultations are attached at Appendix 2.

Before elucidating these principles, the report provides the rationale for the G20's commitment to this global challenge by providing an overview of the research and experience that relates to innovative financial inclusion. This includes data on the scale of financial exclusion; the importance of financial inclusion for both economic growth and poverty alleviation; the critical role of consumer protection and financial capability in access to financial services; and the nature of good practice regulation, which these nine principles follow.

Most of the world's poor are financially excluded

Between 2.1 billion and 2.7 billion adults, or 72 per cent of the adult population in developing countries, do not even have a basic bank account.[7] This is the simplest way to measure financial access. The number of people with access to the broader range of financial services covered in this report, such as payments services (national and international) and micro-insurance, would be even lower.

The map and graph below shows regional variations in access. In general, the poorest regions have the lowest level of access to bank accounts, although some countries have been able to adopt policy responses that have allowed higher levels of financial inclusion than would be expected given their state of development. The importance of leadership in establishing a policy framework to improve access is captured in Principle 1.

[6] The International Association of Insurance Supervisors (IAIS) Joint Working Group on Microinsurance also contributed two of the cases. Appendix 4 has more information on the IAIS.

[7] The 2.1 billion number is an FAI estimate based on usage numbers from Chaia et al (2009). The 2.7 billion is a CGAP estimate based on supply numbers from CGAP (2009a).

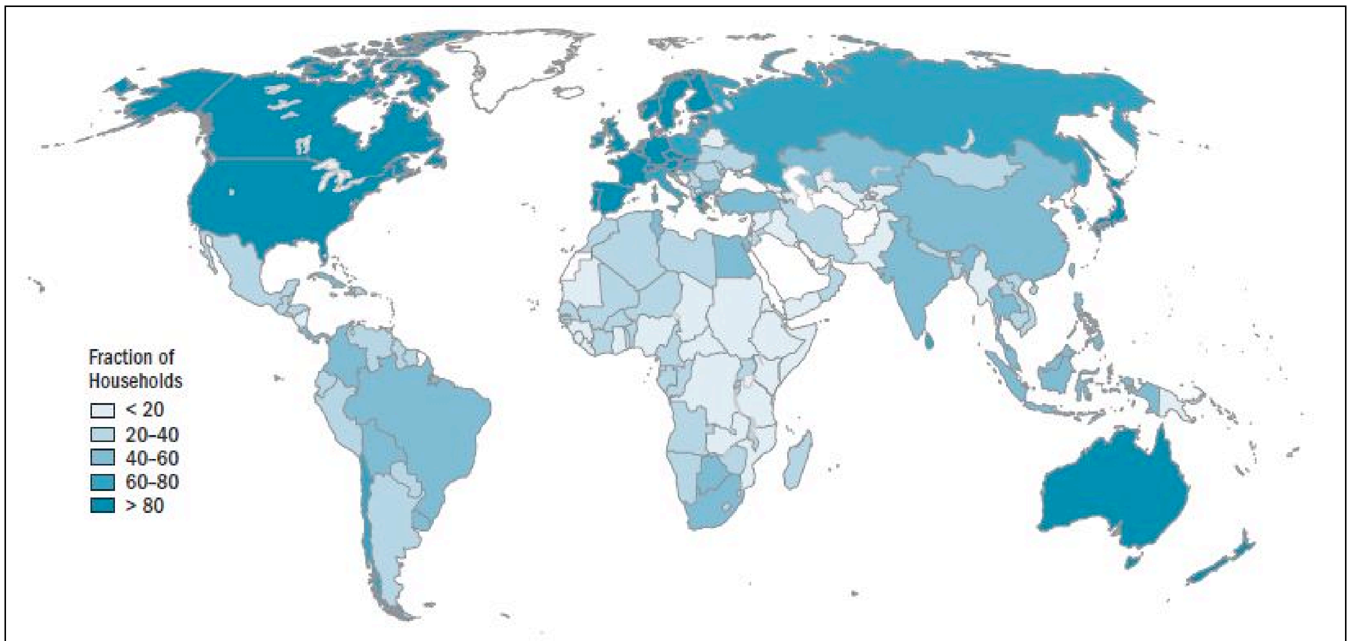

Figure 1: Global differences in households with accounts in financial institutions

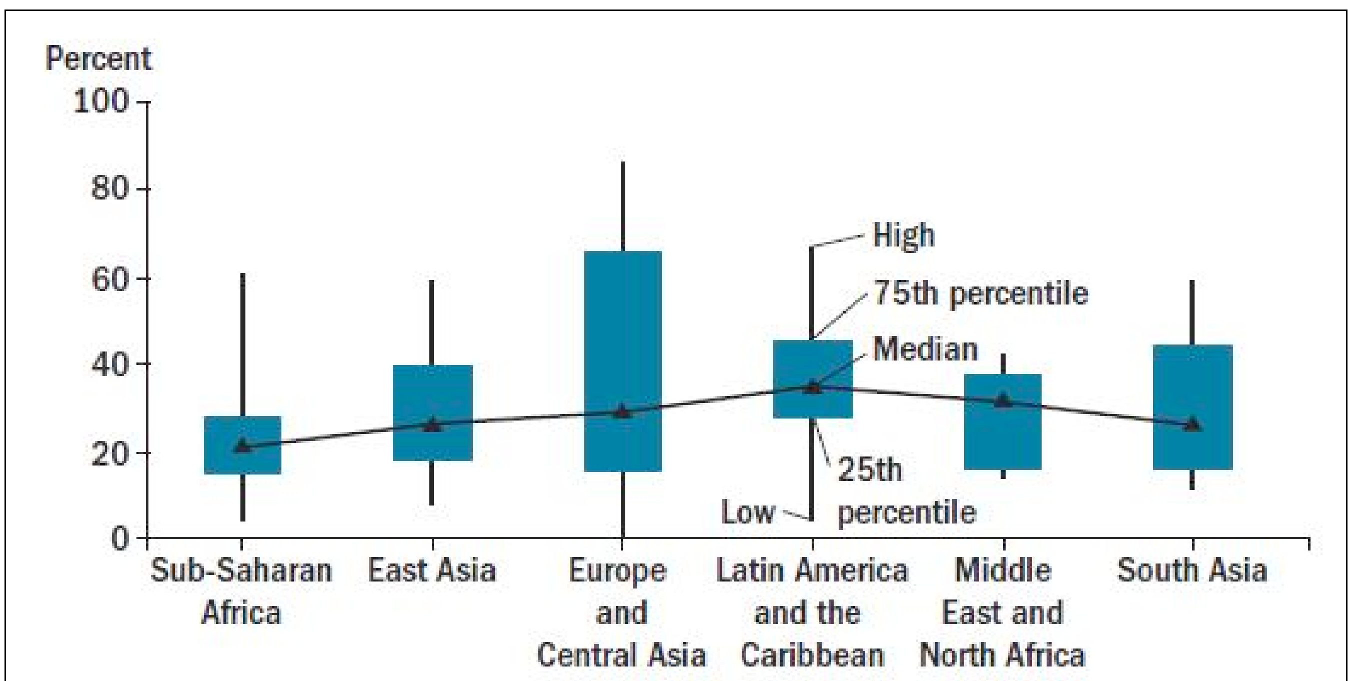

Figure 2: Proportion of households with an account in a financial institution

Note: Figure 2 shows the highest and lowest national percentages within the region as well as the medians and quartiles, for the countries in each region. Source: *Finance for All?* based on work by Patrick Honohan (2007)

The map also shows significant variation across countries within regions. The highest rates of exclusion are generally in non-G20 countries, which highlights the importance of cooperation and outreach as the G20 takes the initiative and provides support in this area. However, there are significant disparities across even

G20 countries, with financial exclusion rates ranging from around 55 per cent for China, South Africa and Brazil, through to four per cent for Canada.[8]

Financial inclusion is a driver of economic growth and poverty alleviation

Inclusive financial sector development makes two complementary contributions to poverty alleviation: financial sector development is a driver of economic growth which indirectly reduces poverty and inequality; and appropriate, affordable, financial services for poor people can improve their welfare.[9]

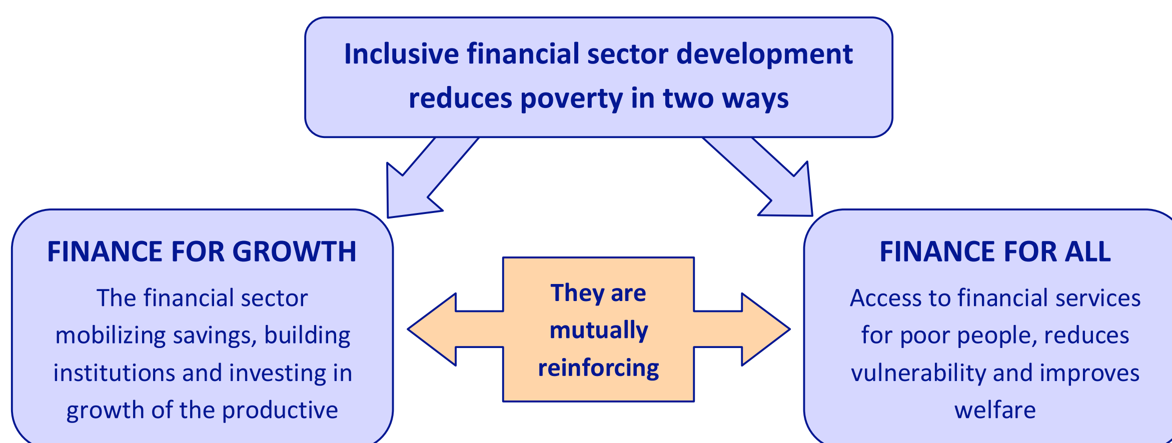

Figure 3: Inclusive financial sector development

They are complementary because financial inclusion enables the previously excluded to connect to the formal economy and contribute to economic growth,[10] while economic growth facilitates the inclusion of more people in the economy and in the financial system.[11]

Poor people need access to appropriate, and affordable financial services [12]

A crucial problem for poor people is that their income is not only low, but also irregular and unreliable. For example, an annual average income of US$2 a day may in actuality range from a high of US$5 to low days when no income is earned (see Figure 2[13]). For farmers and others with seasonal occupations, variations over a year can be even greater.

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[8] These figures have been taken from Demirgüç-Kunt, Beck and Honohan (2008) because it is essential to use the same sources when making cross country comparisons and this is the most recent comprehensive source of comparisons. It should be noted, however, that there are significant disparities between sources even in the relative levels and rakings of access in different countries. For example, Demirgüç-Kunt, Beck and Honohan (2008) indicates that the percentage of adults with access to formal financial services was 46 per cent in South Africa, 10 per cent in Kenya and 15 per cent in Zambia, whereas the FinScope surveys in the same mid-decade period found access levels of 57 per cent in South Africa, 27 per cent in Kenya and 23 per cent in Zambia.

[9] The development of these ideas is summed up in Demirgüç-Kunt, Beck and Honohan (2008).

[10] Even if this is simply through increased consumption per Johnston and Murdoch (2008).

[11] Until relatively recently, people focused mainly on microcredit when discussing finance for the poor, but it is now recognised that financial inclusion needs to encompass a wide range of financial services in addition to credit, such as savings, insurance and money transfer services.

[12] This understanding has been enriched by 'financial diaries,' tracking the financial transactions of the poor at regular intervals over a long period, as reported in Rutherford and Arora (2009); and Collins, Murdoch, Rutherford and Ruthven (2009).

[13] Adapted from Collins, Murdoch, Rutherford and Ruthven (2009).

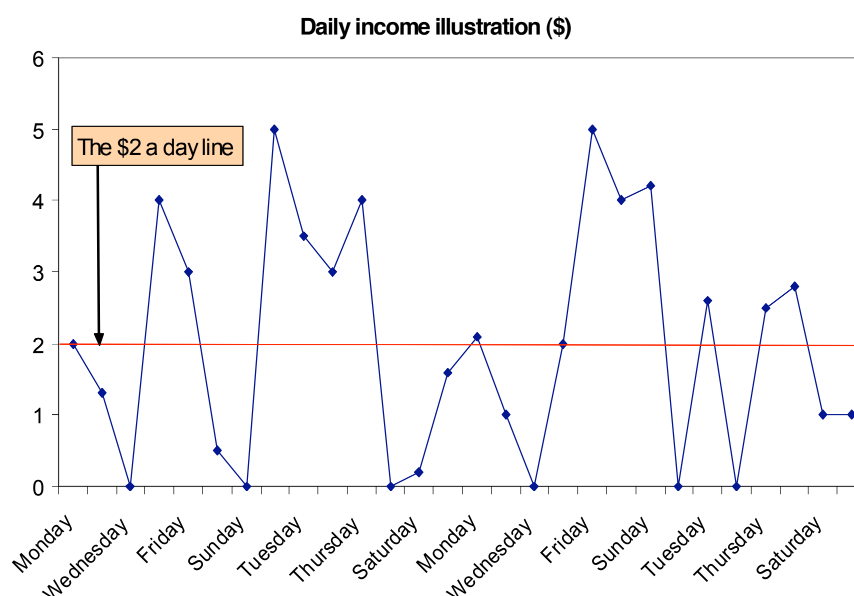

Figure 4: Fluctuations in daily income for poor people

Poor people need to be able to manage this low, irregular and unreliable income to ensure regular cash flow and to accumulate sufficient amounts to cover lump sum payments. Lump sums are needed for: lifecycle events such as school expenses, marriages and funerals; economic opportunities eg., buying inputs for businesses; and emergencies like illness or sudden unemployment. For poor people, money management is an absolutely central part of daily life, perhaps more than for any other economic group.

Poor people, like most people, need a range of appropriate and affordable financial services to address a range of financial needs, such as safe accessible savings, microcredit, payments and transfer services (both domestic and international) and insurance.

In the absence of formal and semi-formal financial services (and typically in addition to them too[14]), poor people use informal services. Although informal services are more accessible, in many cases they are also less reliable, less secure, and/or more expensive than semi-formal and formal services.[15]

In most developing economies access to formal financial services is limited to 20 to 50 per cent of the population. The, poor and not-so-poor alike are excluded. The provision of better access to financial services for the not-so-poor can have an especially favourable indirect effect on the poor in terms of jobs and vibrant local economies. Hence, to promote pro-poor growth, it is important to improve access not only to the poor, but also to all who are currently excluded. Additionally, further gains are possible through improving

[14] Johnson and Nino-Zarazua (2009).

[15] For example, when Bank Rakyat Indonesia's Unit Desa microbank was charging an effective interest rate of 2.8 per cent per month on loans to prompt payers, borrowers reported paying rates between 10 per cent and 1,930 per cent per month to informal moneylenders. These charges are reported in Robinson (2001), who notes, 'While it is true that informal commercial moneylenders provide important financial services to the poor, they typically charge very high interest rates to low-income borrowers in developing countries.' The importance of these services to the poor, despite their cost, in the absence of accessible, affordable and appropriate formal financial services has been verified in Collins, Murdoch, Rutherford and Ruthven (2009). The authors conclude that the provision of better financial services, based on the principles of reliability, convenience and flexibility, will reduce the need for poor people to rely on these expensive informal mechanisms.

financial access through more traditional means, but this is not the focus of this report as the Pittsburgh Declaration asked for a focus on innovative approaches.

Finance for economic growth and poverty alleviation

Financial sector development drives economic growth by mobilizing savings and investing in the growth of the productive sector.[16] The institutional infrastructure of the financial system also contributes to reducing information, contracting and transaction costs, which in turn accelerates economic growth.[17] Economic growth also indirectly contributes to lower poverty rates. There is also now growing evidence that financial sector development promotes pro-poor growth, because it impacts economies in ways that contribute to a reduction in poverty and inequality. For example, financial sector development is associated with a drop in populations living on less than US$ 1 a day.[18]

Finance for all and poverty alleviation

Access to financial tools such as savings products, payment services, remittances and insurance, equips poor people with a greater capacity to increase or stabilize their income, strengthen their resilience to economic shocks and build assets. Detailed ethnographic work, undertaken by tracking the 'financial diaries' of poor people in Bangladesh, India and South Africa, powerfully shows how access to a range of appropriate and affordable financial services helps poor people reduce their vulnerability to shock, improves their welfare and, in many cases, raises their income.[19] Research has also shown that, in addition to the income benefits of a safe place to save[20] and access to larger sums of money, micro-savings and micro-credit has resulted in positive outcomes such as a reduction in child labour and increases in agricultural productivity.

Sustainable provision of a diverse range of financial services for poor people

As microfinance institutions broadened their remit to offer a wider variety of financial services, the meaning of the term microfinance evolved to encompass all financial tools designed for poor clients (savings products, microcredit, payment services, remittances and microinsurance).[21] More recently, it has become common to use the term financial inclusion to refer to providing such services. There is a wealth of research and data on 'microfinance'. This data indicates that microfinance clients often pay market rates for financial services and are reliable clients.[22] These market rates can cover the higher transaction costs of small loans and often include significant risk premiums. The majority of microfinance providers that have significant numbers of clients are profitable (i.e. financially sustainable), and are funded by social and commercial investors not donor grants.

Experience indicates the potential grains from linkages between different financial services. For example, expanded payment systems for domestic bills can also provide scope to reduce the cost of remittance

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[16] The pivotal work in this area was by King and Levine (1993) and Levine, Loayza and Beck (2000). Using both traditional cross-section, instrumental variable procedures and recent dynamic panel techniques, these found that the exogenous component of financial intermediary development is positively associated with economic growth. Finally, Honohan and Beck (2007) suggested that careful comparative analysis of the growth rates of different countries over a 30 year period has produced convincing evidence that having a deeper financial system contributes to growth and is not merely a reflection of prosperity.

[17] Levine 2005.

[18] Beck, Demirgüç-Kunt and Levine (2007).

[19] Collins, Murdoch, Rutherford and Ruthven (2009).

[20] First randomised controlled trial of Savings in Robinson (2001).

[21] For as much information as you could possibly want on microfinance including the diversity of financial services and providers see: www.microfinancegateway.org

[22] For comprehensive data on the performance on microfinance institutions see: http://www.mixmarket.org/

payments. Remittance systems can be a lever to expand other microfinance services (see Appendix 6). Micro-credit arrangements can also be bundled with micro-insurance, similar to the experience of housing or other loans sometimes requiring mortgage insurance. Bringing insurance to the poor can help reduce poverty by allowing individuals greater scope to invest without the fear of loss from national catastrophes and other destructive forces. Microinsurance currently covers 135 million people, only an estimated 5 per cent of the potential market. [23]

Rapid growth of microfinance institutions, as is the case for traditional banks, can lead to problems, including: risk management failure as systems and controls become overstretched; a weakening of loan repayment incentives as competition for market share intensifies; and possible client over-indebtedness as discipline in lending erodes.[24]

Given the potential for innovative approaches to providing financial services to stimulate rapid growth in microfinance institutions, it is important that close attention be paid to the regulatory and policy regime. The lessons learnt from these and other experiences in the financial and telecommunications sectors have been captured and built into the principles (discussed below) for building an appropriate framework conducive to spurring innovation while protecting financial system stability and consumer's rights.

Emerging Innovative Approaches

Innovation to provide appropriate, affordable financial services

Service providers are now pushing boundaries to find ways of meeting the demand for the full range of financial services for the poor and not-so-poor. 'Innovative Financial Inclusion' refers to the delivery of financial services outside conventional branches of financial institutions (banks or microfinance institutions) by using information and communications technologies and non-bank retail agents (including post offices) and other new institutional arrangements to reach those who are financially excluded. In this report, innovative financial inclusion will also be referred to interchangeably with 'banking beyond branches' or 'branchless banking'[25], but it is not limited to "banking activity" under most domestic regulatory frameworks. In addition to traditional banking services, it can include alternatives to informal payment services, insurance products, savings schemes etc.[26] Delivery mechanisms include both mobile phone-based systems and systems where information and communications technologies, such as point-of-sale device networks, are used to transmit transaction details among the financial service provider, the retail agent, and the customer.

Branchless banking can be either "additive" or "transformational."[27] It is additive when it adds to the range of choices or enhances the convenience of existing customers of mainstream financial institutions. It is transformational when it extends financial services to customers who would not otherwise be reached profitably with traditional branch-based financial services. Branchless banking taps into existing

[23] The size of the potential market for micro-insurance is estimated to be between 1.5 and 3 billion policies according to Lloyds 2009. www.lloyds.com/News_Centre/360_risk_insight/Research_and_reports.htm

[24] Based on Chen, Rasmussen and Reille (2010).

[25] "Branchless banking" and "Banking beyond branches" refer to the delivery of financial services outside conventional bank branches using information and communications technologies and non-bank retail agents Lyman, Pickens and Porteous (2008).

[26] Lyman, Pickens and Porteous (2008).

[27] Porteous (2006).

infrastructure that already reaches unbanked people—such as mobile phones and local retail outlets (including post offices) that might be used as agents for cash-in/cash-out and other customer interface functions such as account-opening. As a result, delivering financial services through innovative delivery mechanisms can be radically cheaper than delivering such services conventionally.

Examples of countries which are achieving rapid growth in financial access from innovative approaches include Kenya and Brazil.[28]

- In Kenya, the *M-Pesa* mobile phone money transfer service, operated by Safaricom, was launched in February 2007 and by the end of 2009 it had over eight million registered users, approximately 40 per cent of the adult population of Kenya. Those in Kenya with access to banking services increased from 18.9 per cent to 22.6 per cent of adults between 2006 and 2009. Those with access to other formal services more than doubled in the same period from 7.5 to 17.9 per cent – an increase largely attributable to *M-Pesa*.

