THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

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Asia-Pacific Forum on Financial Inclusion: Conclusions and Recommendations

Banking with the Poor Network
Foundation for Development Cooperation

PURPOSE For review.

ISSUE Conclusions and recommendations of the Asia-Pacific Forum on Financial Inclusion

BACKGROUND The Asia Pacific Forum on Financial Inclusion took take place in Shanghai, China from 25-27 June 2012 at the Shanghai National Accounting Institute. The Forum brought together 72 international financial inclusion experts, senior regulators and policy-makers representing 21 APEC economies. The Forum also included senior representatives of 12 microfinance networks from the region.

PROPOSAL Financial education requires a multi-stakeholder approach and should be built into the curriculum of schools and educational institutions. Other requirements are guidelines to enforce financial education instead of pure product marketing by MFI's and coordination of funding agencies.

Key points of attention are: use of alternative data (ie utilities, cell phone and rent payments), the use of multiple data sources for identification and the incorporation of informal and semi-informal institutions delivering financial services to the poor in credit reporting through appropriate incentive structures.

Prudential and non-prudential regulation should both be proportionate. Regulation such as client protection is best supervised by several different bodies to ensure that all clients, are protected, including those served by non-banking institutions.

Enforce transparency, prevent over-indebtedness and assure proper grievance channels/complaints procedures. This needs to be applicable to all providers of financial services to the poor regulated and supervised by different authorities. Adhere to international standards and implement a combination of self-regulation and regulation.

Focus should be on formalizing remittances and savings, stimulating account-to-account transfers and creating the opportunity to deliver financial services based upon income coming from work abroad. Points of attention are to facilitate cross-border data transfer, acknowledgment of remittances as income and the facilitation of partnerships. Utilizing innovative technology such as mobile banking is important. Regulatory frameworks for agent networks also need to be developed and elaborated.

DECISION POINT Endorse the outcomes of the Forum

Asia-Pacific Forum on Financial Inclusion: Approaches, Regulation and Cross-Border Issues

Shanghai, China
25-27 June 2012

Forum Conclusions and Recommendations

Prepared by the Banking with the Poor Network and the Foundation for Development Cooperation

Introduction

The Asia Pacific Forum on Financial Inclusion took take place in Shanghai, China from 25-27 June 2012 at the Shanghai National Accounting Institute. The Forum brought together 72 international financial inclusion experts, senior regulators and policy-makers representing 21 APEC economies. The Forum also included senior representatives of 12 microfinance networks from the region.

This was the 3rd Asia Pacific Forum on Financial Inclusion and was co-organized by the APEC Business Advisory Council (ABAC), the Asian Development Bank Institute (ADBI) and the Asia-Pacific Financial Development Center (AFDC) and supported by the Citi Foundation, the Banking with the Poor Network (BWTP) and the China Association of Microfinance (CAM).

Over the past three decades, microfinance institutions (MFIs) have gained considerable success by providing services to millions of poor people throughout the region. Despite this, it is estimated that approximately half of the world's adults remain unbanked (2.5 billion people)[1]. Governments play a crucial role in promoting the development of microfinance and the Asia Pacific Forum on Financial Inclusion provided an opportunity for them to learn and share knowledge on relevant industry policy and regulation, financial education, client protection, technology promotion and cross-border microfinance collaboration.

The Forum facilitated policy dialogue on expanding new channels to serve the financial needs of the unbanked, and explore ways in which APEC can harness regional public-private cooperation to promote the sustainability and expansion of undertakings using these new channels. The Forum also provided an important platform for capacity building to help relevant policy makers and regulators in the region address key issues for expanding financial services to micro-, small and medium enterprises (MSMEs). This paper provides an overview of the key conclusions and recommendations of the Forum. These points will be further expanded upon in a full report of the Forum to be published later this year.

[1] *Measuring Financial Inclusion. The Global Findex Database*. World Bank, April 2012.

SESSION 1
Approaches to Promote Financial Literacy

1. The provision of microfinance services is an important tool to increase financial inclusion and reach excluded parts of the population. The utilisation of new technologies such as mobile banking is often regarded as crucial to the scaling of microfinance services to reach the unbanked. However, financial education and increasing financial capability are rapidly becoming priority issues as the industry comes to learn that access is not enough for the poor, and that understanding the services available to them is equally important. The success of effective financial capability building requires the attention of multiple stakeholders including policy makers and regulators, the traditional banking sector, microfinance institutions (MFIs) and educational institutions. By making financial education a priority, regulators have an opportunity to provide important support to the industry's health and growth.