The Kenyan example illustrates the potential of mobile phone technology to support the extension of access to financial services in developing countries. As can be seen in the graph below, in developing regions such as Sub-Saharan Africa, South Asia and the Middle East and North Africa, mobile phone subscription levels have virtually doubled every two years. There were 3.3 billion mobile phone subscriptions in the world in 2007[29]. About one billion people in developing countries do not have a bank account but have a mobile phone[30], and that number is expected to grow to 1.7 billion in 2012. This suggests that there is a significant opportunity to expand financial access via mobile phones.

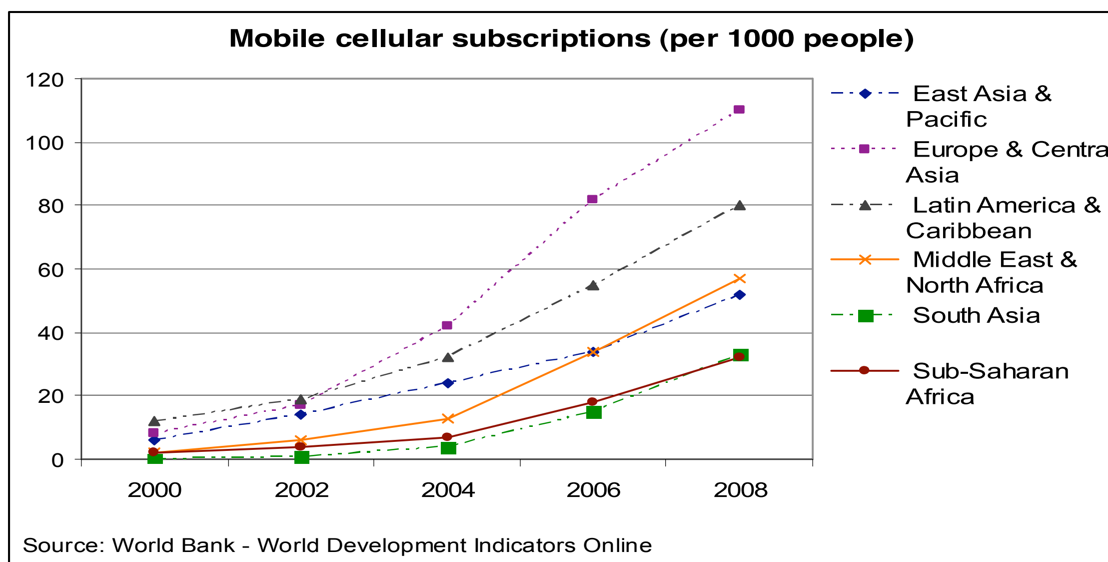

Figure 5: Mobile cellular subscriptions (per 1000 people), 2000 - 2008

- Brazil adopted a 'correspondent' banking model, often referred to as 'agent' banking, which has driven its success in expanding outreach of financial services into un-served and remote areas. In 2000, there

[28] CGAP (2010b, 2010f, 2010j).
[29] International Telecommunication Union estimate: http://www.itu.int/ITU-D/ict/newslog/PermaLink,guid,2a17f1ba-8e2f-4c1e-b885-040e59685f0a.aspx
[30] CGAP-GSMA Mobile Money Market Sizing Study quoted in CGAP (2009b).

were 63,509 agents and by January 2010 the number had grown to 132,757, reaching even the most remote areas of Brazil. The agents are relying on point-of-sale devices to conduct their business. The agents mostly provide bill payment services, but a wide range of services are authorized by regulation, including deposits, money transfers and receiving, verifying and forwarding documentation to provide credit and open checking accounts. Traditional bank branches now account for only 38 per cent of the points of service in the nation's financial system. Even those living relatively close to a bank branch regularly use agents, like supermarkets or post offices, to conduct their transactions. Widespread access to financial services has helped manage Brazil's social safety net programs. Now the 12 million families (2010) who benefit from *Bolsa Família* can withdraw their allowances locally, without traveling long distances or paying someone else to conduct their transactions for them. In addition to the benefits to the end user, the agent mode of delivery benefits the government by reducing transaction costs of providing social payments.

Brazil's success with using agents in a country with significant geographic challenges illustrates the potential of agents to expand access to financial services. It also demonstrates that the use of innovative approaches to delivering government-to-people transfers, can lower transaction costs for both the government and clients and enhance the efficiency and reliability of their delivery.

Developing country policymakers and regulators are aware of these potential options and want to embrace them. The recent survey by the Alliance for Financial Inclusion reported that the use of information and communication technology is seen to have great potential to reduce transaction costs and allow for the expansion and diversification of financial services. (The complete AFI survey can be found at Annex 2.) It also opens up new options for non-bank players, such as mobile network operators or agents, to get involved with the provision of these services via mobile telephones or other devices.

The importance of consumer protection

One of the lessons of the global financial crisis is the importance of financial consumer protection.[31] There are three main consumer protection goals which apply to markets everywhere. First, information about the terms and conditions given to the customer should be transparent. Financial service providers should disclose key information clearly, at appropriate points before, during, and after a transaction is completed; truth in advertising typically requires particular attention. Second, customers should be treated fairly and ethically. Third, financial service providers should put easy-to-use systems in place for resolving errors, complaints or disputes. Of course, some of the responsibility lies with consumers too – to make sound financial decisions to the best of their ability, hence the need to develop financial capability as discussed below. However, inexperienced or low-income customers with lower levels of formal education or literacy, can be particularly vulnerable to unscrupulous conduct. Regulation to protect customers can help increase financial inclusion by building trust in formal financial services. It can also promote healthy competition, which results in a more level playing field for responsible providers and better products and practices for consumers. Taken together, these improvements can also contribute to overall financial stability.

Financial literacy and financial capability: increasing access and appropriate use

Financial capability encompasses financial literacy, financial education, financial knowledge and skills, and household money management skills. A financially capable person has the *knowledge, skills, attitude and*

[31] CGAP (2010). This CGAP Focus Note includes a tool to help regulators start assessing consumer protection concerns in their own markets and options to address them.

behaviors to be aware of financial opportunities, make informed choices to suit their circumstances, and take effective action to improve their financial well-being. This includes, for example: *knowledge* of financial or money concepts such as an interest rate; *skills* such as preparing a family budget or using an automated teller machine (ATM); *attitudes* such as trust in a service provider; and *behaviors* based on the above, such as saving up for school fees instead of taking a loan. In the context of branchless banking, a financially capable person will, for example, be able to make a reasoned decision as to whether to sign up for a mobile payment service or continue with her/his existing payment mechanisms (such as giving cash to a bus driver for transport to a recipient elsewhere). Limited financial capability is a major barrier that prevents poor people from accessing financial services, and once they have access, converting this into effective and appropriate usage of financial services. Financial capability is critical when considering innovative financial products and services because of its potential to be the gateway for to financial inclusion for the previously unbanked. Financial capability, branchless banking as well as microinsurance are nascent fields so there is limited experience at their interface and a great deal to learn. Appendix 4 provides more information and was written with the advice of the OECD Financial Education project.[32]

Inclusive access to finance is not only pro-growth but also pro-poor, reducing income inequality and poverty, and improving welfare.[33] Millions of microfinance clients demonstrate that poor people can seize opportunities provided by appropriate financial services efficiently and imaginatively if available.

Good regulation is critical for innovative financial inclusion

From the perspective of increasing access for all to a range of financial services, regulators have three main goals: maintain financial soundness and stability (consistent with international standards), encourage the provision of financial services to the poor and the not-so-poor, and protect the interests of the customers. Since financial innovation has emerged as a promising vehicle to greatly expand access, policy makers and regulators face the challenge of clearing the way for innovation while continuing to meet its other goals. It takes well-informed, experienced and hard-working regulators and policy makers (learning from peers and leaders) to strike the balance. For example, competition is an important driver of financial innovation, but competition unconstrained by an appropriate regulatory framework can have serious negative consequences, just like its counterpart, market dominance. The entrance of non-financial service providers and alternate delivery channels, ranging from retail outlets to telecom companies, further complicates the task.

Good practices: The past couple of decades have witnessed marked changes in the financial services arena, encouraged in part by dramatic improvements in technology and in the quality of telecommunications and information services. Rapid innovation is often accompanied by alternating episodes of liberalisation, de-regulation and re-regulation, as authorities have reconsidered the legal and regulatory framework in which financial institutions operate to ensure that the financial services industry remains safe and sound, but also flexible, innovative and efficient. While there are special conditions appropriate for regulation for innovative financial access, the experiences of the last decades suggest that there are some broad best practices that should be followed in designing or revising financial regulatory frameworks. These best practices, which are

[32] OECD has set up in International Gateway on Financial Education that aims to serve as the global clearinghouse on financial education. http://www.financial-education.org/pages/0,2987,en_39665975_39666038_1_1_1_1_1,00.html

[33] Demirgüç-Kunt, Beck and Honohan (2008).

articulated below, draw on work done by the OECD[34] and provide a valuable complement to the principles for innovative financial inclusion that are the focus of this paper.

GENERAL GOOD PRACTICES FOR AN EFFECTIVE AND EFFICIENT FINANCIAL REGULATORY PROCESS

Efficient regulation is essential to a well-functioning economy and can be used to achieve important economic, social and environmental objectives. The financial system in particular could not operate without a range of comprehensive regulatory frameworks, including those that establish accounting, auditing, legal and judicial systems, as well as sector-specific requirements such as prudential regulation. Regulation that is properly designed and implemented helps the financial system to function as intended. In this context, high-quality regulation may be defined as that which produces the desired results as cost efficiently as possible. The two main components of this definition are that regulation succeeds in achieving the intended objective (i.e. it is effective) and does so at reasonable cost (i.e. it is efficient). Good practice regulation making process is comprised of four main steps.

First, policymakers should make the case for regulatory intervention. This involves:

- defining the regulatory philosophy and establishing proper policy objectives;
- establishing an open and transparent regulatory decision-making process; and
- comprehensively analysing the market failure to identify and define the issue to be addressed and determine whether there is evidence that government action is justified.

Second, policy makers should design and implement appropriate policy measures, by:

- identifying measures that address the problem as identified, including non-regulatory measures and the status quo;
- assessing the benefits and costs of each alternative policy proposal, preferably through a formal and structured regulatory impact assessment; and
- designing and implementing the chosen regulatory solution while taking account of issues including clarity, consistency, proportionality and accountability.

Third, to guarantee the success of policies, authorities should design effective enforcement strategies, preferably by leveraging off existing incentive structures. Enforcement measures should be fair and transparent and well-integrated in the overall regulatory decision-making process.

Finally, policymakers should conduct ex-post evaluation, to determine whether the regulation remains relevant in its current form or if its goals could be better achieved in another way. Less frequently, the entire regulatory framework – including the underlying regulatory philosophy, should also be reviewed.

[34] OECD (2009).

These steps are incorporated into the nine Principles for Innovative Financial Inclusion: Principles 1 and 2 make the case for regulatory intervention; Principles 3, 4, 5, 7 and 9 are about designing and implementing appropriate policy measures; incorporated into Principles 6 and 9 are strategies for accountability and enforcement; and the focus of Principle 8 on continuous assessment is totally consistent with the need for evaluation to assess whether the regulation is achieving its goals.

BRAZIL CASE

Brazil is an innovative financial inclusion leader due to the success of its agent (or correspondent) model.

The Financial Inclusion Challenge for Brazil: Brazil covers 8.5 million square kilometers with 5,564 municipalities and 190 million inhabitants (approx. 2008), almost 20 million of whom live in states with population densities under 6.4 inhabitants per square kilometer (2007), such as the Amazon region. Traditional bank branches in these areas are very expensive and sometimes difficult to get to – some towns are only accessible by boat or plane. But, since 2002, all municipalities have access to financial services.

Action taken by Brazil to promote Financial Inclusion: Some of the important steps taken by the Central Bank of Brazil (CBB) in their development of the agent model are noted in the timeline below.

- (1979) Financial institutions set contracts with agents compliant with minimum requirements provided by regulation.
- (1995) Agents are not permitted to charge extra fees.
- (1999) All institutions regulated by the CBB are held liable for their agents´ actions; the agent must post a notice stating that it is acting on behalf of the regulated entity.
- (2003) CBB has full access to the documents, information or data related to the transactions conducted by the agents.
- (2003)All institutions regulated and supervised by the CBB are allowed to hire agents.
- (2008) Institutions no longer need to obtain a license from the CBB for each contract, they just have to register the agent on its system.
- (2008) The agent is allowed to conduct international remittances (subject to specific procedures), limited to a cap of US$ 3,000 per transaction.

The CBB doesn't interfere in the business model e.g. technology, remuneration or exclusive services.

Financial Inclusion Analysis: Brazil's success with using agents to expand access to financial services is a result of many years of experience, evolving from more restricted possibilities to less stringent licensing conditions, without loosening the monitoring capacity of the supervision authority. However, this important achievement has been only possible because of coordination among different stakeholders, such as financial system regulators, private institutions and other governmental entities, which together supported financial inclusion with the overall goal of meeting customers´ needs. But there is still much work ahead to maintain and expand innovations achieved to date. New challenges include claims by agents for the same labor rights as banking employees and discussions about agents' security requirements. These will require a coordinated approach, involving different authorities. [35]

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[35] Sources: Banco Central do Brasil (2010); Soares and Sobrinho (2008); Fadel and Dias (2009); Wikipédia - based on data of Instituto Brasileiro de Geografia e Estatística - http://pt.wikipedia.org/wiki/Lista_de_estados_do_Brasil_por_densidade_demogr%C3%A1fica; and Instituto Brasileiro de Geografia e Estatística..

Standard setting bodies (SSBs): Five international financial SSBs provide guidance for regulatory and supervisory authorities in areas of particular relevance to innovative approaches to deepening financial inclusion. These include

- The Basel Committee on Banking Supervision (BCBS) for sound banking;
- The Committee on Payment and Settlement Systems (CPSS) for both payments systems and remittances;
- The Financial Action Task Force (FATF) for anti-money laundering and counter-terrorism (AML/CTF);
- The International Association of Insurance Supervisors (IAIS) for insurance markets; and
- The International Association of Deposit Insurers (IADI).

The Financial Stability Board (FSB) is an umbrella organization established by the G20 to coordinate and oversee the work of the SSBs, among other responsibilities.

FATF is the SSB typically considered to be of particular relevance for increasing access through innovation since it can be difficult to be certain that domestically designed risk-based approaches to implementing FATF standards will be seen as fully compliant. But in the words of FATF President Paul Vlaanderen in a letter to the ATISG Co-Chairs on 1 April 2010 "Financial integrity and financial inclusion are [therefore] complementary policy objectives. The question is how to harvest potential synergies and how to address existing uncertainties." Adopting risk-based approaches to money laundering and terrorist financing recommendations – tailored to the realities and needs of low-income population segments traditionally excluded from the formal financial sector – promotes not only financial inclusion but also financial integrity as more people are brought into the formal and more easily monitored financial sector.

Data is critical for policy makers and regulators. Financial sector depth - measured as domestic credit provided by the banking sector - has increased rapidly since 2000.[36] But other than this measure, policy makers and regulators typically have very limited data for measuring access to financial services. This is also true for the insurance sector - measured by insurance penetration (premium in per cent of GDP) and density (premium per capita). One key problem is that analysis of aggregated data sets has limited value. Simply knowing how many deposit accounts there are, for example, does not reveal much. Some individuals or firms may have multiple accounts, while others have none and some are dormant. Even so, less than 70 per cent of countries collect information on the number of bank deposit accounts and even fewer countries have information on regulated non-bank institutions. Only 30 per cent of countries could provide information on the number of deposit accounts in cooperatives, specialized state financial institutions, and microfinance institutions. Regulatory authorities generally have no need to collect data on individual account holders for financial system stability and so this data is not systematically available. Data on the number of loans are even more limited. As a result, there are no reliable time series data for financial access available.

Work has been launched in recent years to generate new evidence about financial access by the World Bank, by academics who are part of the Financial Access Initiative, by FinMark Trust, by national regulators and others. For example, a series of nationally representative surveys focused entirely on financial sector issues

[36] World Bank (2009). While domestic credit in high income OECD countries expanded considerably in the 1990s, from 145 per cent of GDP in 1990 to 186 per cent in 2000, it remained largely static in low and middle income countries, at around 30 per cent and 69 per cent respectively. From 2000 to 2008, the opposite happened, with domestic credit changing very little in high income OECD countries, but increasing from 30 to 46 per cent of GDP in low income countries and from 69 to 74 per cent in middle income countries.

has been carried out by FinScope in 14 African countries and in Pakistan at the request of the authorities, and repeat surveys carried out in several of them.

Regulatory Approaches to Branchless Banking: In this specific area and from the point of view of existing regulation in many countries, it can be useful to think of branchless banking as consisting of two basic models: a bank-based model and a nonbank-based model.[37] In the bank-based model, customers have a direct contractual relationship with a bank or similar prudentially regulated and supervised financial institution — a transaction account, a savings account, a loan, or some combination—even though the customer may deal exclusively with the staff of one or more retail agents hired to conduct transactions on the bank's behalf. In the non-bank-based model, customers do not have a direct contractual relationship with a bank or similar prudentially regulated and supervised financial institution. Instead the contractual relationship is with a non-bank service provider such as a mobile network operator or an issuer of stored-value payment instruments. Customers exchange cash at a retail agent in return for an electronic record of value. This virtual account is stored on the service provider's server. Nevertheless, although there is no contractual relationship directly between a bank and a customer, a bank is likely to be involved, for example, as a potentially safe and liquid place for the non-bank provider to hold the float.

The regulatory significance of the distinction between the bank-based and nonbank-based models lies in the fact that behind every transaction under the bank-based model, there stands a prudentially regulated and supervised financial institution. In the case of the non-bank model, unless reforms have been undertaken to bring non-bank providers under an appropriate regulatory framework, this may not be the case.

However, business models in branchless banking are proliferating, and "bank-based" does not necessarily mean "bank-led." In many cases, the bank involved in the bank-based model may have outsourced such critical functions—and risk—to non-bank actors that it has in effect shifted the primary focus of regulatory concern from the prudentially licensed bank to its unlicensed partner. For this reason, among others, policy makers and regulators increasingly focus on the risks involved in branchless banking, and prescribe regulation that attempts to mitigate these risks for a variety of potential types of provider. The approach is type-of-service-driven regulation that, to the extent possible, provides a level playing field for both bank and non-bank providers, while mitigating the risks to customers, the institutions, and the financial system.

Competition and Increasing Financial Access: To increase financial access leaders in this field have recognised that "policy should encourage competitive provision of financial services to customers such as low- and middle-income households and small firms. Policy should favour entry of qualified suppliers that are likely to improve the quality and price of services to such customers (in a manner consistent with financial stability and consumer protection). Competition policy should empower the active investigation of anticompetitive behavior".[38] Effective competition requires clients to have both the information and the skills to compare rates and product attributes, one of the many reasons that developing financial capability is so critical. Examples of the positive effects of competition include better terms for borrowers, e.g., reduced

[37] Lyman, Ivatury and Staschen (2006).
[38] Claessens, Honohan and Rojas-Suarez (2009).

interest rates and expanded services. Examples of the negative effects of competition in poorly regulated and supervised financial markets abound.

However, there are additional challenges in addressing competition issues in markets where profits are razor thin and huge volumes of transactions are necessary to achieve financial viability. Policy-makers may need to consider ways to enable service providers achieve economies of scales through partnerships and the outsourcing of certain functions, such as the design and operation of the technology platform.

Regulatory Issues Specific to Innovative Financial Service Delivery: Diagnostic work shows that the following regulatory issues are the most central:

- rules applied to low-value accounts, payments and agents;
- the use of retail agents for handling cash-in/cash-out functions and other customer interface functions such as account opening;
- oversight and rules for payment system access and participation, with a focus on retail payment systems, as well as the delineation among, payments, e-money and other stored-value instruments, and deposits;
- rules governing liability and recourse, disclosure, and data privacy and security; and
- rules around creating a level playing field for providing new services, averting undue market dominance, striking the balance between competition and cooperation, and promoting interoperability and interconnection.[39]

Other Determinants of Success in Expanding the Reach of Financial Services: In addition to the regulation issues identified above, three other interrelated issues will determine how rapidly branchless banking scales up and pushes the frontier of financial access in a significant way: (i) development of profitable business models with sufficient incentives for all involved to serve low-income people with financial services; (ii) understanding of incentives and other factors (e.g. cultural norms) that affect customer adoption among unbanked poor people, especially the financial capability of customers[40]; and (iii) how complex political economy challenges play out in each market, including the role of powerful stakeholders in the government and private sector.

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[39] The nine areas considered in the original diagnostic assessments were those listed, plus: *E-commerce and e-security:* rules on the legal status of electronically authorized transactions (e-signatures) and rules that ensure adequate security for conduct of banking via electronic channels; *Foreign exchange control:* rules affecting foreign remittances in or out; *Taxation:* differing tax treatment of transactions depending on channels and types of entities involved; and *Telecommunications regulation:* rules affecting mobile phone-based financial services. Lyman et al (2008).

[40] Banking beyond branches must be accompanied by efforts to improve consumers' financial capability to enable uptake and responsible use of services. Key issues at the intersection of financial capability and branchless banking include improving consumer awareness of the availability of branchless banking services and products, and how they can make their lives easier; equipping consumers with skills to subscribe to branchless banking services and use the relevant technology e.g. mobile phones or agents at retail outlets for transactions; building consumers trust and confidence in using new technology-based methods for financial services. Furthermore, financial capability and branchless banking have potential mutually reinforcing benefits such as using mobile phones or agents to improve financial capability, for example, sending text messages on financial topics such as the importance of savings.

Principles for Innovative Financial Inclusion

The following principles for innovative financial inclusion are derived from the experiences and lessons learned by policymakers throughout the world, especially leaders in financial inclusion from developing countries. These principles are a reflection of the conditions conducive to spurring innovation while protecting stability and consumers. They are not a rigid set of requirements but are designed to help guide policymakers in the decision making process. They are flexible enough so they can be adapted to different country contexts.

1. **Leadership:** Cultivate a broad-based government commitment to financial inclusion to help alleviate poverty.

The governments of the most successful countries in the area of financial inclusion have demonstrated, at the highest levels, a strong commitment to expanding financial inclusion as a critical component of their national growth and development strategies. The depth of their commitment can be manifested in a variety of ways including: the governments' proactive approach to addressing policy and regulatory issues; openness to considering innovation; fostering broad-based alliances; captivating private sector interest; offering supportive services such as financial education and payment system infrastructure; gathering and providing data on the nature and depth of the unmet demand for financial services; and paying careful attention to proportionality in measures to maintain the safety and soundness of their financial systems. The cases of Mexico and Pakistan below illustrate this. In the absence of such government leadership, efforts by the private sector and non-profits to increase financial inclusion are likely to fail to reach their full potential as regulatory, market infrastructure and competitive barriers go unaddressed.

Mexico: The Federal Government conducted by Secretariat of Finance and Public Credit established in the Development National Plan 2007-2012 a policy agenda in order to increase financial inclusion level, strength consumer protection and enhance financial literacy. The Secretariat works closely with the supervisory agencies, the Central Bank of Mexico, as well as the National Savings Bank and legislators amongst other policymakers to keep financial inclusion as a priority on the policy agenda. In 2008, the Mexican Congress approved a reform to the Banking Law in order to enable the use of non-financial entities as banking agents and allow to establish Specialized Banks "Niche Banks" in order to increase the financial services access. The National Banking and Securities Commission of Mexico issued the operational rule for the use of non-financial entities as banking agents to provide financial services in underserved regions. To expand their reach to unbanked rural areas, Savings and credit institutions received assistance to become formal regulated institutions and accept deposits and were supported by the new National Savings and Financial Services Bank, created to provide back-office and banking services to these institutions in close cooperation with the Secretariat of Finance and Public Credit, National Banking and Securities Commission and the Secretariat of Agriculture, Livestock, and Rural Development.

Pakistan: Broad-based political commitment to financial inclusion in Pakistan is demonstrated by its key place in the overall financial sector strategy for the country. With the State Bank of Pakistan at the forefront of these efforts, a wide range of policymakers are taking substantive steps to fulfill these objectives. Examples include support for the commercialization of the microfinance industry, facilitating competition in the industry by allowing multiple domestic and international players, and innovating and diversifying product and service delivery channels. Policy innovations and regulation for financial inclusion include a pilot partnership between the First Microfinance Bank Limited and Pakistan Post to use the national post office infrastructure for expanded outreach; financing facilities and funds for institutional strengthening for

microfinance; and guidelines for how microfinance banks and microfinance institutions can share information about their customers through private pilot credit information bureaus with necessary privacy safeguards. The State Bank of Pakistan has adopted enabling regulation for the delivery of financial services through agents and mobile phones. Other policymaking bodies also support these efforts. The Ministry of Finance has recommended consistent tax treatment for mobile banking operations to support national outreach to rural and remote areas. The Pakistan Telecommunications Authority has also regularized registration and annual license fees on satellite communication systems and other technologies relevant to the outreach of financial services.

2. **Diversity**: Implement policy approaches that promote competition and provide market-based incentives for delivery of sustainable financial access and usage of a broad range of affordable services (savings, credit, payments and transfers, insurance) as well as a diversity of service providers.

A diversity of innovative products and providers in the marketplace can increase the availability of services and promote healthy competition. Experience has shown that to reach traditionally un-served populations, expanding the remit of financial institutions to offer banking services beyond branches and expanding the range of financial service providers and products, is essential. The Brazilian, Kenyan and India cases (see below) illustrate a diversity of new financial services and providers to increase access and usage. Governments should facilitate the development of market structures that promote entry and competition among all types of financial services and providers. In designing such systems, care must be given to ensure that appropriate incentives are provided to participants in the supply and demand chain e.g. banks, communications technology providers (such as mobile phone operators), agents (such as retail outlets), microfinance institutions, mutual funds, insurance providers, remittance service companies and customers. Policy and regulatory arrangements that establish the groundwork for competitive and market-based approaches will be critical for delivering sustainable improvements in access. Regulatory experience in other areas suggests that it can be very difficult to limit the adverse influence of entrenched interests that can develop around preferential marketing arrangements. Policymakers should be aware of this but not let it stop them from implementing policy approaches that expand financial access and usage.

Brazil: Brazil's correspondent banking system enables clients to access a range of services from bank agents. Services include opening bank accounts, obtaining credit cards, and buying shares of mutual funds through agents that receive and forward applications. Applications for loans can also be submitted through agents. Clients can use agents to make and receive a variety of payments. These may be loan payments, receiving government benefits, utility bills, and taxes. Funds can also be transferred between parties, such as person-to-person transfers. Agents have not always been able to provide such an array of services – this has been an evolution that began with simple payments. Recently, regulation has enabled certain authorized institutions to allow agents to conduct international money transfers. Policymakers have also supported the growth of agent banking through the creation of simplified accounts and by channeling government transfers through accounts that can be accessed through agents. This was an important step in making the agent model sustainable and supporting the widespread use of these accounts and services. Brazil continues to explore other avenues to increase access to and use of financial services. A 2009 national conference on financial inclusion for Brazil, hosted by the Central Bank of Brazil, revealed that there is a focus on increasing the level of credit available through microfinance activities and that the Central Bank aims to diagnose the state of the microfinance sector. Furthermore, policymakers in Brazil are taking first steps in microinsurance with the drafting of a Microinsurance Bill to provide high-level legislative guidance.

Kenya: Kenya's experience as a pioneer in mobile phone financial services through the "*M-Pesa*" service has allowed over eight million Kenyans to gain access to financial services (as of December 2009) that centre

around simple payment services. A financial inclusion goal central to Kenya's Vision 2030 strategy drives the Central Bank of Kenya to continue to play an active role in expanding access in its domain of regulating and supervising commercial banks. In 2009-2010, the Central Bank of Kenya investigated two areas which will have a dramatic impact on reducing the costs of delivering financial services through the banking system: the introduction of agents for use by the banks to deliver their services; and the revision of current regulations and guidelines related to branch outlets. Kenya has proposed amendments to the Banking Act to allow for the use of agents and a draft regulation has been issued for comment. Kenya is also looking to expand access to microinsurance and the Insurance Regulatory Authority of Kenya is investigating necessary amendments to the Insurance Act for this purpose.

India: India's Insurance Regulatory and Development Authority has relaxed agent regulation, promoted linkages between regulated insurers and nongovernmental organisations (NGOs), introduced product features, and allowed composite insurance services through its microinsurance regulations. It has allowed self-help groups to tie-up with insurers not only for the collection of proposal forms, but also for the collection and remittance of premium and policy administration services. The regulation has also allowed self-help groups to assist in the claims settlement process.

3. **Innovation**: Promote technological and institutional innovation as a means to expand financial system access and usage, including by addressing infrastructure weaknesses.

Experience has shown that key sources of innovation in expanding financial system access and usage have been new technology and new institutional arrangements. Harnessing the capacity of technology to reduce costs has made it economically viable for financial service providers, often in partnership, to reach significantly greater numbers of poor people without compromising the safety and soundness of financial operations. The case study below shows how e-money and mobile phones are being used for loan payments, deposits and transfers in the Philippines. Technology can also play a critical role in building a financial identity for the previously unserved by transforming their transaction history into an asset that they can use to leverage access to financial services. Increasing numbers of countries with large financially excluded populations are also pioneering institutional innovations such as the use of agents as the customer point of contact to bridge physical barriers and lower costs. Brazil's case, below, demonstrates how the effective introduction of agents can rapidly expand access. However, experience in some countries has also shown that infrastructure weaknesses, for example in interbank and wholesale payment systems, can inhibit the introduction of such innovations and may also need to be addressed according to national priorities.

The Philippines: In the Philippines, technological and institutional innovations have enabled the growth of two different pioneering models of mobile phone financial services: the bank-based *Smart Money* (led by mobile network operator SMART) and the non-bank-based *G-Cash* (led by mobile network operator Globe Telecom). Though permitted to launch by the Central Bank of the Philippines on a "test and learn" basis at a time when little relevant regulation was in place (see Principle 7 below), both models continue to flourish now under carefully crafted regulation on the issuance of electronic money. The Filipino e-money circular, tailored to the risks involved with the types of financial services in question, creates a level playing field for both bank and non-bank providers, while maintaining the integrity and stability of the financial system. Beyond the flexibility shown in permitting the original launch of *Smart Money* and *G-Cash*, the Central Bank of the Philippines has continued to make space for innovation, entering into dialogue with industry to allow mobile financial services to evolve. For example, Globe Telecom has been allowed to use sub-distributors to act as cash-in/out agents for its *G-Cash* product. This is expected to increase the reach and add significantly to the convenience and use of the *G-Cash* product. The Central Bank of the Philippines has also been involved in dialogue with the Rural Bankers Association of the Philippines to allow the launch of an innovative application using mobile money. The Association developed specific mobile phone banking

applications that utilize the *G-Cash* platform to support the microfinance services offered by the rural banks. These allow rural bank clients to make loan repayments, deposits, transfers, etc. using their mobile phones.

Brazil: The correspondent (or agent) model in Brazil has flourished through the use of technological and institutional innovation under the supervision of Central Bank of Brazil. The model in Brazil was adopted to address a crucial physical access barrier where many municipalities did not have a single bank branch. Retail stores, lottery outlets and post offices are now employed by regulated financial institutions to act as their agents and use point-of-sale devices or mobile phones, which allow them to conduct transactions on behalf of the institutions they serve. The Central Bank of Brazil enabled the growth of this model by allowing all financial entities regulated and supervised by the Central Bank of Brazil to hire agents anywhere in the country, and by providing: clarity on which services could be delivered by the agents; the necessary guidelines on contracts between the institution and its agents; and the reporting requirements to the Central Bank of Brazil. Agents are indirectly supervised by the Central Bank of Brazil through the regulated institutions which are liable for the actions of their agents. In addition agents may be inspected by the Central Bank of Brazil if deemed necessary. To hire new agents an institution needs only to register the agents in the Central Bank of Brazil online system and keep these records up to date.

4. **Protection**: Encourage a comprehensive approach to consumer protection that recognises the roles of government, providers and consumers.

Introducing new services, new service providers, new avenues for service delivery to inexperienced service users can create an environment with significant scope for consumer fraud and abuse, as well as unintentional technical and human errors that put consumers' interests at risk. Developing equitable, sustainable and transparent financial markets is an important goal of consumer protection laws and regulations. All major stakeholders in the financial markets – providers, consumers and government – are required to work together responsibly to create a responsible finance framework that will protect customers. Governments, regulators and supervisors should consider establishing clear and transparent consumer protection regulations that require transparency in pricing and services; identify the parties ultimately responsible for upholding the protections (including protections against fraud with funds entrusted to the service provider or its agent); define supervisory authority; and ensure effective means of dispute resolution and redress are in place. Financial services providers are also part of the solution as they have an incentive to build trust and long-term relationships with their clients. And consumers are at the center of financial markets. They need to understand both their rights (such as recourse mechanisms) and their responsibilities (such as paying on time). The remit of consumer financial service protections varies significantly across countries. The innovative financial inclusion path-breakers offer some examples from which to learn. Colombia, Mexico and India have mitigated the risk posed by the use of agents by placing liability on financial service providers for agents' violations of regulation applicable to the outsourced services. In considering regulation on all of these topics, care is warranted not to set the consumer protection bar so high that responsible providers are dissuaded from entering the market.

Colombia, Mexico and India: Holding providers liable for the acts of third parties delivering services on their behalf is a basic risk management standard applied to all outsourcing in financial services; it is also a powerful consumer protection tool. The agency regulations in Colombia, Mexico and India, for instance, hold financial institutions liable for their agents' acts within the scope of their agency, and place responsibility on agents to comply with bank secrecy and data privacy rules. In addition, providers in Colombia and Mexico are required to train agents on anti-money laundering controls, post their customer service number and all applicable fees and charges at agent facilities, establish out-of-court redress mechanisms, and make sure

that safety and privacy features of data storage and transmission are robust enough to prevent loss or theft of customer funds and information. But poor, unbanked customers in these and other countries pioneering innovative financial inclusion face other risks which providers cannot be asked to cover. For instance, a bank generally will not be held liable for the misdeeds of a merchant who collected deposits and payments from the public pretending to be its agent. To reduce this particular risk, Mexico publicizes a current list of all existing agents through a variety of media, and educates consumers on how to check on agent status (e.g., by calling the provider or the consumer protection body). In order to strength consumer protection, the Mexican Congress issued the new Transparency of Financial Services Law in the summer of 2007, which establishes more precise transparency standards regarding the fees charged by financial institutions, disclosure statements principles and the obligation for banks to offer basic saving products. Also, in 2009 the Congress issued legal reforms in order to establish the fundamental pillars to adequate consumer protection rights by strengthening the powers of the CONDUSEF (Financial Consumer Protection Agency).

5. **Empowerment**: Develop financial literacy and financial capability.

Financially capable consumers have the knowledge, skills, attitude and behaviors to be aware of financial opportunities, make informed choices to suit their circumstances, and take effective action to improve their financial well-being. Low levels of financial capability form a significant barrier to accessing and properly using formal financial services. With enhanced financial capability, poor people will be able to understand basic financial concepts, appreciate how newly available services can meet the needs currently filled via informal financial arrangements, and have the skills to apply their knowledge. Their financial capability is a necessary complement to consumer protection, as it enables clients to understand the information that banks and other providers are required to disclose and to make use of the available recourse mechanisms. It is also a complement to supply-side measures, as developing financial capability can build demand for innovative financial services. Experience has shown that the most effective financial capability initiatives provide practical, easy-to-understand and impartial advice so consumers can make informed choices. Examples of this experience in Ghana and South Africa are discussed below. More details and private sector examples of measures to increase financial capability in the case of branchless banking customers are included in Appendix 5.

Ghana: The Ghanaian goverment considers that consumers must be capable of making well informed financial decisions and financial service providers must follow principles of responsible finance to increase participation in the financial markets. A survey in 2007, however, revealed that the level of knowledge of financial institutions, services, and products among urban Ghanaian adults was low and that even when consumers were knowledgeable, this did not translate into behavioral changes. In response, the government together with its development partners launched an extensive Financial Literacy Program in 2008 to create awareness of financial topics and build a relationship of trust between consumers and financial service providers – deemed a prerequisite for sustainable financial inclusion. In January 2009, Ghana's National Forum on Microfinance adopted the National Strategy for Financial Literacy and Consumer Protection in the Microfinance Sector, one of the first national strategies on financial literacy in Africa. The strategy addresses key dimensions of financial capability: knowing, understanding and behavioral change. The three main activities carried out include: Financial Literacy Week, ‘Road Shows’ in rural areas, and the development of educational material on loans, saving, (micro) insurance and investment.[41]

[41] Adapted from *“Fact Sheet: Financial Literacy in Ghana”* Ministry of Finance and Economic Planning & SPEED/GTZ FSD Ghana.

South Africa: The National Credit Regulator and the Financial Services Board have responsibility for enhanced financial capability in the areas of consumer credit and non-credit services, respectively. The Financial Services Board Act (1990) mandates the Financial Services Board to "promote programs and initiatives by financial services institutions and bodies representing the financial services industry to inform and educate users and potential users of financial products and services". The Board has engaged in financial education activities, some of these have included community outreach and awareness workshops to improve knowledge of basic concepts and consumer rights, playing tapes in taxis that provide basic financial education messages, and teacher training materials to support them in providing financial education in schools. Financial education has been incorporated into the school curriculum. The Board also established the Financial Education Foundation, with an independent governance structure, for funding financial education activities. The National Credit Regulator has largely focused on building knowledge of consumer rights and recourse mechanisms in order to foster better attitudes to addressing problems, and education materials in order to promote responsible use of credit.

6. **Cooperation**: Create an institutional environment with clear lines of accountability and co-ordination within government; and also encourage partnerships and direct consultation across government, business and other stakeholders.

Innovative financial services and delivery channels typically cross multiple, distinct regulatory domains and public bodies. Coordination failure amongst the relevant authorities can constrain the growth of innovative services and create unforeseen problems. Dialogue and policy coordination are key to identifying and coping with risks associated with new products and delivery channels. A formal arrangement for coordination such as those that Pakistan, Colombia and Brazil have set up, with a lead agency clearly identified and empowered to set up and manage coordination mechanisms, will improve accountability, the effectiveness of regulatory reforms and the consistency of relevant regulations across regulatory spheres. In addition, dialogue with private sector and other industry stakeholders is essential if regulators are to understand the different incentives for each of the actors involved in innovative approaches to serving low income customers, as well as how these incentives might be affected by regulation. Actively promoting partnerships and direct consultation among stakeholders can contribute to increasing efficiencies and stimulating innovation.

South Africa: In 2006, the Ministry of Finance and the South African Reserve Bank coordinated on customer due diligence requirements in branchless banking to create a model for proportionate regulation combating money laundering and the financing of terrorism. In 2008 the Department of Justice independently amended legislation that permits the interception of information passed over electronic communication channels, including mobile phones. The amendment compels operators and distributors of mobile phones to perform customer identification and verification procedures on any person to whom they provide a mobile phone or SIM-card (including both new and existing clients). These measures are intended to counter the abuse of mobile phones by criminals. However, an unintended result is that some customers are finding it difficult to meet the new requirements and are at risk for losing both their access to mobile communication as well as the ability to use their phones to access financial services. Further inter-authority coordination may be required if South Africa wishes to continue to support the expansion of mobile banking serving the unbanked poor.

Pakistan, Colombia and Brazil: In Pakistan the Governor of the State Bank of Pakistan launched a strategy to improve financial inclusion in 2007, and branchless banking was included as an important component. When she formed a committee to discuss enabling regulation, she invited not only the relevant units of the State Bank, but also representatives of the Ministry of Information Technology - the primary regulator of mobile network operators and a vitally important constituency if innovative financial inclusion is to reach its potential. A Colombian government program aimed at fostering financial inclusion known as "Banca de las

Oportunidades" ("banking opportunities") successfully coordinated with the tax authority and the banking sector to exempt transactions between banks and their agents from a tax imposed on financial transactions. This avoids a double tax that would likely have rendered doing business through agents unprofitable or simply too complex for either agents or banks to be bothered with. Banca de las Oportunidades also successfully coordinated with the tax authority to exempt low-value financial transactions on simplified savings accounts, such as mobile phone-based accounts. This is an example of inter-authority coordination to overcome a specific, significant regulatory barrier. In Brazil, an interdisciplinary Microinsurance Commission was set up, comprising all relevant government entities, the insurance industry and other private sector players such as industry networks and academic institutions. The Commission has recommended: (i) differentiated treatment for microinsurance and a separate license category for underwriting microinsurance; (ii) specific consumer protection norms via product regulation; (iii) the introduction of a microinsurance broker – with lower training requirements; and, (iv) the introduction of a microinsurance correspondent – to regulate the relationship between insurers, insurance consumers and intermediaries.

7. **Knowledge**: Utilize improved data to make evidence based policy, measure progress, and consider an incremental "test and learn" approach acceptable to both regulator and service provider.

Appropriate and reliable data are needed by policy makers and regulators to assess financial inclusion performance, inform the design of appropriate policy, monitor progress over time, and measure policy impact. Periodic progress reports can also help focus policy attention on outstanding financial inclusion issues. Currently available data typically falls far short of the level required. Most countries do not compile financial inclusion data, while others have incomplete data or data that provides an overly-simplistic view of financial inclusion and thus does not support evidence-based policy making. Some countries are taking action to address the data gap. Mexico, for example, has made a commitment to improve its financial inclusion data, and in the Philippines, innovators are required to provide detailed operational data so the Central Bank can track progress.

Achieving the appropriate balance between safety and soundness, on one hand, and facilitating growth and development, on the other, is particularly difficult in cases where innovative approaches, new services and untested business models figure prominently. Unanticipated risks can emerge down the road while perceived risks can generate overly cautious regulatory approaches. Since a deeper knowledge of the actual risks will emerge as markets mature, a "test and learn" approach to regulation, under which incremental adjustments to policy are made after businesses launch may help achieve regulatory balance. For example, the Central Bank of Kenya permitted branchless banking business schemes on an *ad hoc* basis, conditioned on measures acceptable to both the regulator and financial service provider to address identified risks, as well as compliance with other relevant existing regulation such as market conduct rules. Now that the market has developed considerably, the Central Bank of Kenya is considering adjustments to its regulatory framework.