2. Promoting and facilitating financial capabilities for children and youth is important to create financially responsible citizens for the future. Child-friendly regulation and certification for child-friendly banking are examples of ways to realise this. Financial education should be considered to be included in the curriculum of education institutions and teachers unions should also be engaged to secure their support. A standardized financial education curriculum could be developed in-line with the interests and needs of children, teenagers and young adults.

3. Traditional financial education programs are expensive and new economically viable and efficient methods of delivery are important. The use of public-private partnerships are particularly important as a way of sharing costs and increasing out-reach. Governments could also play an important role by defraying the costs to deliver financial education training and simultaneously develop a better understanding of consumers and their levels of financial capability.

4. Effective promotion of financial literacy and education requires a multi-stakeholder approach with Governments playing an active role leading and coordinating activities such as policy orientation, raising awareness and providing data. Greater coordination and alignment of stakeholders is also necessary to ensure efficient delivery and impact. Further guidelines are needed to better facilitate this as they will help the industry define and understand the concepts of financial education and product marketing.

5. Greater involvement of financial institutions in financial education programs is needed. Financial education programs should be combined with access to adequate banking services to build financial capability; thus making financial institutions an important partner in promoting financial literacy. Financial institutions should also pay special attention to the development of products which meet the needs of their clients, noting the need to be cognisant of the distinction between financial education and product marketing.

SESSION 2
Financial Identity

1. There exist significant challenges for lower income segments to build the reputational collateral necessary to access formal lines of credit. The main challenges associated with this include establishing a financial identity and building financial histories. Information sharing can contribute to financial inclusion and help to bring people into the mainstream financial system by using alternative data such as utility payments, cell phone bills and rental and remittances payments. Many countries manage financial identity through national identification data (ID) numbers, however, there are other unique non-financial ID sources which can also provide useful data on individuals for the purpose of establishing financial identity. Using multiple data sources to determine financial identity helps to overcome the difficulty of identifying over the course of many life phases (ie name changes after marriage and divorce, etc). Further collaboration with third-party sources (ie utilities, telecommunications companies, etc) is needed to explore this potential to deliver positive identity proofing.

2. Access to a diverse set of Microfinancial services is important for poor people and household level business. For small and medium enterprises (SMEs) access to credit is particularly important. However, the majority of SME entrepreneurs do not have access to the formal financial sector. This is partly due to their lack of credit information/financial identity which is necessary to access credit. Another issue is the fact that movable assets are often not taken as collateral. Taking movable assets as collateral for SME lending has the potential to make a great impact on financial inclusion. The challenge remains, however, on how to best capture this data.

3. Regions that have greater access to financial services also tend to have greater private sector involvement in credit reporting. So it is very much a matter of public and private sector involvement (credit bureaus). Credit information systems which involve private sector players tend to have a wider outreach. However, consumer protection (ie the confidentiality of personal data) also needs to be assured, making the involvement of governments equally important for the development of standards and supervision.

4. Throughout the region the majority of loans provided are by informal lenders. These informal lenders are also far more capable of reaching the poor, which make up the overwhelming majority of the region's "financially excluded" population. A key issue for policy makers is to determine how to incorporate these important players in the credit bureaus. This is a critical challenge for regulators, and one which is necessary to overcome in order to achieve true financial inclusion and protect against, for example, over-indebtedness. The development of relevant incentive structures is likely a key element to the solution to this challenge.

5. While some companies (ie telecos) or utilities (ie water/electric) may not see the value in sharing their customer data, there is growing evidence of the business case for them to be more open to this. Some case studies have suggested that rental payment rates improved when clients were informed that it was included in their credit history. Rent and cell phone payments are considered to be the top two of non-financial data streams to have a huge potential for increasing financial inclusion. As such, regulators should seek to include important partners such as companies and utilities in order to achieve greater financial inclusion.

SESSION 3
Microfinance Regulation

1. There are an increasing number of actors entering the financial inclusion space. This creates many opportunities as well as challenges. More specifically, there is a need to further assess the informal economy to determine the potential to "work with it" rather than attempt to "fix it" for the benefit of greater financial inclusion. Further exploration of this approach, as well as other new models, are important steps to reach the financially excluded rather than a continued focus on trying to modify current models which are proving inadequate to the needs of the financially excluded.