The Philippines: Filipino regulators state expressly that their approach is to "follow the market." After satisfying themselves that the *Smart Money* and *G-Cash* branchless banking schemes proposed by the country's two largest mobile network operators each adequately addressed perceived risks, regulators approved their operation on an ad hoc basis. As a condition of their permission to launch, *Smart Money* and *G-Cash* each agreed to furnish detailed operational data to the Central Bank of the Philippines. Based on its observations of the market's development over more than four years, the Central Bank of the Philippines issued e-money regulations in 2009 carefully tailored to the domestic market. For example, since e-money

schemes in the Philippines were operated by both banks and non-banks, the regulation addresses e-money as a service that may be provided by either legal type.

Kenya: Kenya provides another successful example of the "test and learn" approach. Before mobile network operator Safaricom's launch of its *M-Pesa* branchless banking scheme in March 2007, the Central Bank of Kenya sent a private letter to Safaricom clearing the way for the launch. Owing to the particularities of Kenyan regulation then in effect, the letter reportedly stopped short of an affirmative approval, but nonetheless provided a sufficient basis for the product to be rolled out, conditioned on Safaricom keeping an audit trail of *M-Pesa* transactions and abiding by the terms of the Kenyan Anti-Money Laundering Bill (then in draft). The letter also reportedly notified Safaricom that *M-Pesa* would be subject to the country's planned National Payment Systems Bill once it became law. The letter effectively enabled *M-Pesa*'s operations, but mitigated the main identified risks and secured for the central bank a data stream to monitor and assess activity on an ongoing basis. A few years after *M-Pesa*'s launch, Kenyan regulators are now drafting e-money regulations based on a deeper understanding of how the Kenyan market has developed and with a clearer understanding of the risks involved.

8. **Proportionality**: Build a policy and regulatory framework that is proportionate with the risks involved in such innovative products and services and is based on an understanding of the gaps and barriers in existing regulation.

Under a proportional regulatory framework, regulatory requirements vary with the benefits and risks associated with a financial service or the provider of the financial service. The aim should be for regulatory policies that enable, rather than inhibit, appropriate innovation in connection with regulated activities in a way that manages risk. The challenge lies in tailoring regulation to mitigate the risks of specific types of services and delivery approaches without imposing an undue regulatory burden that could stifle innovation. Estimates vary according to a variety of characteristics of the service or service provider, including scale, accessibility, financial backing, duration, supervision, and systemic importance. Proportionality in regulation can be accomplished, for example, by setting different requirements correlated with the differing levels and types of risk involved in different activities, as Brazil has done in the case below. Proportionality is particularly critical to efforts to adopt innovative approaches to expanding financial inclusion, where experience is just now emerging. The compliance costs associated with an unduly burdensome regulatory regime could prevent the entry of service providers or squeeze out those attempting to introduce new business models, products and services. Unnecessarily restrictive regulation can also force customers to continue to use informal service providers where risk to financial integrity (and to the customers) can be much higher. Regular thorough diagnostic exercises which identify the gaps and barriers in current policy and regulation should inform sound innovative financial inclusion policy formulation, as the experiences of Argentina, Russia and Mexico demonstrates. Such reviews are important because the barriers and gaps in existing regulation that prevent innovative financial inclusion reaching scale rapidly, yet safely, are not necessarily obvious. Often, they only become apparent after: close expert diagnostic analysis of laws, regulations, and other policy guidance; discussion with relevant policy makers and regulators about the application of these texts to the facts of proposed branchless banking approaches; and dialogue with industry proponents.

Brazil: The experience gained by the Central Bank of Brazil over more than a decade of the supervision of branchless banking has allowed it to assess the risks involved in the business of providing financial services through agents. The Central Bank has concluded that most agent-related risks are not material enough (either systemically or institutionally), and as a result recently determined that requiring authorization to use

agents is disproportionately onerous, particularly given that the Central Bank holds institutions fully liable for the actions of the agents they select. Other risk-mitigating measures that support this approach include: (i) requiring regulated institutions to manage their own risk e.g. by setting transaction limits or implementing mechanisms to block transactions remotely when necessary; and (ii) subjecting the agency agreement and all supporting documentation related to the services rendered by the agent to scrutiny by Central Bank, which also conducts onsite and offsite inspections. At the same time, the Central Bank is currently preparing changes in the agency regulation that will address existing gaps (such as the definition of agents), and is conducting impact studies of the main risks observed through supervision (such as reputation and legal risks).

Argentina, Russia and Mexico: In Argentina, a diagnostic exercise highlighted the absence of basic regulation permitting the use of agents – a threshold barrier to reaching the unserved poor, and one that is now at the center of planned branchless banking and financial inclusion related reforms. In Russia, a regulatory vacuum concerning e-money was identified by a branchless banking diagnostic exercise. Now, the Ministry of Finance and Russian Central Bank are leading an initiative to craft e-money regulation for the vibrant industry that has grown up in this space. In Mexico, a series of diagnostic and data gathering exercises carried out by or on behalf of the financial authorities identified both gaps and barriers in critical areas. These issues were addressed in Mexico's recently issued regulation on agents, including mobile network operators to set up agent networks and manage mobile accounts on behalf of banks; mobile banking scheme and specific regulation for mobile banking accounts (simplified regime) and limited scope banks "niche banks".

9. **Framework**: Consider the following in the regulatory framework, reflecting international standards, national circumstances and support for a competitive landscape: an appropriate, flexible risk-based AML/CFT regime; conditions for the use of agents as a customer interface; a clear regulatory regime for electronically stored value; and market-based incentives to achieve the long-term goal of broad interoperability and interconnection.

A regulatory framework for innovative financial inclusion needs to be based in the context of a globalizing world which is giving greater prominence to the importance of cooperation on international standards. These international standards generally provide sufficient flexibility to be adapted to national circumstances – and to the innovation inherent in innovative financial inclusion. However, the complementarities between international standards and financial inclusion are often not well understood and there is scope for better information and clarification. The regulatory framework for innovative financial inclusion also needs to ensure it builds on what is known about what shapes good regulatory practice, including an understanding of the long-term benefits of a competitive landscape. Key elements of a regulatory framework that supports the safe and sound spread of innovative financial inclusion emerge from the experience of countries leading in the use of new approaches to reach unserved poor people.

The objectives of AML/CFT recommendations are better served by having clients inside the net of electronic transactions that can be traced and monitored rather than outside in the opaque and untraceable cash economy. The AML/CFT recommendations have the flexibility to be implemented by national regulators in a manner proportionate to the risks involved in using innovative approaches to serving poor people. Appropriate implementation might include permitting remote account opening with customer due diligence

checks performed by agents, based on the limited formal documentation normally available to low income clients, as well as allowing for low cost approaches to producing and storing client records. AML/CFT risks with subsequent transactions can be mitigated by imposing caps on transaction amounts, monthly flow-through and balances, as well as by implementing training and software for identifying suspicious transactions. The cases of the Philippines and South Africa which have both taken measures to balance financial inclusion and a risk-based AML/CTF regulatory regime illustrate this principle very well. These measures have subsequently been assessed by the FATF and effectively deemed compliant with FATF recommendations.

The Philippines: Several years ago, policymakers and regulators committed to expand financial inclusion; e-money schemes from the country's two largest mobile network operators, *Smart Money* and *G-Cash*, seemed like promising means towards this end. At the same time, Filipino policy makers – and the Anti-Money Laundering Council in particular – were looking for ways to improve AML/CTF regulation and enforcement so that they could be removed from the FATF blacklist of "noncompliant countries and regions". The challenge was achieving both goals. Key features of the Filipino risk-based approach included:

- Customer due diligence must be conducted face-to-face by a bank employee or a "remittance agent" that has received training on anti-money laundering measures.
- Remittance agents must require each remitter to fill out an application form with details such as name, address, birth date, source of foreign currency (if applicable) and name of and relationship to the beneficiary. Remittance agents must also maintain records of all transactions for five years, and report suspicious transactions.
- Remittance agents must require first time remitters to present a photo-bearing identification document. The list of valid IDs includes a wide array of options more easily obtainable by low-income Filipinos.
- E-money instruments such as *Smart Money* and *G-Cash* are subject to an aggregate monthly load limit of PHP 100,000 (approximately USD 2,225).

The Philippines was the subject of a FATF Mutual Evaluation in 2008, and the related assessment was issued in July 2009. According to the assessment, both *G-Cash* and *Smart Money* were "successfully engaging in high-technology transactions while complying with AML/CTF and submitting themselves to (Central Bank) supervision."[42] The regulators achieved a win-win result that worked for the telecommunication companies, their customers, AML/CTF compliance and worked towards achieving the policy goal of increasing financial inclusion.

South Africa: In South Africa the Financial Intelligence Centre Act (FICA) and its regulations determine the AML/CTF obligations of financial institutions. The Act provides that an accountable institution must keep a record of the identity of the client and any documents obtained in verifying that identity. Two requirements of the FICA regulations were subsequently identified as potential obstacles for customers in the low-income market: (i) a national identity document to verify personal details and (ii) documentary proof of residential address when opening a bank account. Approximately one-third of adult South Africans, many of whom live in informal housing, could not provide such documentary proof of residential address.

- In 2002 an exemption was issued eliminating the need to obtain and verify address details, and relaxing record keeping requirements for accounts and services subject to balance and transaction

[42] Paragraph 661, Mutual Evaluation Report for the Republic of the Philippines (July 8, 2009). However, the report did cite the relative ease of counterfeiting IDs and weak supervision of the requirements set forth under Circular 471 - comments applicable to the financial sector as a whole and not only to branchless banking.

limits.[43] Further refinements in 2004 supported a basic bank account ("*Mzansi*") and related payment services. To date, more than six million such accounts have been opened.

- In 2006, the South African Reserve Bank allowed banks to open mobile phone-operated bank accounts (within certain transaction and balance limits) without having to undertake face-to-face customer due diligence and with even lower transaction limits.[44]

South Africa was the subject of a Mutual Evaluation in 2008[45] and the related assessment was issued in 2009. The assessment did not identify any major concerns related to the low transaction accounts, but did express concerns about the impacts of the relaxed record-keeping.

An important first step for extending the reach of financial services will be to clarify the legal power of agents to perform cash-in/cash-out and other customer interface functions as Brazil, Colombia and India, among a growing list of countries, have done. Some regulators may prefer to start with a narrower range of permitted agents, permitted services or even regions where working through agents will be permitted, in order to develop confidence that they do not pose a risk to the safety and soundness of the system. Others may be comfortable with banks working through agents, but less comfortable about other types of financial service providers. Still others may be ready to permit agents, but not sub-agents or additional layers of agency. Overly detailed regulatory prescriptions on the contractual relations permitted with agents, including limitations on pricing, may dampen appetites of potential agents and financial service providers alike and the consequence of such decisions may be slower uptake. Ultimately, extensive agent networks, possibly provided by third party network managers such as mobile network operators and technology providers, may prove to be critical to increasing innovative access to financial services.

Brazil: The country's history with innovative bank-based solutions for financial inclusion is one of continual experimentation with various degrees of permissiveness in agency functions. Although permission for banks to work through retail agents for some limited functions dates back to the 1970s, significant reforms were undertaken in the late 1990s with one of the policy objectives being to increase efficiency in the delivery of welfare payments. At the same time, the range of services that could be outsourced to agents was expanded. In 2000, removal of the prohibition on banks using agents in locations with bank branches offered banks the opportunity to expand their agent networks rapidly (tapping the low income market that felt more comfortable working through retail outlets in their own communities). As a result, the total number of agents being used by banks swelled to over 64,000 by the end of 2000. In 2003, the regulations were again amended as part of the government's financial inclusion policy, permitting any financial institution to hire any type of agent, anywhere. Further changes in 2008 permitted agents to offer low-value international transfers and did away with the requirement to seek previous authorization from the Central Bank of Brazil to hire agents. Today, there are more than 132,757 registered agents throughout the country delivering financial services at more than 170,000 retail establishments. Furthermore, The Central Bank of Brazil has

[43] The balance may not exceed ZAR 25,000 (approximately US$3,400); the daily transaction limit is ZAR 5,000 (approximately US$680), and the monthly limit is ZAR 25,000 (approximately US$3,400).

[44] The transactions on such an account are limited to ZAR 1,000 (approximately US$135) per day. If clients wish to exceed this limit, a face-to-face confirmation of the client's identity must be carried out in accordance with the provisions of Exemption 17. Some industry participants argue that the caps in Guidance Note 6 are too low and should be adjusted upward to facilitate market development.

[45] Financial Action Task Force (2009).

recently conducted a data gathering exercise focused specifically on consumer protection issues in related to agents to identify regulatory or supervisory gaps and proportionate approaches to addressing them.

Colombia: Policymakers and regulators considered lessons from the Brazilian experience when the Colombian Financial Superintendence issued regulations in 2006 allowing financial institutions to outsource functions through retail agents. The Colombian regulation allows any type of legal entity (including savings and credit cooperatives, with prior authorization from the Superintendence) to be hired as an agent of a licensed institution to deliver financial services either on its own premises or in other locations where its services or products are offered. Agents in Colombia may provide most banking services, including: bill payments, transfers, deposits and withdrawals, disbursement or repayment of loans, receiving and forwarding account and loan applications, and domestic money transfers. Although the agency regulation sets forth important minimum requirements and restrictions on agents' operations under certain conditions, as well as minimum contractual clauses that every agency contract must contain (such as reference to the financial institution's liability for its agents' actions and a clear description of risk-mitigation measures), financial institutions have substantial freedom to structure their agency relationships as they see fit (conditioned on prior authorization by the Superintendence).

India: Regulators first permitted banks to work through "business correspondents" in 2006. This first iteration limited the establishments eligible to serve as business correspondents to nonprofit institutions, post offices, and cooperatives. Additionally, it prohibited business correspondents (as well as the banks themselves) from charging customers for services rendered on behalf of the bank. These restrictions stymied initial product offerings and uptake, leading the Reserve Bank of India to form a working group to assess the regulatory landscape for business correspondents and recommend suitable changes. In late 2009, based on the findings of the working group, the Reserve Bank of India permitted banks to charge customers for using business correspondents and expanded the scope of permissible business correspondents to include, among others, small retail shops and individual petrol pump owners. Although it is too early to judge the effects of these changes, policy makers in India are optimistic that there will be a substantial expansion of access to financial services among the poor.

The emergence of e-money, mobile money and other stored-value instruments is rapidly transforming retail payment systems, particularly in emerging and developing economies. Indonesia and the Philippines provide examples. Both banks and non-bank entities such as mobile network operators, remittance service providers and issuers of prepaid cards, are all potentially interested in serving this market. In order to achieve regulatory proportionality, governments should consider establishing an e-money regulatory regime geared to the risks inherent in the type of service involved. Such a level regulatory playing field will open the market to which types of provider are most interested in reaching unserved poor people. A proportionate regulatory regime might include, for example, a combination of maximum allowable transaction, turnover, and balance thresholds and liquidity and solvency-related requirements.

Indonesia: Indonesian regulations were promulgated that permitted non-banks to issue e-money in 2009, in recognition of the importance of improving infrastructure for financial inclusion, and after a period of learning how the market was operating. Four principles were considered essential for e-money regulation: *safety, efficiency, equitable access to all users, and consumer protection*. Both banks and non-banks are allowed to provide an electronic payment instrument (e-wallet). In addition to meeting basic licensing requirements, e-money regulations and related circulars require that non-bank issuers place 100 per cent of the float in a commercial bank, in a savings account, a current account or a time deposit account, in order to protect customers' funds. The float can only be used to fulfill the issuer's obligations towards customers and agents. Banks are also permitted to be e-money issuers, and have to report the float as immediately payable

liabilities. Both non-bank and bank issuers are prohibited from issuing e-money with higher or lower value than the amount deposited by the e-money holder.

The Philippines: When Filipino regulators concluded the time was right to issue comprehensive regulation on e-money,[46] the Central Bank of the Philippines issued a circular addressing the risk to customers' funds by requiring non-bank e-money issuers (such as the corporate parent of *G-Cash, GXI*) to maintain liquid assets in an amount equal to the amount outstanding e-money issued. Liquid assets must remain unencumbered and may be bank deposits, government securities or other assets as the Central Bank of the Philippines may allow. The Filipino e-money circular also sets a high bar for potential new non-bank e-money issuers[47] to enter the market, requiring minimum capital of over US$2 million for a non-bank e-money license.

[48]

Interoperability and interconnectivity are keys to achieving the efficiency and long-term growth potential of financial inclusion (and even broader social goods). Key aspects of interoperability and interconnectivity can be built into systems from the onset, regardless of whether those capabilities are immediately used. Retrofitting systems with the various technical patches and interfaces necessary to connect can be extremely costly. Market incentives may not encourage service providers to adopt systems with the capacity for interoperability and interconnectivity. However, encouraging or requiring that all systems have the technical capacity to connect with other systems and requiring systems to be interconnected from the onset are two very different things. To encourage market innovation and new market entrants, governments should avoid regulation mandating that systems be interconnected *ex ante*. Instead, policymakers should monitor competition and efficiency in the market, and encourage an eventual move toward an interconnected network of individual systems. Needless to say, how this principle will be worked out in each market will be different, as the Mexican case shows

Mexico: As part of their efforts to increase financial access in Mexico, the regulatory authorities have recently coordinated to create regulations for accessing and using the retail payment system, the internal rules and governance of which were identified as an obstacle to expanding the number of merchants equipped with point-of-sale devices in the country. The forthcoming regulations will provide better conditions for new entrants, such as non-bank payment service providers, to use the existing payments infrastructure on equal terms with bank participants, and include mandated interoperability and interconnection, as well as limitations on interbank fees. The objective is to increase competition in the switching and merchant acquiring businesses, aiming at reducing the costs for merchants to accept electronic payments.

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[46] See *Principle 7* above.

[47] Like the relevant Indonesian regulation, the Filipino e-money circular covers both bank-issued and non-bank-issued e-money, creating as level as possible a playing field for both the bank-based Smart Money and non-bank-based *G-Cash* branchless banking schemes.

[48] A narrow definition of "interoperability" would be the condition achieved among communications-electronics systems or items of communications-electronics equipment when information or services can be exchanged directly between them and their users, normally based on common messaging systems. But as used in the context of branchless banking, "interoperability" can include a broader set of concepts that overlap with those captured in the term "interconnection", such as: (i) the ability to switch mobile service providers but keep mobile banking services; (ii) the ability to use one branchless banking service to send funds to the user of another service; (iii) the ability to use any outlet (such as ATMs or agents) to conduct financial services; (iv) the ability of a financial institution to acquire a customer, regardless of the mobile services provider; and (v) the ability to move funds from bank accounts to mobile accounts and vice versa.

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We also acknowledge the input from participants at the consultations on the draft principles at the Windsor meeting on 11 March 2010, the OECD Committee on Financial Markets on 16 April 2010, and the G24/AFI Roundtable on 23 April 2010 (more details in Appendix 1, 2a, 2b and 2c).

Members of the Secretariat from Australia, Brazil, the Consultative Group to Assist the Poor, and the Alliance for Financial Inclusion: Ruth Goodwin-Groen, Crispin Bokea, Julie Chan, Denise Dias, Lara Gidvani, Sina Grasmann, Sung-Ah Lee, Kevin Playford, Yanina Seltzer, Tyson Self, Alyson Slater, Robert Stone and Michael Tarazi.

Paul Flanagan
Co-Chair (Australia)

Rodrigo Pereira Porto
Co-Chair (Brazil)

Appendix 1

Access Through Innovation Sub-Group

of the G20 Financial Inclusion Expert Group:

Outreach and Consultation Process

Consistent with the objectives of the G20, the Co-Chairs of the *Access Through Innovation sub-group* (ATSIG) have undertaken wide outreach and consultation. This has included the G-24, the OECD, a set of leading developing countries involved with financial inclusion (known as the Windsor Group), relevant SSBs, and key industry groups. As most countries with large proportions of financially excluded people are not G20 members, outreach was particularly important in ensuring that the "Principles for Innovative Financial Inclusion" had broad support. These inputs have supplemented the expert input from the members of the Sub-Group.

In preparing the report, ATSIG has relied extensively upon the technical inputs from the CGAP and the Alliance for Financial Inclusion (AFI).

- CGAP is an independent policy and research centre dedicated to advancing financial access for the world's poor. It is supported by over 30 development agencies and private foundations who share a common mission to alleviate poverty. CGAP provides market intelligence, promotes standards, develops innovative solutions and offers advisory services to governments, microfinance providers, donors, and investors.
  - CGAPs technical inputs were based on diagnostic work on the following countries: Argentina; Brazil; Colombia; India; Indonesia; Kenya; Mexico; Pakistan, the Philippines; Russia; South Africa.
- AFI is a network of policy makers and regulators in developing countries which provides it members with tools and resources to share, develop and implement the knowledge of financial inclusion policies that work.
  - AFI has members from nearly 80 developing countries whose populations account for nearly 70 per cent of the world's 'unbanked' population.

In preparing the principles outlined in this report, three key outreach meetings have been held. Records of each of these outreach meetings are included in Appendix 2.

- Windsor Seminar, 11 March 2010. The co-chairs hosted a meeting with of senior officials from 14 developing and emerging countries (Russia, El Salvador, Mexico, Peru, Indonesia, Papua New Guinea, Bangladesh, India, Tanzania, Nigeria, Ghana, Pakistan, Kenya and The Philippines) considered to be the

pioneers of 'branchless banking'. CGAP and AFI provided technical support for the meeting. Participants were asked to comment on a draft set of policy and regulatory principles for innovative financial inclusion policies drawn from the experience of a range of countries and were asked for views on the most useful role and approach by the G20.

- OECD Committee on Financial Markets, 16 April 2010. A short seminar on the G20 ATISG was facilitated by the OECD as part of a regular meeting of the OECD Committee on Financial Markets. Participants were asked to provide feedback on a set of draft set of principles (revised based on feedback from the Windsor Seminar) for innovative financial inclusion policies. Members of the OECD are: Austria; Australia; Belgium Canada; Czech Republic; Denmark; France; Finland; Germany; Greece; Hungary; Iceland; Ireland; Italy; Japan; Luxembourg; Mexico; Netherlands; New Zealand; Norway; Portugal; Poland; Republic of Korea; Slovakia; Spain; Sweden; Turkey; United Kingdom; United States.

- Seminar by the G24 Seminar, 23 April 2010. The G24 facilitated a seminar on the work of the Access Through Innovation Sub-Group, with technical assistance provided by the Alliance for Financial Inclusion. Participants were invited to comment upon a set of further revised principles to support innovate financial inclusion policies. Members of the G24 are: Algeria; Argentina; Brazil; Colombia; Cote d'Ivoire; Democratic Republic of the Congo; Egypt; Ethiopia; Gabon; Ghana; Guatemala; India; Iran; Lebanon; Mexico; Nigeria; Pakistan; Peru; The Philippines; South Africa; Sri Lanka; Syria; Trinidad and Tobago; Venezuela.

In addition to these formal events, the co-chairs of the ATISG have been in contact with a range of key stakeholders, many of whom have been invited to provide comments upon the draft synthesis report. These stakeholders include:

- The Committee on Payment and Settlement Systems (CPSS);
- The Basel Committee on Banking Supervision (BCBS);
- The International Association of Insurance Supervisors (IAIS);
- The Financial Action Task Force (FATF);
- The International Association of Deposit Insurers (IADI);
- The Financial Stability Board (FSB);
- The Islamic Financial Services Board (IFSB);
- World Bank Group;
- International Monetary Fund (IMF);
- The United Nations Committee on International Trade Law (UNCITRAL)
- World Economic Forum (Davos);
- World Council of Credit Unions (WCCU);
- World Savings Banks Institute (WSBI); and
- The GSM Association (GSMA)

The co-chairs have sought to ensure G20 members have been kept informed of progress of the sub-group through: circulation and agreement to the sub-groups work plan; circulation of technical papers in February 2010; circulation and seeking feedback on initial draft principles in March 2010; circulation of the initial draft synthesis report in early May 2010; teleconferences with ATISG members to discuss the principles on 31 March and 29 April, and a meeting of the ATSIG at a wider meeting of the FIEG on 10 May 2010 in Toronto, Canada.

Appendix 2a

Windsor Access Through Innovation Workshop

Thursday 11 March 2010, Oakley Court Hotel, Windsor, United Kingdom

In attendance:

Rebecca Bryant, Ruth Goodwin-Groen (AusAID); Paul Flanagan, Kevin Playford (Australian Treasury); Alessandra Dodl (Central Bank of Brazil); Michael Tarazi, Tim Lyman, Denise Dias, Yanina Seltzer (CGAP); Alfred Hannig, Crispin Bokea (Alliance for Financial Inclusion); Mahesh Mishra (UK DFID); Dr. Atiur Rahman (Bangladesh Bank); Dr H.A. Kofi Wampah (Bank of Ghana); Dr Kamel Chakrabarty (Reserve Bank of India); Dr Carlos Acevedo (Central Bank of El Salvador); Ruben Mendiolaza (Superintendency of Banking, Insurance & Private Pension Funds, Peru); Kamran Shehzad (State Bank of Pakistan); Prof. Njuguna Ndung'u (Central Bank of Kenya); German Saldivar (Ministry of Finance & Public Credit, Mexico); Raul Hernandes- Coss, Carlos Lopez (Mexico); Nickson Kunjil (Bank of PNG); Nestor Espenilla (the Philippines); Joseph Attah (Central Bank of Nigeria); Mr. I.T. Nwaoha (Central Bank of Nigeria); Dr M. Hadad (Bank Indonesia); Agapito Kobello (Bank of Tanzania); Mikhail Mamuta (Russian Microfinance Centre), Andrey Shamraev (Bank of Russia).

1. Introductions and welcome - Ruth Goodwin-Groen (facilitator); Paul Flanagan (ATISG Co-Chair Australia); Alessandra Dodl (ATISG Co-Chair Brazil)

G20 Leaders at Pittsburgh established a FIEG with the objective of extending financial services to the poor. The Access Through Innovation Sub-Group is one of two sub-groups tasked with supporting the safe and sound spread of new modes of financial service delivery capable of reaching the poor.

The Access Through Innovation Sub-Group is being co-chaired by the Governments of Australia and Brazil, and its work is being actively supported by CGAP and the Alliance for Financial Inclusion (AFI). The first report of this sub-group is due to be presented to G20 Leaders in June 2010. This first report will provide a clear rationale for the work, summarise lessons learned to date, devise a policy framework for success and propose a set of draft principles for policy makers and regulators.

2. Policy principles for access through innovation – Alfred Hannig (Alliance for Financial Inclusion)

Participants were directed to a draft set of 6 policy principles, drawn from a range of sources including the 2010 AFI global survey "State of financial inclusion policy in the developing world". Mr Hannig reported that 79 surveys had been sent to central banks in Africa, Asia and Latin America

and that 30 had been returned. In depth telephone interviews were conducted with 20 central bank officers. From this information conclusions have been drawn about the state of financial inclusion policy and a set of policy principles developed. These policy principles were discussed with revised wording suggested.

3. Regulatory Principles for access through innovation - CGAP Senior Policy Adviser Tim Lyman

Mr Lyman provided an overview of CGAP's diagnostic exercise, and the preparation of the lessons learnt and draft regulatory principles document that was circulated to all participants before the meeting. Participants then divided into small groups for discussions. These principles were carefully discussed with improvements suggested and possible actions to implement them.

4. Action themes – Ruth Goodwin-Groen (Facilitator) and Michael Tarazi (CGAP Adviser)

The facilitators presented a summary of the action themes drawn from the small group discussions as follows:

a. Developing regulator and supervisor capability and capacity (including inter-governmental coordination)
b. Sharing positive and negative lessons learned/peer consultation
c. Risk analysis eg: for AML/CFT
d. Interaction with Standard Setting Bodies (guidance principles?)
e. Development assistance – is it helpful?
f. Target setting – qualitative and quantitative
g. Data collection

5. Next Steps – Ruth Goodwin-Groen (facilitator)

The ATISG proposes to continue consulting with a wide range of stakeholders. The comments from the meeting will be built into a revised set of principles. These will be circulated for further comments to the wider Access through Innovation Sub-Group, a meeting with OECD financial experts in mid-April, and with the G-24 at the Spring meetings. A synthesis report, including the principles, will be discussed at an ATISG meeting on 10 May and forwarded onto **G20** Deputies, Finance Ministers and Central Bank Governors, and Leaders at their June meeting. An action plan will be prepared for the November meeting of **G20** Leaders in Korea.

The meeting highlighted the importance of on-going consultation with a wide range of stakeholders (for example, non-financial regulators such as telecom regulators, industry associations, development partners, banking associations and technology providers).

Participants agreed that lesson learning from financial inclusion is an ongoing commitment and all expressed an interest in remaining engaged. The Co-Chairs agreed that this would happen.

Appendix 2b

‘Principles for Innovative Financial Inclusion: Banking Beyond Branches’ presentation at the CMF 110th Session

Friday 16 April 2010, OECD, Paris

Background: G20 Leaders at Pittsburgh established a FIEG with the objective of extending financial services to the poor. The Access Through Innovation Sub-Group is one of two sub-groups tasked with supporting the safe and sound spread of new modes of financial service delivery capable of reaching the poor.

The Access Through Innovation Sub-Group is being co-chaired by the Governments of Australia and Brazil, and its work is being actively supported by CGAP and the Alliance for Financial Inclusion (AFI). The first report of this sub-group is due to be presented to G20 Leaders in June 2010. This first report will provide a clear rationale for the work, summarise lessons learned to date, devise a policy framework for success and propose a set of draft principles for policy makers and regulators.

The Draft Principles were discussed and comments submitted at an ‘Access Through Innovation Workshop’ held in March 2010. These comments have been built into a revised set of principles that are now being re-circulated for further comment.

1. **Session Opening**

Introduction by Bruno Lévesque, Principal Administrator for the OECD’s Financial Affairs Division.

2. **Presentation of Draft Principles for Innovative Financial Inclusion: Banking Beyond Branches** - CGAP Senior Policy Adviser Tim Lyman

Mr Lyman provided an overview of the G20 context through which this initiative was developed. He gave a presentation on ‘branchless banking’ and an overview of the principles and related examples outlined in the ‘Draft Principles’ document. The Secretariat then opened the floor to participants for a plenary round of comments and questions.

3. **Summary of comments from participants**

Participants provided a variety of comments that underscored the value of the G20 initiative for development and the importance of the draft principles. They emphasised the need for a strong regulatory framework to protect consumers, particularly in transactions with non-bank agents. The document could benefit from highlighting the risks associated with the fact that providers are not legally responsible for agent conduct. Participants recommended further research to explore how to encourage providers to take on this responsibility. However, they also noted that a balance must be struck between the need for strong regulation and the purpose of the initiative, which is to expand the network of branchless banking.

Participants commented that the document needs to provide more detail on the process of conducting non-bank vendor transactions across different countries, where regulations on E-

money transactions may be inconsistent. This issue is particularly relevant given the potential value of branchless banking for remittance payments which generally occur between different countries.

Participants also gave thoughts on areas that require further consideration in the draft principles. They questioned the implications of the proposal for a separate E-money regulatory system and the risk of this causing regulatory arbitrage. They also raised the potential risk of E-money becoming a counter party to monetary policy, which would have adverse effects on financial stability.

4. Next Steps

The OECD Secretariat has already undertaken significant work in this area and emphasised that it would be useful for both the OECD and the G20 to continue engaging in this work. Mr Lévesque invited participants to submit all written comments to the Secretariat by COB 23 April 2010.

Appendix 2c

G24/AFI Roundtable at IMF/WB Spring Meeting

22 April 2010, IMF HQ2 Room 1A-280, Washington D.C

In attendance:

Luis Gustavo Mansur Siqueira, Central Bank of Brazil; Partha Ray, Reserve Bank of India; Iraq, Njuguna Ndung'u, Governor, Central Bank of Kenya; Christ Gacicio, Central Bank of Kenya; Saad Andary, Central Bank of Lebanon; Joseph Mwanamvekha, Ministry of Finance, Malawi; Dr. Perks M. Ligoya, Governor, Reserve Bank of Malawi; Richard Perekamoyo, Ministry of Finance, Malawi; Nations Msowoya, Ministry of Finance, Malawi; Levie J. Sato, Ministry of Finance, Malawi; Timothy Makamba, Treasury, Malawi; Dr. Grant Kabango, Reserve Bank of Malawi; Rodgero Chawani, Reserve Bank of Malawi; Pius Ailoyafen, Ministry of Finance, Nigeria; Nyeso George, Ministry of Finance, Nigeria; Lamido Sanusi, Central Bank of Nigeria; Sarah Alade, Central Bank of Nigeria; Tunde Opadeji, Central Bank of Nigeria; Mohammed Abdu Yakasai, Central Bank of Nigeria; Ahmed Abbas Samusi, Central Bank of Nigeria; Sadiq Usman, Central Bank of Nigeria; P.J. Obaseki, Central Bank of Nigeria; O.A. Uchendu, Central Bank of Nigeria; Giovanna Prialé Reyes, Superintendency of Banking, Insurance and AFP, Peru; Yesenia Cabezas, Embassy of Peru; Gil S. Beltran, Department of Finance, the Philippines; Adib Mayaleh, Governor, Central Bank of Syria; Michelle Durham-Kissoon, Ministry of Finance, Trinidad and Tobago; Visanu Dhanpan, Ministry of Finance, Trinidad and Tobago; Nelson Lugo, Central Bank of Venezuela.

AFI: Alfred Hannig, Sung-Ah Lee, Merle Wangerin; BCEAO: Derm N'gbe; Bill & Melinda Gates Foundation: Claire Alexandre, Sheila Miller; CGAP: Michael Tarazi; G20: Paul Flanagan, Australian Treasury; Nkosana Mashiya, National Treasury, South Africa; G24 Secretariat : Amar Bhattacharya; IFC: Nina Bilandzic, Bikki Randhawa; IMF: Leslie Ann Des Vignes, Mohammed Dairi, Gebreselassie Y. Tesfamichael, Buah Saidy; Islamic Development Bank: Nosratollah Nafar;

South Centre: Ifran Haque; West African Monetary Institute: Temitope Oshikoya; World Bank: Natalia Speer, Khalid Alkhudairy, Sultan Lutfi, Suzette Taylor, Mamou Ehui.

1. **Introduction and welcome**

Amar Bhattacharya, Director, G24 Secretariat

Mr. Bhattacharya welcomed the participants and referring to the first event of this kind at last year's Spring Meetings, he expressed his appreciation for a platform for dialogue on financial inclusion for AFI and G 24 members. He acknowledged the presence of the Co-Chairs of the G 20

Financial Inclusion Experts Group and their openness to incorporate the views of developing countries into their work.

Professor Ndung'u, Governor of the Central Bank of Kenya and Chair of the AFI Steering Committee

Professor Ndung'u outlined the importance of financial inclusion as one of the cornerstones in achieving growth and poverty reduction and appreciated the G 24 in providing this opportunity for exchange and AFI as a platform for building a network to deepen and share knowledge on financial inclusion and peer learning.

He briefly outlined progress in financial inclusion in Kenya and highlighted the need to increase financial services that allow financial intermediation. In his view, the G20 should actively engage developing countries in the discussion and keep in mind that many of the successful financial inclusion strategies come from these countries. A network providing strategic direction at the global level while emphasizing different country approaches would be useful.

Luis Gustavo Mansur Siquiera, Deputy Head of the Department of International Affairs, Banco Central do Brasil

Mr. Mansur Siquiera highlighted the opportunity for including the views of developing countries in the G20 process. He highlighted the success factors driving financial inclusion in Brazil, in particular the importance of having a national financial inclusion strategy.

There is a huge pool of knowledge on financial inclusion policymaking in developing countries. Including non-G20 countries' view in the G20 process is important to develop a broad consensus among policymakers. He very much welcomed the survey that AFI has undertaken and commended AFI for providing a knowledge sharing platform for policymakers.

2. **Objectives and progress on the G20 FIEG- Access Through Innovation Sub-Group**

Paul Flanagan, International Finance and Development Division, Australian Treasury, ATISG Co-Chair

Mr. Flanagan provided an overview of the objectives and progress on the G20 ATISG work and presented the draft principles developed by the ATISG. He emphasized the importance of the views of developing countries where the vast majority of the financial inclusion innovations take place. A key priority for the G20 was outreach to other institutions and countries, and it was a high priority that the G20 consulted with non-G20 developing countries, whether through the Windsor forum (as was done in March), the G24 at this meeting or other fora. In this context, he appreciated AFI's role in mobilizing the voices of developing country policymakers. He informed about the next steps of the ATISG and invited the participants to provide feedback on the draft principles and possible action points to be presented at the Leaders' Summit in Seoul.

3. **Overview of progress by the SME Sub-Group**

Nkosana Mashiya, Director of Financial Regulation Macro Economic Policy, South Africa Treasury, SME Sub-Group Co-Chair

Mr. Mashiya provided a brief overview of the work of G2O SME Sub-Group. The Sub-Group carried out a stock taking exercise in order to collect best practices on policy, regulatory framework, and successful public-private collaboration and developed principles for SME finance. He stressed that the group will benefit from listening to the G24 countries and will review the recommendations they are developing through the G20 process.

4. **Preliminary findings from the AFI survey on financial inclusion policy in developing countries**

Alfred Hannig, Executive Director, Alliance for Financial Inclusion (AFI)

Mr. Hannig gave a presentation on the preliminary findings of the financial inclusion policy survey that AFI conducted based on inputs from its members. He shared the key trends and barriers in financial inclusion policymaking, lessons learned from the survey and an outlook. The survey was originally requested by the AFI Steering Committee with the aim of informing the future work, development and areas of focus for the AFI network. The survey results have also become a part of the ATISG work program.

5. **Discussion**

Moderated by Amar Bhattacharya, Director, G24 Secretariat

Participants shared their views and experience on financial inclusion policy, focusing on the ATISG draft principles. Some of the key discussion points include:

- The need for a holistic approach to financial inclusion. A multipronged approach anchored in a good knowledge of constraints and results is required to achieve financial inclusion goals.
- Financial inclusion policymaking should be an integral part of the mainstream financial sector policy.
- Coordination among different government agencies is a key challenge in financial inclusion policymaking and implementation. Motivating different government players is therefore key in developing and implementing financial inclusion policies.
- Providing financial services to the poor represents a serious challenge in the absence of national identification systems.
- Peer learning and knowledge sharing is ever more important in bringing the financial inclusion status to the next level. Participants expressed their strong willingness and desire to learn from other countries that have already implemented successful policy solutions. Apart from the successful policies, it is very important to analyze the underlying factors that made success happen.
- Lack of data and evidence is as a key constraint for policymakers. Efforts to measure success need to be strengthened in order to allow for evidence-based policymaking.

- General principles should be flexible enough to take the specific social and economic context of a country into account.
- Participants underlined the necessity for openness to innovative approaches in financial inclusion policymaking.
- Effective public-private partnerships based on a clear understanding of the roles of the public and the private sector were recognized as an enabling factor for success financial inclusion policymaking.
- AFI was encouraged to further contribute to a better understanding with regard to the different stages of countries in the learning cycle.
- The Australian ATISG Co-Chair assured the participants that the G 20 will continue to monitor and evaluate progress of announcements and commitments on financial inclusion.

6. Next steps

Professor Ndung'u; Amar Bhattacharya; Paul Flanagan; Nkosana Mashiya

- G24 will circulate the presentations to all participants including the principles enunciated by both sub-groups. G24 will request that any additional feedback be forwarded to the ATISG Secretariat by May 1.
- Some immediate revisions of the principles by the ATISG could include:
    - Including in the principle on data and evidence-based policy making a statement on the importance of measuring progress.
    - A clarification of principles on cooperation, knowledge and enablement.
- ATISG encourages the participants to submit proposals on how to translate these principles into action and possible practical steps that G20 can undertake.
- ATISG will share the more detailed synthesis report including country examples. More country examples to back up the principles would be welcome.
- ATISG would like to continue the dialogue with developing country policymakers towards the G20 Seoul Summit. The AFI Global Policy Forum in September and or the Annual Meetings could provide such a platform.
- G24 and AFI will continue the collaboration and will provide such forums to engage developing countries in global discussions

Appendix 3

Draft Work Plan
G20 Financial Inclusion Experts Group:
Access through Innovation Sub-Group

Prepared by Brazil and Australia: 29 December 2009

Background

"We commit to improving access to financial services for the poor. We have agreed to support the safe and sound spread of new modes of financial service delivery capable of reaching the poor and, building on the example of micro finance, will scale up the successful models of small and medium-sized enterprise (SME) financing. Working with the CGAP, the IFC and other international organizations, we will launch a G20 Financial Inclusion Experts Group. This group will identify lessons learned on innovative approaches to providing financial services to these groups, promote successful regulatory and policy approaches and elaborate standards on financial access, financial literacy, and consumer protection. We commit to launch a G20 SME Finance Challenge, a call to the private sector to put forward its best proposals for how public finance can maximize the deployment of private finance on a sustainable and scalable basis".

(G20 Leaders' Statement, The Pittsburgh Summit, 24 – 25 September 2009)

The global crisis reinforced the adverse effects of financial exclusion, resulting in, for example, rising costs often borne by those who can least afford them. However, the crisis also offers a unique opportunity for policymakers to advance financial inclusion policies that foster economic resilience. In this context, the G20 has agreed to work towards broadening access to a full range of financial services thus granting better conditions for sustainable growth worldwide.

On September 25, 2009, the G20 Leaders committed to improving access to financial services for the poor and directed the establishment of a G20 Financial Inclusion Experts Group (FIEG) to:

a) Support the safe and sound spread of new modes of financial service delivery capable of reaching the poor. In the context of these new modes of financial service delivery, the FIEG will: identify and describe lessons learned on innovative approaches to providing financial services to the poor; identify, describe and promote successful regulatory and policy approaches; and identify, describe and elaborate relevant principles on financial access, financial literacy, and consumer protection.

b) Scale up the successful models of small and medium-sized enterprise (SME) financing. The FIEG will launch a G20 SME Finance Challenge, with a call to the private sector to put forward its best proposals for how public finance can maximize the deployment of private finance on a sustainable and scalable basis.

Two sub-groups have been established and designated as: (1) the Access Through Innovation Sub-Group, and (2) the SME Finance Sub-Group. Each Sub-Group will report regularly to the FIEG. The FIEG will report results to the G20 Finance Ministers for their review in preparation for endorsement by the Leaders in 2010.

Co-Chairs for the FIEG have been identified as the three Summit hosts: the US, Canada and Korea. Co-Chairs for the two sub-groups have been identified as Brazil and Australia for the Access Through Innovation Sub-Group and South Africa and Germany for the SME Finance Sub-Group.

This paper represents the revised workplan for the Access Through Innovation Sub-Group which was initially discussed at our meeting on 3 December in Washington D.C.

Goal

The world economy is now in the midst of dramatic changes. New technologies and financial products are altering people's lives and work patterns all around the world. While positive developments are clear, there is also growing evidence that the market has not been able to meet everyone's needs. It is estimated that about 2.5 billion adults lack the access even to the simplest kind of formal financial services.

Financial exclusion causes adverse effects in many ways, but it especially makes people more vulnerable to financial distress, debt and poverty. There is a growing worldwide awareness of this problem, and the FIEG represents a G20 response to meet urgent needs as well as future challenges in supporting growth and development across the globe. Many developing countries have been at the forefront of successfully reforming their financial systems in the aftermath of financial crises over the last decade, and this experience needs to be drawn upon.

A key new mode of financial service delivery is branchless banking. Branchless banking is "the delivery of financial services outside conventional bank branches using information and communications technologies and non-bank retail agents, for example, over card-based networks or with mobile phones." (CGAP 2009 Focus Note 57 Scenarios for Branchless Banking). It has the potential to radically reduce the cost of delivery and increase convenience for customers. Branchless banking can increase poor people's access to financial services. Financial services can include services such as transfers, payments, credit, savings, and insurance."

In order to identify and promote successful approaches to new modes of delivering financial services, the Access through Innovation Sub-Group will need to cooperate with other international organizations and fora, consult developing country policymakers, support peer learning and scaling-up of successful policy innovations, and build off of existing work on the topics to be addressed by the Sub-Group. The aim is to develop common positions, add political momentum to decision-

making, and support the goal of the safe and sound spread of new models of financial service delivery capable of reaching the poor.

Objectives

As noted in the Pittsburgh declaration, the key objectives for the sub-group are to "identify lessons learned on innovative approaches to providing financial services to these groups, promote successful regulatory and policy approaches and elaborate standards on financial access, financial literacy, and consumer protection." These objectives will be pursued through the following activities.

- Identify and assess key policy, regulatory and supervisory issues associated with new modes of financial service delivery to broaden and deepen access to and use of formal financial services. These issues include, but are not necessarily limited to, the following areas already identified by financial inclusion experts:

  Electronic money / stored value instruments
  Retail payment systems
  Third party agent use
  A diverse array of financial services (deposit-taking, insurance, lending, payment services, etc.) and financial services providers (both banks and non-banks)
  Interoperable payment systems
  Financial capability (i.e. literacy, capacity, education)
  Consumer protection
  Competition
  Risk-based approaches to promoting financial integrity (eg proportionate AML/CFT measures adapted to country contexts)
  Data collection
  Incentives

- Identify successful approaches relevant to the regulatory and policy issues identified above, building off work already done or in progress.

- Review relevant existing international financial standards and guidance.

- Consolidate findings into a report to:
  - Outline the lessons learned (in both G20 countries and non-20 countries);
  - Spread knowledge of successful approaches, taking into account different regulatory and policy contexts, and the challenge of designing financial products to meet the demand of those with limited financial resources and low, irregular and/or unreliable incomes;
  - Identify general principles for building strong enabling environments for new modes of financial service delivery to the poor, based on recent experience and existing international standards;
  - Point out potential critical gaps or barriers to be addressed by SSBs.

- Develop strategies for the successful implementation of agreed general principles and for the dissemination of successful / good practice examples.

Workplan Components

<u>Component 1 – Analyse recent experience and lessons learned, develop preliminary general principles and identify regulatory gaps and barriers.</u>

Key Tasks:

(a) Co-Chairs to lead an experts group comprising G20 representatives, CGAP, AFI and other international organizations focussing on the experience of a select group of countries (including both G20 and non-G20 adviser countries) in branchless banking and other financial services (successful and unsuccessful), with the aim of bringing up to date information on the state of policy and regulation in their respective national systems. The purpose of this "case study" exercise will be to ensure that information is the latest available on the current state of play with respect to policy, regulation and supervision of new modes of financial service delivery to the poor.

(b) Undertake a workshop with key countries, including non-G20 adviser countries, in an effort to draw out further valuable lessons on innovations which are increasing access to formal financial services, as well as information about gaps and barriers in the enabling environment.

(c) Prepare a report synthesising the 'state of play information', including key lessons learned and the elements of successful regulatory and policy approaches, drawing on case studies from CGAP and an AFI Survey and other work outlined in the schedule below. The report will build a narrative containing preliminary general principles and case studies of successful approaches exemplifying these principles, as well as the policy and regulatory gaps and barriers that have been identified in improving access to financial services through innovation. This report will be compiled by Co-Chairs following extensive consultation with G20 experts, non-G20 advisor countries, standard setting bodies, IFI advisors and other interested stakeholders. Inputs will be sought from stakeholders, thus ensuring that this is a collaborative exercise. Consultations will occur across a variety of mediums – email (including written submissions) and tele and video conferences.

First Draft Due: April 2010

Final Draft Due: May 2010

<u>Component 2 – Promote successful regulatory and policy approaches through the development and implementation of relevant principles.</u>

Key Tasks:

(a) Refine the preliminary general principles in line with June Leaders' outcomes and further consultations.

(b) Devise options for the achievement of successful approaches, including through refinement of existing diagnostic tools that countries can use for self-assessment purposes and possibly through development of guidance on performance measurement.

(c) In consultation with FSB and SSBs, prepare strategies for addressing possible identified gaps and barriers in the existing international standards and develop programs of working with SSBs as appropriate.

(d) Prepare a framework for Leaders which comprises (i) the key outcomes from tasks (a) to (c) above (ii) proposed actions for supporting the development of more country specific approaches, including capacity building and other support by IFIs and donors.

First Draft Due: August 2010

Final Draft Due: September 2010

Intended Outcomes / Deliverables

1. An enhanced commitment by G20 members to building strong enabling environments for new modes of financial service delivery to the poor through clear, proportionate, efficient and equitable policy frameworks and regulation, incorporating a clear understanding of incentives affecting clients, agents, parent bodies and other key stakeholders, relating to electronic money and stored value cards, retail payment systems, data collection, third party agent use and participation by a diverse array of financial service providers, and clear and appropriate policies and guidance to support interoperable payment systems, financial know-how and literacy, consumer protection, competition and financial integrity in the context of new models.
2. A set of general principles and related policy guidance encompassing the key areas critical for building such strong enabling environments.
3. A well-accepted diagnostic tool that can be used by countries to self-assess the state of policy and regulation on the new modes of delivery financial services to the poor in their national systems.
4. A framework for promoting success for Leaders as described in key task (d) of Component 2 above.
5. Consistent with G20 practices, recommendations to G20 Deputies on how any new G20 Leaders' commitments in this area could be implemented and reviewed.

Proposed Management Arrangements

Key stakeholders

Members	
Co-Chairs	Brazil / Australia
G20 Experts	All interested G20 countries
Advisers and Participants	
Standard Setting Bodies (SSBs)	The Committee on Payment and Settlement Systems (CPSS) The Basel Committee on Banking Supervision (BCBS) The International Association of Insurance Supervisors (IAIS) The Financial Action Task Force (FATF) The International Association of Deposit Insurers (IADI) The Financial Stability Board (FSB)
Non-G20 Country Advisors	Kenya, the Philippines, Pakistan, Peru, Bolivia, Colombia, Ghana, Uganda and Papua New Guinea will be invited to participate.
IFI and other international Advisors	Experts from CGAP and AFI. Other experts from the World Bank Group, the IMF, the IADB, the EBRD, the AfDB, the ADB, the UN and the OECD.

Membership of the Access through Innovation Sub-Group is voluntary. The opportunity to contribute at any time will remain open to all members throughout the course of the process. Expert group outputs will be distributed to all G20 members and to participants in the work of the Sub-Group.

Participation is welcomed from all relevant stakeholders, but in particular those organisations and countries described above.

Overall Task Management

Overall responsibility for ensuring completion of this initiative rests with the Sub-Group Co-Chairs, Australia and Brazil.

Technical support to the Sub-Group Co-Chairs will be provided by a technical secretariat comprising initially one technical adviser from each of Australia, Brazil, CGAP and AFI, and other resources, including from the World Bank Group, as appropriate.

A schedule and breakdown of activities to be undertaken under Component 1 of the initiative is provided below. In consultation with G20 Experts, the Co-Chairs have appointed 'task captains' in a number of instances. These 'task captains' will have responsibility for the preparation and presentation of technical and strategic advice to the Co-Chairs in the nominated areas.

Schedule and breakdown of activities for Component 1

The following table outlines key tasks and actions intended to be undertaken during the first phase of this initiative (ie. up until June 2010).

Actions	**Responsibility**	**Dates**
Short paper outlining the background to this initiative, includes rationale	CGAP / ATISG Secretariat	End Dec 09
Diagnostic of up to 16 countries - includes updates to existing studies and case studies on specific issues as appropriate	CGAP / World Bank Group plus consultants	End Jan 10
Short paper on existing international financial standards, identifying: - Relevant existing standards - Potential gaps, barriers and implementation challenges - Options for engaging/consulting with SSBs	Germany and the US as task captains, drawing on inputs from others who have pre-existing relationships with SSBs	Mid Feb 10
Short paper on financial capability	UK as task captain, working closely with CGAP and others	Mid Feb 10
Short paper on lessons learned in branchless banking based on updated and new case studies	CGAP, with input from relevant World Bank Group units	Mid Feb 10
Short paper on innovation elements of the state of financial inclusion policies in developing countries	AFI	End Feb 10
Short paper for G20 Deputies - progress update	Co-Chairs	Mid Feb 10
(Very) early synthesis draft circulated to G20 Experts for comment	Co-Chairs – supported by ATISG Secretariat and CGAP	End Feb 10

Workshop in London for CGAP case study countries	Co-Chairs – supported by CGAP, AFI and UK	11 Mar 10
Preliminary report on finding from Component 1	Co-Chairs – supported by ATSIG Secretariat and CGAP	End Apr 10
Meeting of ATISG in Canada - consideration of prelim report	Co-Chairs – with Canada and US	Early May 10
Final report to G20 Deputies	Co-Chairs	End May 10

Modalities

The sub-group will primarily be run as a 'virtual forum', with activities conducted mainly via e-mail and teleconferences as well as with workshops/meetings held if necessary to support the drawing out of lessons learnt and finalise draft reports.

In accordance to the established protocol for G20 study/work groups, final substantive discussion of policy lessons will remain within the Deputies' meetings. Deputies will decide whether to take the report, or issues arising from it, to Ministers and Governors.

Timeline

Date	Milestone	Details
27 Nov 09	Circulation of draft work plan	- Circulation to all G20 Experts of draft work plan for Access Through Innovation Sub-Group
3 Dec 09	First meeting of FIEG in Washington	- Confirmation of workplan for FIEG
Dec 09 – end Feb 2010	Informal consultation and stocktaking	- Liaison with key stakeholders and sub-group participants - Collection of data, background information, lessons learnt - Drafting
March 2010	Workshop on CGAP case studies with affected countries	- One day workshop involving G20 and non-G20 advisers with the aim of discussing preliminary lessons learnt and principles document
April 2010	Draft report on preliminary findings circulated to G20 Experts	- Draft circulated for comment
May 2010	Possible G20 Experts Group meeting in Canada	- Meeting to finalise draft report including draft general principles
May/June	G20 Deputies	- Consideration of draft report - Comments and feedback returned

May/June	G20 Finance Ministers	- Consideration of amended report - Comments / feedback returned and report finalised
Jun 2010	G20 Canada Leaders	- Leaders' endorsement of final report
Aug 2010	Draft Framework for Promoting Success of Access through Innovation	- Draft of Framework circulated to sub-group - Possible teleconference/meeting to facilitate feedback
Aug 2010	Sub-group meeting?	- Meeting to finalise draft report?
Sep 2010	G20 Deputies	- Consideration of Draft Framework for Leaders - Comments / feedback returned and Framework amended
Oct 2010	G20 Finance Ministers	- Consideration of draft Leaders Framework - Comments / feedback returned and Leaders Framework finalised
Nov 2010	G20 Seoul Leaders	- Leaders' endorsement of Framework

Formal meetings will be supplemented through email exchanges across the Sub-Group and teleconferences.

APPENDIX 4

DRAFT SUMMARIES OF THE WORK OF THE INTERNATIONAL STANDARD SETTING BODIES

FOR COMMENT – APRIL 2010

The Financial Action Task Force (FATF)

The Financial Action Task Force (FATF), established in 1989, is an inter-governmental body whose objective is to develop and promote standards, both nationally and internationally, to combat money laundering and terrorist financing. It currently has 33 member jurisdictions and two regional organizations (the Gulf Cooperation Council and the European Commission). The Financial Action Task Force also works closely with eight FATF-style regional bodies in Africa, Asia/Pacific, the Caribbean, Europe, Eurasia, the Middle East and North Africa, and South America, representing the majority of countries in the world. Globally, approximately 180 jurisdictions have directly endorsed FATF's recommendations. The Financial Action Task Force has issued 40 recommendations on money laundering and 9 special recommendations on terrorist financing (known as the 40 + 9 recommendations). The FATF monitors member progress in upholding these measures by collaborating with international bodies and publishing mutual evaluations.

Financial inclusion and financial integrity are complementary, not conflicting policy objectives. Certain elements of the FATF 40 + 9 Recommendations, such as Customer Due Diligence, can appear to impose obstacles to providing financial services to low-income population segments. However, the FATF recommendations are flexible and allow countries to apply a risk-based approach. Adopting risk-based approaches to money laundering and terrorist financing – tailored to the realities and needs of low-income population segments traditionally excluded from the formal financial sector – promotes not only financial inclusion but also financial integrity as more people are brought into the formal and more easily monitored financial sector. Within the context of branchless banking, several countries have already implemented regulatory frameworks promoting both financial integrity and financial inclusion. Common risk-based measures include, for example, reduced customer due diligence requirements, tiering, and balance and transaction caps

The International Association of Insurance Supervisors (IAIS)

and its process to develop financial inclusion guidance

The IAIS represents insurance regulators and supervisors of 140 countries, constituting 97 per cent of the world's insurance premiums. It is the international standard setter for insurance and issues principles, standards and guidance which provide a globally accepted framework for the regulation and supervision of the insurance sector. These are developed and accepted through wide consultation with members and subject to the acceptance of the annual meeting that includes all member countries. Although all jurisdictions should aim to comply with international standards, the IAIS recognises that there is a need for local circumstances to be taken into account. Since 2006, the IAIS has been addressing regulatory issues for promoting access to insurance. Key elements of the process include:

1. The Joint Working Group. The IAIS subgroup on Microinsurance, the Regulation, Supervision and Policy Working Group of the Microinsurance Network49 and IAIS observers who represent industry associations, insurers and reinsurers and international financial institutions, formed a Joint Working Group in 2006 to exchange knowledge on how regulation, supervision and policy impact the growth and development of microinsurance in different jurisdictions. It meets at least four times every year and serves as a global dialogue platform on regulation, supervision and policy issues relating to access to insurance. The objective of this dialogue platform includes: identifying issues; undertake studies, support dissemination via publications and events and share good practices and lessons. A list of confrences and worshops are at the end of this section.

The major output from the JWG have been: Issues Paper on the Regulation and Supervision of Microinsurance50: This paper was formally adopted by the IAIS in 2007. A draft Issues Paper on the Role, Regulation and Supervision of Mutuals, Cooperatives and other Community-based organizations (MCCOs) in increasing access to insurance markets and Draft guidance on regulation and supervision of Microinsurance are also concurrently under development. In addition the JWG has commissioned five country studies to explore the impact of regulation and supervision on the development of microinsurance markets in Colombia, India, the Philippines, South Africa and Uganda. It has also held an International "Conference on Integrating Microinsurance into the Financial Sector" (Switzerland, 16-18 Sept 2008) - and a Policy Seminar in Senegal (Nov 3, 2009) - back-to-back to the 5th Annual Microinsurance Conference of the Munich Re Foundation and the MIN

The critical success elements of the JWG are its seamless integration with the formal structures through the subgroup on Microinsurance with the IAIS Technical and Implementation Committees for standard setting and standard implementation respectively, its composition which enriches dialogue and learning between supervisors and practitioners /experts. The practise of regional rotation of meetings allows supervisors (both IAIS members and non-members) from all over the world to participate and contribute, and a well laid out workplan for three years with clear outputs and goals to be achieved.

[49] Information can be found at: http://www.microinsurancenetwork.org/workinggroup/Regulation-Supervision-and-Policy/10.php

[50] http://www.iaisweb.org/__temp/Issues_Paper_in_regulation_and_supervsion_of_microinsurance__June_2007.pdf

Most importantly, the JWG is led and driven by supervisors and as such not only lends credibility but also encourages actual implementation.

2. The Access to Insurance Initiative: The Access to Insurance Initiative (the Initiative) www.access-to-insurance.org is a global partnership between the International Association of Insurance Supervisors (IAIS), the German Ministry of Economic Cooperation and Development (BMZ) together with the German Technical Cooperation (GTZ) who acts on its behalf (and who hosts the Secretariat of the Initiative), the CGAP, the International Labour Organisation (ILO) and the South Africa-based FinMark Trust. The purpose of the Initiative is to strengthen the capacity of policymakers, regulators, and supervisors seeking to advance insurance market access by promoting sound, effective and proportionate regulation and supervision of insurance markets that will facilitate the growth in availability of insurance products appropriate for the low income consumers.

3. Lessons learned: Insurance supervisors and regulators are the key drivers in shaping a well-structured reform path that can lead to sound microinsurance market development. The following success elements find increasing mention in dissemination events:

(1) Microinsurance should be promoted with the support of all stakeholders through stakeholder dialogue with the industry.
(2) Identification of market potential and barriers in regulation, supervision and policies on the basis of a country diagnostic is a sound basis for action´.
(3) Cooperation and dialogue with other sector authorities such as Central Bank, Ministry of Finance and Cooperative Authority.
(4) Informal market needs monitoring separately.
(5) The regulatory costs need to be kept low.
(6) Microinsurance has its limitations and is not an alternative to government subsidised social security programs for the poorest.
(7) Promotion of financial literacy and insurance awareness is important.
(8) Revision of regulatory and supervisory framework is a long and tedious process – to get started is the most important step in this process.
(9) Financial sector policies that include commitment towards development of microinsurance are helpful.

To implement these recommendations, the insurance supervisors from developing and emerging markets require technical assistance and support in terms of country diagnostics, country-coaching and capacity building.

3. Recent Major Conferences and Dialogue Workshops

- Switzerland/Basel (September 2008), Integrating Microinsurance into the Financial System - Regulatory, Supervisory and Policy Issues (Financial Stability Institute, FSI, and IAIS/JWG)
- Tanzania/Dar-es-Salam (May 2009): Insurance Regulators Seminar as part of 36th AIO Conference (AIO, IAIS, Tanzania Insurance Supervisory Department, GTZ, World Bank)
- China/Taiyuan (July 2009), Chinese Insurance Regulatory Commission (CIRC) and JWG: Improving Financial Access through Microinsurance- – Lessons from Regulatory and Industry Initiatives for China (CIRC, IAIS/JWG)

- Ghana/Accra (October 2009): Regional Seminar for Supervisors in Africa on Market Conduct, Anti-Money Laundering and Microinsurance (FSI, National Insurance Commission, IAIS/JWG)
- Senegal, Abidjan (November 2009): Access to Insurance Policy Seminar for Regulators and Supervisors (IAIS/JWG/Access to Insurance Initiative, ……..
- Egypt, Cairo (December 2010): Paving the Road for Micro-Insurance in the MENA Region (Egyptian Financial Services Authority, IAIS/JWG/Access to Insurance Initiative)
- Berlin (May 2010), BAFIN, BMZ and Access to Insurance Initiative: Enabling Insurance Market Development, A joint challenge for the insurance industry, regulators and supervisors

4. Papers

IAIS and CGAP Working Group on Microinsurance (2007): Issues in Regulation and Supervision of Microinsurance.

IAIS Issues Paper on the Regulation and Supervision of Mutuals, Cooperatives and other Community-based organisation in increasing access to insurance (Draft, February 2010)

A five country-case study project was undertaken under the guidance of the International Association of Insurance Supervisors (IAIS) and Consultative Group to Assist the Poor (CGAP) Joint Working Group on Microinsurance. From Bester H., Chamberlain D. and Houggard C.:

- South African Case Study December 2007
- India Case Study January 2008
- Colombia Case Study February 2008
- Philippines Case Study February 2008
- Uganda Case Study December 2007

Synthesis Paper - Making insurance markets work for the poor: insurance policy, regulation and supervision, Evidence from Five – Country Studies (2008)

Basel Committee on Banking Supervision

The Basel Committee on Banking Supervision (BCBS), established in late 1974, provides an international forum for regular cooperation on banking supervisory matters and develops standards in all aspects of banking supervision. The BCBS currently has 27 member countries.[51]

The objective of the BCBS is to improve the quality of banking supervision worldwide by enhancing information exchange on supervisory issues, with a view to promoting adequate implementation of common standards and approaches without proposing harmonization of supervisory techniques at the national level. Its standards are not legally binding. The BCBS is best known for the following: international standards on capital adequacy; the Core Principles for Effective Banking Supervision known as "the Core Principles", (global de facto standard for sound prudential regulation and supervision of banks); the Concordat on cross-border banking supervision and the principles on outsourcing, which directly relates to the work of the ATISG.

The BCBS has recognised the emerging provision of microfinance by banks and non-banks (for example, microfinance institutions and financial cooperatives) to the poorer demographic. In February 2010, the BCBS issued a consultative paper on microfinance, titled 'Microfinance Activities and the Core Principles for Effective Banking Supervision'. It contains guidance for the application of the Core Principles to depository microfinance activities. This guidance is to assist countries in developing a coherent approach to regulating and supervising microfinance. The paper also reviews the range of practices on regulating and supervising such activities.

The main conclusions from the consultative paper illustrate the general applicability of the Core Principles to the supervision of microfinance activities undertaken by deposit taking institutions and consistently highlight four key needs:

1. to allocate supervisory resources efficiently, especially where depository microfinance does not represent a large portion of the financial system but comprises a significant number of small institutions;

2. to develop specialised knowledge within the supervisory team to effectively evaluate the risks of microfinance activities, particularly microlending;

3. to recognise proven control and managerial practices that may differ from traditional banking but may suit the microfinance business in both small and large institutions; and

4. to achieve clarity in the regulations concerning permitted microfinance activities for different institutional types, while retaining flexibility to deal with individual cases.

[51] Basel Committee Member Countries are: Argentina; Australia; Belgium; Brazil; Canada; China; France; Germany; Hong Kong SAR; India; Indonesia; Italy; Japan; Korea; Luxembourg; Mexico; the Netherlands; Russia; Saudi Arabia; Singapore; South Africa; Spain; Sweden; Switzerland; Turkey; the United Kingdom; and the United States.

The Committee on Payment and Settlement Systems

The Committee on Payment and Settlement Systems (CPSS), established in 1990, is a standard setting body for payment and securities settlement systems. Members of the CPSS consist of senior officials who are responsible for payment and settlement systems in central banks.[52]

The objectives of the CPSS are to:

- contribute to the strengthening of financial market infrastructure by promoting sound and efficient payment and settlement systems; and
- monitor and analyse developments in domestic payment, settlement and clearing systems as well as in cross-border and multi-currency settlement schemes.

The CPSS formulates broad standards and guidelines for payment and securities settlement systems with the goal of maintaining financial stability by strengthening the financial infrastructure. For example, the CPSS has produced the Core Principles for Systemically Important Payment Systems. The CPSS and the Technical Committee of the International Organization of Securities Commissions (IOSCO) jointly issued Recommendations for Securities Settlement Systems in November 2001 and Recommendations for Central Counterparties in November 2004. The CPSS also produces Red Books for different countries which provide a comprehensive description of a country's payment systems.

In January 2007, the CPSS and the World Bank published "General principles for international remittance services". This report sets out general principles for promoting safe and efficient international remittance services by encouraging markets for services to be contestable, transparent, accessible and sound. The five general principles recommended in the report are: market transparency and adequate consumer protection; improving the payment system infrastructure to increase efficiency; sound, predictable, non-discriminatory and proportionate legal and regulatory framework; competitive market conditions; and appropriate governance and risk management practices. The report recognises the increasing number of international remittances that are occurring, especially to those who are unbanked, and emphasizes the importance of having a network (that is, access points) where consumers of remittance services pay and receive funds. Also needed are procedures to link those access points to enable messaging (the transfer of information about the remittance) and settlement (the transfer of the funds). The report identifies the relative high cost of providing remittance service in comparison to the small amount of funds transferred. Although the CPSS report includes examples of how to implement the principles, the responsibility for the implementation of its general principles ultimately lies with the remittance service providers and the relevant public authorities.

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[52] The member institutions are: the Reserve Bank of Australia; National Bank of Belgium; Central Bank of Brazil; Bank of Canada; The People's Bank of China; European Central Bank; Bank of France; Deutsche Bundesbank; Hong Kong Monetary Authority; Reserve Bank of India; Bank of Italy; Bank of Japan; Bank of Korea; Bank of Mexico; Netherlands Bank; Monetary Authority of Singapore; Sveriges Riksbank; Swiss National Bank; Central Bank of the Russian Federation; Saudi Arabian Monetary Agency; South African Reserve Bank; Central Bank of the Republic of Turkey; Bank of England; the Board of Governors of the Federal Reserve System; and Federal Reserve Bank of New York.

The International Association of Deposit Insurers

The International Association of deposit Insurers (IADI), established in 2002, is a non-profit organisation based at the Bank for International Settlement in Basel, Switzerland. It serves as an international forum for deposit insurers to cooperate to provide research and guidance on deposit insurance matters. IADI currently represents 60 deposit insurers from 52 jurisdictions.

The objectives of IADI are to contribute to the stability of financial systems by promoting international cooperation in the field of deposit insurance and to encourage wide international contact among deposit insurers and other interested parties. In particular, IADI:

- enhances the understanding of common interests and issues related to deposit insurance,
- sets out guidance to enhance the effectiveness of deposit insurance systems taking into account different circumstances, settings and structures,
- facilitates the sharing and exchange of expertise and information on deposit insurance issues through training, development and educational programs,
- provides advice on the establishment or enhancement of effective deposit insurance systems,
- undertakes research on issues relating to deposit insurance, and
- takes such other action as may be necessary or useful for its objects and activities.

One of IADI's top strategic priorities is to promote international cooperation and encourage international contact among deposit insurers and other interested parties. Through its outreach strategy, IADI sponsors and participates in international and regional events related to deposit insurance. Each year, IADI hosts an Annual Conference and participates in activities and events held in members' own jurisdictions. Issues related to financial inclusion and the role of deposit insurance in promoting financial access are frequently topics of such events. For example, the theme of IADI's Seventh Annual Conference held in 2008 was "The Role of Deposit Insurance in Promoting Financial Stability and Economic Inclusion." Notable speakers on the topic of financial inclusion from around the world participated in the two day event which focused on the role that the financial safety net, including deposit insurers, can play in promoting financial and economic inclusion. The conference sessions focused on the current state of economic inclusion from a global perspective, recent research on economic inclusion around the world, innovative ways of promoting economic inclusion and financial literacy, and the role of deposit insurance in promoting economic inclusion.

Another key IADI objective is to undertake research and issue core principles and effective practices. IADI's Research and Guidance Committee (RGC) undertakes a wide variety of research topics including some that are relevant to consumer protection and financial inclusion issues. The development of deposit insurance core principles has been a significant recent priority in this area. In June 2009, IADI and the Basel Committee on Banking Supervision (BCBS) jointly approved and released the Core Principles for Effective Deposit Insurance Systems.[53] The Core Principles serve as a valuable benchmark for countries to use to strengthen existing and develop new systems of deposit insurance. The Principles are comprehensive in nature, addressing issues of coverage, funding, powers, membership, cross-border cooperation, transitioning from blanket to limited coverage, public awareness, early detection and timely intervention and resolution, reimbursement of depositors, and recoveries on assets. They are adaptable to a broad range of country

[53] The Core Principles were published on 18 June 2009.

circumstances and reflect lessons learned from the current crisis regarding the importance of adequate regulatory and supervisory frameworks and resolution procedures for failing institutions. IADI is currently working on the development of a Core Principles Methodology with the BCBS, European Forum of Deposit Insurers (EFDI), and the International Monetary Fund (IMF) that can be used by deposit insurers worldwide to assess the effectiveness of their deposit insurance systems against the Core Principles.

APPENDIX 5

TECHNICAL PAPER ON FINANCIAL CAPABILITY AND BRANCHLESS BANKING[54]

April 2010

EXECUTIVE SUMMARY

Recent research reveals that poor consumers are intensive users of financial networks– typically informal - as they struggle to make ends meet. They manage their financial lives outside of the formal financial system the best they can, based on guidance and tips passed on through informal channels, family ties and community groups.[55] There are various financial tools that offer the poor opportunities for access to formal finance and may contribute to efforts toward financial inclusion. One such possible tool is branchless banking which makes use of technologies, such as mobile phones and payment networks. It is invariably too early in the development of the industry to draw conclusions about the degree of impact that branchless banking has or will have on improving the financial lives of the poor. Nonetheless, it is very possible that this technology could be a gateway for the financial inclusion of previously unbanked people across the developing world, by offering them access to mobile bank accounts and payment systems. One possible constraint to the growth of branchless banking, however, could be the limited level of financial capability of consumers, especially in developing countries.

A financially capable person can be defined as one who has the knowledge, skills, attitudes and behaviors to be aware of financial opportunities, make informed choices to suit his or her circumstances, and to take effective action to improve his or her financial well-being. For example, a financially capable individual is able to compare financial products, open accounts or sign up for financial products or services that they consider beneficial and if necessary, can seek help when something goes wrong with a financial product or service. In the context of branchless banking, a financially capable person may have an understanding of the basic benefits of branchless banking. This knowledge then enables them to make a reasoned decision as to whether to modify their behavior and sign up for and use a branchless banking service to send remittances, or continue with other alternative payment mechanisms such as giving cash to a bus driver or using other informal channels. Other examples of financial capability in this context could be making use of branchless banking services for receiving government payments, for paying a utility bill or buying cell phone minutes, for saving money, or for accessing credit. Both financial capability and branchless banking

[54] Prepared by Margaret Miller and the Financial Capability team at CGAP with Expert Advice from Daryl Collins (Bankable Frontier Associates) and Bruno Levesque (OECD) under the guidance of Kerry Nelson (DFID) the ATISG Task Captain.

[55] For example, the 2009 book *Portfolios of the Poor* presents research findings from financial diaries of 300 poor families in Bangladesh, India, and South Africa. It showed that these households use on average 8 to 10 different financial instruments per year and far from being passive consumers, actively manage their financial lives. The participants in the financial diaries had savings and found creative ways to insure against risk or get access to credit even when these products were not available from formal financial services providers.

are nascent fields about which there are limited pilot studies and even less empirical evidence of their impact upon improving the lives of the poor. Nevertheless, both are recognized as high potential tools for financial inclusion of the poor, which merit further investigation.

This paper presents a framework for understanding both financial capability and branchless banking as two tools for financial inclusion of low-income consumers in developing countries. It makes the case for understanding, beyond simple uptake, how consumers can be best given information regarding the respective characteristics and costs of various services, how to use them securely and the redress mechanisms when things go wrong. One of the prime objectives of financial capability in this context is to foster in poor clients an understanding of their rights and how to assert them, as branchless banking products become more ubiquitous. Without reaching any definitive conclusions on the efficacy of financial capability programs or branchless banking tools, the paper instead considers how these two aspects of financial inclusion can be used to support one another. It goes on to profile the results from a mapping exercise in which leading branchless banking providers from around the world—representing a key aspect of the financial inclusion landscape—were contacted to discuss what they are doing and thinking with respect to financial capability. Provider views on the role of the public and private sectors and their interest in developing financial capability outreach for current and future clients are considered. The paper ends with recommendations for future areas of work in this sphere[56].

I. INTRODUCTION

Financial inclusion is a development priority for policy makers in most, if not all, developing countries. Taking into account the critical role played by the financial sector to enable efficient and secure payments, manage risks, provide a safe place for savings, and move resources toward productive investments, financial inclusion of the poor takes on particular significance. Whether governments are interested in sending social transfer payments to their poorest citizens or in supporting innovation among microentrepreneurs, access to finance plays a critical role. Unfortunately, only about one-third of people living in developing countries enjoy access to financial products and services[57].

Responding to this sizeable unmet need and the interest from governments around the world, the G20 Financial Inclusion Experts Group (FIEG) and the Access Through Innovation (ATI) Sub-Group are focusing on spreading new models of financial service delivery to the poor with an eye to the safety, sustainability, and quality of these innovations. Some of the most promising solutions, which offer the potential to reach scale and also be commercially viable, involve the use of technology. These include solutions involving *branchless banking*, which refers to the delivery of financial services outside conventional bank branches using information and communication technologies and non-bank retail agents. For example, the expense of a costly bank branch is bypassed through agent

[56] This paper was prepared for the G20 Financial Inclusion Experts Group (FIEG) through the Access Through Innovation (ATI) Sub-Group. Australia and Brazil are the co-chairs of this sub-group and CGAP is leading the technical work with the UK's support.

[57] Based on survey of 139 countries, presented in Financial Access Indicators, CGAP, 2009.

networks that leverage existing retailers such as pharmacies or supermarkets, using cards and point of sale terminals. The other main branchless banking approach uses cell phone networks to provide financial services. With more than 4 billion active cell phone users worldwide – and growing - this kind of "mobile banking" has the potential to reach the previously unbanked including many low income consumers and rural inhabitants of developing countries.

The supply or availability of new branchless banking technologies in a country does not necessarily lead, however, to widespread financial access for the poor or the use or adoption of these services. The reasons for this vary by region and country and parallel reasons for limited reach and use of the traditional financial system by low income consumers. For example, branchless banking tools may first be marketed to existing customers of financial institutions rather than used to expand access to the poor, just as is often the case for other financial product and service innovations. Regulatory or legal obstacles can also discourage investment in and introduction of branchless banking. On the consumer or demand side, possible constraints include (i) a lack of knowledge about branchless banking including basic information on what it is and how it works; (ii) limited skills to use the technology; and (iii) an absence of trust in the functionality or security of the service; and (iv) a lack of understanding of the value proposition.

This paper addresses the potential complementary role that financial capability outreach and training could have in the context of promoting financial inclusion through branchless banking. This role may have various dimensions beginning prior to the adoption of branchless banking by the consumer. For example, financial capability can potentially support a more informed decision process on whether or not to become a branchless banking customer, including comparing different provider offers where competition exists. For low income customers who decide to adopt branchless banking services financial capability programs may be able to contribute to a smoother, more efficient adoption process and more optimal use of the available services. In the event that customers are dissatisfied with branchless banking, financial capability may have a role in promoting awareness and use of consumer protection regulations and redress mechanisms available from both the provider and third parties including government.

Branchless banking and financial capability as they relate to financial inclusion are also aligned with the FIEG and ATI Sub-Group priorities in terms of the following three core issues:

1. Adoption: Revealing early promising strategies and models for increasing branchless banking uptake in developing countries through financial capability programs and initiatives.

2. Improving consumer protection: Using financial capability to strengthen the effectiveness of transparency and disclosure in branchless banking and promoting the proper use of recourse mechanisms.

3. Strengthening competition: Using consumer education and financial capability training to increase competition and help developing country consumers to critically evaluate and compare providers.

The rest of the paper is organized as follows. Section II presents an operational framework for considering financial capability including a working definition. Section III briefly discusses the experiences and views of a few leading branchless banking providers with financial capability. An analysis of gaps and opportunities is presented in Section IV and Section V concludes.

II. FINANCIAL CAPABILITY – A FRAMEWORK

***What is financial capability*?**

A financially capable person can be defined as one who has the knowledge, skills, attitude and behaviors to be aware of financial opportunities, make informed choices to suit their circumstances, and take effective action to improve their financial well-being. This can be summarized into four components[58]:

- *Knowledge*: for example the relative advantages and disadvantages of using formal vs informal financial services, the benefits of using financial products such as savings, and knowing what your rights are as a client including what to do when things go wrong
- *Skills*: for example the ability to prepare a family budget, use a PIN or ATM securely without sharing the PIN code, skills to present proper identification and complete the necessary paperwork
- *Attitudes*: for example, having the confidence to request a financial product or service in the first place as well as to approach a service provider with a complaint

And finally and most critically, for the knowledge, skills and attitudes to translate into positive behavioral changes

- *Behavior*: for example changes that include budgeting and regular financial planning, setting aside money on a regular basis for savings and using credit responsibly by making loan payments on time. Also, comparison shopping for the best financial products.

In the past few years, there have been increasing efforts by governments and NGOs to strengthen the financial capability of consumers. The focus of these initiatives is usually on understanding and possibly using financial products and services. The "rules of the financial road" such as consumer protection regulations and recourse mechanisms offered by both government and providers are also frequently covered. The more comprehensive financial capability programs seek to cultivate the life skills that will help avoid personal financial crises and manage uneven income flows, which are common among the poor. Many low-income individuals are putting into practice skills like knowing how to optimally administer resources through the use of budgeting, saving, credit and insurance. However, others may need additional information and skills training in these areas.

Another worthy example of the ways in which financial capability education could contribute to the financial inclusion of poor consumers and thereby to the financial ecosystem is in helping consumers to understand the function of credit bureaus, where these are in operation. Although credit bureaus don't exist in all countries, in those where credit bureaus are present and functional, consumers can

[58] This framework corresponds to a typical behaviour change communication (BCC) approach.

be made aware of where they are located, what a credit bureau score means, and how to go about tracking a credit score. In terms of interest rates, this may also be an area where a better understanding of what the poor consumer needs to know is required. According to financial diary research, the poor are already making calculations such as interest rates for determining the best community member from whom to borrow, in the informal sector. Financial capability training may, in this case, simply be a matter of translating what developing-country consumers are already doing into formal sector "language" and then teaching an understanding of how powerful such a calculation can be to comparison shop in selecting a microcredit provider or mobile money provider offering savings products.

While there is limited empirical evidence on what types of interventions show the greatest impact in developing countries, there is considerable anecdotal research pointing to creative, financial capability interventions. In practice, effective financial capability interventions use strategies that are culturally appropriate and engaging in the particular context for which they are developed. Some interesting examples from across the developing world include the use of street theater, entertainment education in the form of radio and television programming, video games, or budgeting and financial management tips pushed to cell phones to engage citizens in the learning process of a subject that would otherwise be overwhelming or dull. As new interventions of all kinds are being designed and implemented with increasing frequency, it is more important than ever to have solid diagnostics and M&E to determine what works best.

Financial capability initiatives don't endeavor to turn people into financial experts, nor do they aim to change all types of financial behaviors at once. Instead, effective interventions break down a broader framework of issues into one actionable issue or behavior change at a time, equipping consumers with the basic knowledge and skills required to make sensible financial decisions for themselves and their families. This is best done with an eye to both the literacy and educational level of the constituent and keeping in mind the most urgent issues for someone in their cultural context. For example, one cannot use percentages to explain the comparative advantage of one financial service over another in a context where such calculations don't have meaning or reference for the consumer.

The model of behavior change communication profiled in this paper and used in the field of public health is designed to engage the consumer and contribute to a transformation in their financial habits. Interventions that have been most effective in the fields of public health and social marketing indicate that in order to produce true behavior change, it is not sufficient merely to provide the individual with a brochure or to have them attend a class. The intervention must be relevant, compelling and geared to bringing about a change in a particular behavior. Thus it is likely that in financial capability the most effective interventions for involving more customers in developing countries with branchless financial services will go beyond merely disseminating information.

Why is financial capability important to the branchless banking agenda?

Poor financial capability is a critical barrier that prevents the poor from accessing financial services, and once they have access, converting this into effective and appropriate usage of financial services. Whilst branchless banking therefore has the potential to increase access to financial services, it must

be accompanied by efforts to improve consumers' financial capability to ensure the uptake and responsible use of services. The core question to address is therefore:
How do you best improve financial capability to help poor consumers understand which branchless banking services may be appropriate for them, how to comparison shop between different products and services and sign up for these services, and how to seek help if something goes wrong?

In relation to the above four components, the following are examples of pertinent issues:

- *Knowledge:* improving consumer awareness of the availability of branchless banking services and products, and how they can make their lives easier – for example by making services more affordable and convenient to use, especially for those in rural and remote areas
- *Skills:* equipping consumers with skills to subscribe to branchless banking services and use the relevant technology – for example, mobile phones, retail outlets for transactions, PINs and ATMs.
- *Attitudes:* building consumers trust and confidence in using new technology-based methods for financial services. This will require addressing attitudes that influence the usage of financial services such as preferences for face-to-face banking and cash transactions as opposed to electronic money.
- *Behavior:* actually changing their behavior such that they use a branchless banking service effectively and appropriately.

In the context of branchless banking, effective financial capability will ideally go beyond encouraging adoption of the service. Clearly, beginning with consumers paying for basic utilities, school fees, for inputs for a microenterprise or to grow a crop for farmers, cell phone air-time purchases, sending money to or receiving money from distant relatives are examples of common financial transactions for the poor which could be transformed to happen through a mobile account.[59] However, it is important to consider that financial capability will have the potential to involve the poor in more advanced financial services and focus on engaging the poor in asset building with more comprehensive savings products where appropriate.

Financial capability is also related to the effectiveness of consumer protection laws and regulations and the extent to which consumers are able to use available recourse mechanisms. The consumer must differentiate this from a situation when they are simply dissatisfied with the product they have purchased because of its price, features, or some other issue.

In its true form, financial capability education is not the same as marketing, nor is it product specific. Rather, as explained earlier, it should aim to provide basic training on a range of issues in order to improve the customer's financial understanding and behavior, across a number of products or services. In the context of branchless banking this distinction is more nuanced. There are, evidently, limitations as to what types of content areas a provider can consider with the consumer—instruction on comparison shopping—without presenting an intrinsic contradiction to their company's bottom line. On the other hand, if a provider develops an intervention to teach consumers how to seek

[59] Along these lines, both policy makers and branchless banking providers see payments and remittances as a logical entry point for financial inclusion and these services have been the focus of most mobile banking services to date.

redress and an evaluative framework for what is a true consumer protection issue, this will likely improve the customer's overall financial capability and becomes a transferable skill. Similarly, if a provider shows the benefits of using mobile money over keeping cash at home, that will, by default, contribute to the likelihood that the consumer and his or her family will become an actor in the financial system. Thus, as reflected in our interviews, profiled in Section III, most outreach and education related to increasing adoption of branchless banking at this stage of the game has considerable overlap with product promotion.

III. WHAT IS THE CURRENT STATE OF PLAY REGARDING FINANCIAL CAPABILITY AND BRANCHLESS BANKING?

With the global proliferation of cell phones, branchless banking services marketed towards the poor have also flourished in a number of different countries. It is important to note that, due to regional differences in cultures, economics, and regulations, branchless banking experiences in one country may not fully apply to all situations. Financial capability, in particular, must be appropriate for the demographics of the specific population in question in order to be effective. Here, we examine four case studies of branchless banking providers, and discuss their interaction with financial capability.[60] While there are clearly other key players in the branchless banking landscape whose perspective is worthy of future study, the present research focused intensively on the supply-side by interviewing providers. The significant rise in the number of mobile money services in low-access environments is being primarily driven by industry innovation. With this in mind, this research endeavored to better understand whether and how providers were incorporating financial capability into their efforts to present branchless banking as an option for the poor and encourage responsible use of the services.

Globe's GCASH (the Philippines)

In the Philippines, Globe's GCASH provides an example of a widely deployed branchless banking service. The Philippines are an interesting branchless banking case study for three reasons. First, the Philippines are a collection of over 7000 islands, making transportation and physical transfer of money between islands a hassle. Second, remittance services are very popular in the Philippines, as many Filipinos send money to their family members. Third, mobile phone penetration is very high; the Philippines are often called the "Texting Capital of the World."[61] Capitalizing on these trends, GCASH has attempted to simplify remittances and other transfers and has built their system primarily on an SMS interface. Aside from both domestic and international remittances, GCASH also offers bill and tuition payment services.

While Globe recognizes the role that financial capability plays in their product, they have yet to implement substantial structured forms of financial capability education. As with most mobile network operators, Globe feels that general financial capability is not their domain. Instead, their outreach is primarily focused on promoting adoption and teaching usage of their specific product. Their extensive marketing campaigns include above-the-line mediums like television and radio ads

[60] See Appendix 1 for a larger table of branchless banking providers and their financial capability initiatives.

[61] http://www.textually.org/textually/archives/2003/04/000493.htm

as well as more culturally based below-the-line approaches like promoting community meetings and training sessions.

These forms of outreach teach customers which services are offered in GCASH and how to access them. However, they fall short of providing widely applicable financial capability education. This sentiment is popular among a number of branchless banking providers, who feel that their role in fostering financial inclusion is providing a delivery channel for financial services. Although Globe in particular understands the importance of financial inclusion, they feel that it is generally the realm of other organizations—perhaps NGOs—to provide more general financial capability education aimed at ultimately increasing financial inclusion[62]. Despite this approach to the issue, several of Globe's marketing methods might be interpreted as financial capability education. For example, it is in Globe's best interests for customers to use a wide variety of GCASH's services. In order to educate customers about the range of features offered, Globe sets up promotional mazes with a new feature displayed at each turn. This promotes usage of more complex financial tools while staying topical to the GCASH service.

South African Bank of Athens's Wizzit (South Africa)

Wizzit operates in South Africa. Its mobile money system offers a familiar set of basic features: cash in/out, payments, and airtime top-up. In addition, Wizzit provides debit cards that allow its users to interact with a broader range of POS devices and ATMs. One aspect of Wizzit's marketing campaign, however, sets it apart: Wizzit deploys over 800 "WIZZkids", previously unemployed individuals that the company uses as sales agents. These agents often engage in informal financial capability education as they attempt to express the value proposition of Wizzit by explaining the risks of cash. They also build rapport with their customers, many of whom come from similar backgrounds as the WIZZkids themselves. Thus, while Wizzit does not explicitly pursue financial capability education, some of their initiatives may nonetheless impact the financial capability of their customers.

Wizzit believes that financial capability is squarely their responsibility as the provider of the financial service. They believe that financial capability can positively impact their profits, and that pursuing financial capability education could be a viable corporate strategy. However, they lack evidence to make this case and justify resources for non-branded or non product specific training or outreach activities. As a result, Wizzit is not actively engaged in financial capability education.

Wizzit expressed interest in expanding their product oriented financial capability campaign to include interactions with primary school education. Such a program could introduce financial services at a young age, fostering trust and comfort with the financial system. Again, Wizzit's main limitation in this realm appears to be money. Further monitoring and piloting of financial capability initiatives may encourage outside donors and international organizations to support the efforts of branchless banking providers like Wizzit who are focused on the bottom of the pyramid. (modify)

Safaricom's *M-Pesa* (Kenya)

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[62] This may be related to the fact that in the Philippines, the government and NGOs, such as the Colayco Foundation, are very active in providing financial capability.

M-Pesa is a Kenyan mobile money service provided by Safaricom, the leading Kenyan mobile network operator. *M-Pesa* features money transfers, airtime purchasing, and bill payment services. Over 7 million people, or roughly one fourth of Kenyan adults, have signed up since the service was launched in 2007. According to CGAP's "Scenarios for Branchless Banking in 2020,"during that same time period, the proportion of financially included Kenyans has doubled, due in part to the popularity of *M-Pesa*. Indeed, these trends are encouraging signs that Safaricom's branchless banking service can have a positive effect on financial inclusion.

Many of Safaricom's current initiatives are centered around influencing usage patterns of their existing customers. For example, Safaricom sends out intermittent SMS messages reminding their customers to safeguard their PIN numbers and passwords. They also use a variety of conventional advertisements to encourage customers to use *M-Pesa* in conjunction with a growing number of financial institutions and retailers. Due to the high adoption rate of *M-Pesa* among the Kenyan population, Safaricom focuses most of its outreach on existing customers who may be misusing or underutilizing the service.

Although Safaricom does not engage in product-neutral financial capability training, they are very much aware of the relevance of financial capability to *M-Pesa*. However, they have suggested that, as a private sector company, any effort they make to provide product-neutral financial capability training may be perceived as an advertisement and disregarded. A third-party consortium of the stakeholders, including government, civil society, and private firms may be able to best provide financial capability training to the public.

Nokia's Nokia Money (multinational; to be launched in 2010)

Nokia, a relatively new entrant into the mobile money field, appears to be approaching financial capability more directly. As a large multinational telecommunications company, their scope can be much broader than that of regional providers. Their new service, Nokia Money, is built upon Obopay's payments platform and is set to debut in selected markets throughout 2010. Early indications are that Nokia Money will initially offer the standard set of mobile money features: peer to peer money transfer, bill payments, and mobile airtime purchases.

However, in addition, many Nokia phones in emerging markets already feature an application called "Nokia Life Tools," which provides free information for a number of situations ranging from agriculture to education to entertainment. Nokia is currently considering expanding Life Tools to include financial capability education, specifically focused on aspects of risk analysis, debt management, insurance, and finances for youth. The information provided would not be specific to usage of Nokia Money, but rather instructive on financial management in general.

For those interested in the future of the interplay between branchless banking, financial capability, and financial inclusion, Nokia's service is one to watch. Its success, particularly if the Life Tools financial capability component is featured prominently in Nokia Money, could spur other providers to consider similar programs.

These four cases provide a brief snapshot of the range of branchless banking providers and their perspectives on financial capability. Generally, most branchless banking providers have not pursued financial capability education meaning outreach and education that is not product specific. Companies like Nokia, which views financial capability as an application of its corporate social responsibility (CSR), are the notable exception in their plans to provide this kind of general or unbranded education and advice. However, many of the companies who do not provide financial capability education are nonetheless aware of the relevance of financial capability to their product. The important question that remains unanswered is whether financial capability can be a profitable pursuit for branchless banking providers.

IV. GAPS AND OPPORTUNITIES

1. **Gap: Branchless banking and financial capability are nascent fields with only small bodies of evidence.** Several providers have implemented varying efforts to increase uptake of their respective branchless banking services and instruct users on the operational and practical elements of these services. Research on the efficacy of these "instructional efforts" is absent. Additionally, apart from the soon-to-launch CSR intervention focused on improving poor customers' quality of life through financial capability education, to date none of the branchless banking providers we analyzed have attempted to engage in financial capability education. As explained above, such a campaign may include areas of skill building around such topics as budgeting, responsible use of credit, the importance of emergency savings, interest rates, evaluating risk.

   That said, providers were eager to learn more about relevant content in financial capability and partake in pilots. The key to promoting this trend will be encouraging increased monitoring and evaluation efforts, which have thus far been insufficient to understand the nuanced ways in which financial capability may contribute to branchless banking, and vice versa, going forward. This can be partially attributed to the fact that profit-focused private sector companies often have insufficient incentives to conduct pilots and testing. In particular, smaller regional mobile network operators may lack the capacity to run comprehensive evaluation programs. Given the proper evaluation tools and technical assistance, however, private sector branchless banking providers are uniquely positioned to collect data about branchless banking usage and the effects of financial capability.

   Opportunity: More pilots can be developed making the best use of resources across sectors. Civil society, donors, and governments should provide assistance or incentives for private sector actors to conduct monitoring and evaluation. Investments in transparent monitoring, evaluation, and piloting may provide the evidence necessary to encourage firms around the world to consider financial capability initiatives. Governments that consider financial inclusion a public good may also be more likely to support branchless banking providers. In other words, the various stakeholders focused on improving financial inclusion may consider developing pilots to understand how clients become empowered or more financially capable with branchless banking services, where and why they fail do be

empowered and how financial capability can be used to increase consumer trust with traditional financial services as well. Pilots can also consider how clients can build on the consumer empowerment strategies that they develop in their attempts to remedy problems with branchless banking services and eventually transfer these skills to dealing with traditional banking services.

2. **Gap: There is not yet a hub for information around financial capability and branchless banking, making the research process challenging and limiting the opportunities for knowledge sharing.** As additional research emerges on interesting advances and opportunities in both the financial capability and branchless banking fields in the context of developing countries, there is presently no place to find such information. For those policy makers and researchers following the development of financial capability in this context, most information is gleaned from company press releases and industry blogs[63]. There are information-sharing platforms on other financial inclusion topics. For example in the area of financial literacy the OECD International Gateway for Financial Education[64] provides information and opportunities for exchange among 70 countries, and in the area of Microfinance, CGAP's Microfinance Gateway[65] serves a similar function, offering comprehensive and current information in three languages. However, there is no common gateway or information-sharing platform on both branchless banking and financial capability. If donors want to follow innovations and look for developments in the field and branchless banking providers want to learn what best practices exist in financial capability, there is presently no centralized resource to find such information.

   Opportunity: Develop a common gateway to share information. International organizations can act as clearinghouses for information about branchless banking and financial capability and can facilitate communication of best practices. Private sector firms lacking the materials to conduct financial capability education as part of their branchless banking programs may look to civil society and international organizations to provide support. As pilots are developed and results become available from impact evaluations, having a platform to share insights and information and to create a community of practice could be valuable. This could be supported by a web-based platform to facilitate knowledge sharing.

3. **Gap: Financial capability training should be appropriate and accessible for the poor.** Providers should be wary of one-size-fits-all approaches to financial capability. Consumers in different situations often have vastly different understandings and attitudes about finances, and those providing financial capability training should be aware of the specific demographics of their target audience. If, for example, consumers do not understand the

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[63] The most advanced research on the connection between financial capability and branchless banking prior to the present paper comes from a 2007 study by Microfinance Opportunities entitled *"Financial Education: A Bridge Between and Branchless Banking and Low Income Clients"* See: www.global**financial**ed.org/documents/Branchless%20Banking.pdf

[64] http://www.financial-education.org/

[65] http://www.microfinancegateway.org/

concept of percentage points, providers may want to rephrase their materials in terms of absolute money saved (“save 12 Kenyan shillings” vs. “save 5 per cent”).

Opportunity: When developing instructional materials and delivery mechanisms for financial capability interventions, it is essential to consider key population characteristics such as literacy rates, adult educational levels, experience with finance, experience with electronic transactions, and trust in financial institutions. Materials and mediums of presentation should be adjusted accordingly. In all cases, however, providing financial capability training must be a viable business proposition for the provider. Private sector branchless banking providers should not be expected to provide comprehensive financial advice if it does not favor their product.

4. **Gap: At this point in the branchless banking industry’s development, financial capability efforts are still focused on growing the market and issues such as customer adoption decisions rather than around either consumer protection or competition issues.** Interviews with providers confirmed that the focus of any financial capability interventions that they were undertaking was focusing on adoption. However, this is only a starting point. More financial capability training is needed regarding comparison shopping, responsible use of credit, and consumer protection.

   Opportunity: Governments and civil society agents may have critical roles to play in providing broader financial advice about topics like comparison shopping, as these topics may cause conflicts of interest for private firms. Additionally, government and international organizations can, in this early moment in the field of branchless banking, develop the best understanding of the intricacies of branchless banking and develop solid consumer protection frameworks. These insights about the latest innovations in branchless banking and the corresponding needs for financial capability of users and prospective users can also be considered as a key component when developing national financial capability strategies.

5. **Gap: Delivery channels for financial capability are difficult to navigate.** One of the unique opportunities presented by branchless banking is the direct channel of communication with a low-income customer via the same device that she is using to manage her finances. However, thus far few providers have attempted to push financial capability education through the cell phone. Although the rapid proliferation of cellular technology has been impressive, in many developing countries only basic phones are economical. These phones are often limited to only voice and SMS, both of which have significant limitations. While voice is easily accessible, it is difficult to solicit user input. SMS, on the other hand, is limited to bursts of 160 characters and provides no inherent structure for feedback. Both voice and SMS are inherently linear and provide few options for differences in language. Due to these constraints, branchless banking providers often struggle to design intuitive and usable interfaces for even the most basic banking transactions. Pushing financial capability education through these channels would be even more challenging.

   Opportunity: Once more advanced cellular technology becomes available, mobile

money providers should seize the opportunity to utilize these more complex channels of financial capability delivery. Data from Gartner shows that over fifty per cent of the handsets shipped to developing countries in the year 2009 are data-enabled "enhanced phones."[66] As these phones become more affordable for the bottom of the pyramid and mobile network operators make mobile data plans cheaper, branchless banking providers must keep up with this evolving channel of distribution. Phones that double as rudimentary web browsers provide enhanced opportunities for providers to offer a richer interface and a wider array of financial tools. Furthermore, providers that were once restricted by the simplicity of SMS will soon have the opportunity to supply financial capability content in multimedia form.

V. CONCLUSION

It is evident that this report has only scratched the surface in terms of profiling the gaps and opportunities for branchless banking and financial capability. Further, financial capability education is not a magic bullet. Instead it is a still-evolving, core component of a much broader financial inclusion effort. This effort can only be effective if considered together with inteligent consumer protection regulations, government oversight and the development of more appropriate financial tools for the poor. Branchless banking is also a very new industry about which much is still yet to be learned. It is not yet clear how to best inspire confidence in branchless banking channels and present their advantages to the poor consumer terms of saving them banking fees, bridging geographic distances and providing a safer alternative to carying cash.

Nevertheless, the union of these fields presents a unique opportunity for developing countries to increase the financial inclusion of their unbanked populations. The future success of branchless banking may depend on whether the various stakeholders—governments, civil society, donors, and private sector firms—seize these opportunities.

The present research effort, taking as a point of departure the nascent nature of both financial capability and branchless banking, endeavored to develop an initial map of what branchless banking providers had in mind when it comes to financial capability. The research also explored what the future could hold for using each of these components of financial inclusion to bring increasing numbers of poor consumers across the world access to financial services. And finally, it has made the case for additional funding being dedicated to pilots, diagnostics and evaluation, particularly in the development of new, smarter phones for the poor, of relevant financial capability content for increasing uptake of branchless banking and improving people's financial behaviors, and responsive, efficient redress mechanisms.

[66] Gartner. 2009. "Forecast: Mobile Devices Worldwide, 2003-2013." Stamford, CT: Gartner.

APPENDIX 6

Provided as an input to the ATISG by France and the AfDB

Some linkages between Remittances and Access to Finance[67].

1. Introduction

Remittances provide a significant source of financing in developing countries, covering mainly basic needs of vulnerable populations and contributing to productive investment, hence economic development of least advanced countries. Including cross border remittance services in mobile banking solutions could provide a two-way opportunity to increase incentives for beneficiary populations to access finance in developing countries and lower the cost of remittances, an objective set out in July 2009 by the G8[68]. Even though its impact is still largely unknown at this time, recent national transposition of new regulatory frameworks relative to payment services (Payment Services Directive[69]) and electronic money[70] (pending) in the EU may also facilitate the development of the remittances market.

At this stage, such cross border services are only available in a limited set of countries among developing countries but are, or may soon, be reaching pilot stage in other developing countries, thereby representing a potential "second stage" in the development of branchless banking solutions[71].

As senders and receivers operate within two different domestic financial systems, the development of such solutions carries however its own set of associated costs and risks: economic efficiency of transferred funds (basic needs vs productive investment), commissions on both ends of the transfer, price segmentation according to speed of delivery, control by the sender of the money sent, cultural appropriation, security of payments along the payment chains, asset building.

From a regulatory perspective, this implies a balancing act between market development (maintaining economic viability of sectors via proportionality of regulatory requirements, avoiding impairing cross-selling, ensuring market liquidity) and adequate regulatory and supervisory adaptation to remittances specific risks. In addition to inter-agency cooperation, optimal level of harmonization between public regulators / supervisors on both sending and receiving ends needs to be determined.

2. Identification of work tracks/possible recommendations

Work currently conducted on remittance transfers in the Franc zone and Maghreb countries has explored some of the following issues[72], some of which also apply to domestic transfers.

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[67] This note, written by Luc Jacolin (Banque de France) and Candice Olivier (Prudential Supervision Authority of France) for the G20 ATISG, reflects the views of French authorities as well as that of the African Development Bank.

[68] The July 2009 G8 objective is to reduce the global cost of remittance transfers by 5 percentage points over 5 years: the "5x5 Objective". Progress in reaching this objective is monitored by the Global Remittances Working Group using the World Bank Remittance Prices Worldwide Database (remittanceprices.worldbank.org). The last meeting of the Group took place on April 23, 2010.

[69] Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market.

[70] Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC .

[71] The April 2010 WB "Migrant Remittance Flows: Findings from a Global Survey of Central Banks" mentions four countries where cross border remittance services are offered (Brazil, Indonesia, Mexico and the Philippines).

Human and cultural aspects:

- Take into account the expectations and needs of specific target populations by offering specific products for young customers/ or for retirees (pension transfers).

- Promote financial education of targeted populations in order to allow better acceptance of new financial products / services.

- Provide incentives reducing preference for cash.

- Promote better control / access of migrant over funds disbursed or saved both to increase propensity to send funds and facilitate financial education of populations in recipient countries through diasporas.

Remittances as a first step to access to Finance:

- Use remittances services as a first step for cross selling of banking services financial products, including mortgages or savings (such as savings accounts of codevelopment available in France for diaspora members). Necessity to take into account the evolution of migrant population (degree of qualification, duration of the settlement).

- Support technology investments to develop news means of payment and necessary infrastructures.

- Promote the interoperability of payment systems at an early stage and removal of exclusivity contracts between systems and institutions.

- Promote partnerships between financial institutions on both sides of the transaction (banks, remitters, MFI).

- Consider « bi-bancarisation », in the case of Maghreb countries. It consists in taking advantage of the high density of branches of Maghreb and French-based groups in reciprocal markets to facilitate the simultaneous opening of "linked" accounts in both sending and receiving countries to reduce transaction costs, foster better control of remittance funds by senders and encourage cross selling of financial products. Exploratory work shows significant potential but further analysis of technical and legal requirements of such cooperation is clearly needed.

- Promote regional integration of financial services to reap economies of scale by developing cross border services within the Franc Zone. In both West African member countries (West African Economic and Monetary Union - WAEMU) and Central Africa (Central African Economic and Monetary Community - CAEMC), both domestic and cross border services issues are partially the responsibility of regional institutions, most notably central banks (Central Bank of West African States - BCEAO, Bank of Central African States - BEAC) and supervision agencies.

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[72] Under the aegis of the African Development Bank, the French Treasury, the French Development Agency (AFD) and participation from the Banque de France. Two workshops about "migrant remittances" were organized in November 2009, bringing together financial operators, mobile networks operators, microfinance institutions, central banks, supervisors, the World Bank and the European Investment Bank. Its final report and recommendations are being finalized.

Specific issues and risks related to the development of branchless banking and supervision:

- In many countries of the Franc Zone and Maghreb, clarification of existing banking laws (including authorizations and status) and, if need be, regulatory adaptation to branchless banking innovation (new financial products, branchless banking processes, market entrants).

- Application of the GAFI principles and in particular the risk-based approach included in the recommendation 5 to new risks related to the money laundering and terrorist financing generated by such products[73]. Cost sensitivity of identification of customers within AML/CFT regulations.

- Legal risks related to the sharing of responsibilities in the chain of transactions (between issuers/ distributors of e-money, operators/ retailers, banks/agents…) and need of a regulatory clarification in the matter. The protection of the personal data and the legal risks concerning outsourcing of clients files by electronic money operators.

- Consider innovative practices of collaboration between regulators of different activities (banking, communication) and of discussion between supervisors of issuer's countries and recipient's countries.

- Provide adequate selection/accreditation criteria of agents (retailers, other agents) and adequate training to risk management. The role of microfinance institutions as possible mobile banking agents was discussed, in the case of the Franc zone. Thanks to specific proximity to customers, these institutions could facilitate accessibility to transfers and other financial products, particularly in rural areas. However, given the significant heterogeneity of this sector in the Franc zone, this is only possible if adequate regulation and supervision to provide security and reliability is implemented.

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[73] The World bank has identified four risks associated with remittances in mobile banking: identification, tracing of transactions, speed of illicit transfers, insufficient controls, Chatain Pierre-Laurent, et. al. *Integrity in Mobile Phone Financial Services: Measures for Mitigating Risks from Money Laundering and Terrorist Financing*. World Bank Working Paper no. 46. 2008