2. Within financial regulation and among industry players more broadly, a renewed focus on the client is needed; particularly on those who are currently excluded or unbanked. Policies that are created for service providers need to enable them to deliver products that are geared to the actual needs of those clients. All consumers need the same level of protection regardless of who their provider is. Not all microfinance providers fall under the same regulatory authority, resulting in the greater importance of self-regulation. However, finding the right balance between self-regulation and formal regulation is difficult. Key challenges are the development of policies on disclosure, fair treatment and effective recourse mechanism/grievance channels which are also applicable for those not banked by the formal banking sector (non-government organisation microfinance institutions (NGO-MFIs), cooperatives, non-bank financial institutions (NB-FIs)). Adequate supervisory capacity to enforce regulation is of equal importance as to the focus on the needs of the financially excluded.

3. With regard to supervising capacity, it is suggested that financial sector stability oversight bodies should have the goal of promoting financial inclusion and specific consideration should be given to the development of national councils of financial inclusion.

4. Effective prudential regulation is necessary to protect regulated financial institutions as well as their clients. Non-prudential regulation, such as regulation for consumer protection, is also very important. However, non-prudential regulation, such as anti-money laundering (AML) and combating financing of terrorism (CFT), can potentially slow the progress of financial inclusion by, for example, stipulating Know Your Client (KYC) requirements which can exclude the poor.

5. The growth and development of the financial industry tends to move faster than regulation. This is particularly the case with technology innovations, such as mobile banking. The current state of the industry in this regard highlights five key areas where further regulation is required: 1. The industry needs more specific regulation on agent banking (Regulation determines 'what agents' are allowed, specifies the role of non-bank agents and non-bank issuers of e-money providers need to be held liable for actions of their agents); 2. Specific requirements are needed for AML/CFT; 3. Protection of (e)money; 4. Consumer protection (specifically consumer understanding, data privacy and security); and 5. Ensuring a legal authority to regulate/supervise providers of mobile banking services.

6. Regulatory approaches to financial inclusion should embrace the concept of "proportionate regulation." The main principals behind proportionate regulation for financial inclusion are: 1. Regulation should encourage market development; 2. Regulatory initiatives should be subject to cost/benefit analysis; and 3. Regulatory environment should create incentives for market players to work towards financial inclusion.

SESSION 4
Consumer Protection

1. Microfinance faces a number of contemporary issues which are often highlighted in the media, such as harsh collection practices, over indebtedness, high fees and debate on its overall impact on alleviating poverty. To address these issues collective action and the promotion of international standards is important. Some initiatives such as the SMART Campaign, the Social Performance Task Force and Microfinance Transparency are global initiatives being undertaken to achieve greater responsible microfinance. These initiatives recognise the potential of microfinance to reach out to the financially excluded and also function to indicate significant risks and ways to manage those risks. Regulators input into such initiatives is necessary, not just to acknowledge the importance and promote inclusive finance practices, but also to create linkage with regulatory frameworks.

2. Noting the above mentioned industry-led initiatives, it is important to recognise that self-regulation and regulation go hand-in-hand. Regulation on consumer protection helps the 'fair guy' in the market from unfair competition. For example, price transparency is very hard implement on your own as an MFI, and if others are not following these rules, the MFI will likely be uncompetitive. As such, external regulation is needed for this instead of self-regulation. This is also the same with over-indebtedness. You cannot protect 'the market' with only your own measures as an individual MFI, or a couple of institutions. Regulation is needed to oversee these important aspects. A key point to acknowledge is: if regulators pay attention and are seen to be actively engaging with clients in an effort to better understand what is going on, self-regulation will improve.

3. Established generic laws for consumer protection are useful, but these laws are not adequate on their own for large parts of the (financially excluded) population. One issue which limits their effectiveness is the fact that supervising bodies are often divided by provider type and do not contribute to the same client protection for everybody (banks, cooperatives, NB-FIs, NGO_MFIs). Regular client protection regulation for commercial banks typically does not apply to most (NGO-)MFIs, which often target a larger and more vulnerable part of the population. The challenge is often lack of coordination between these multiple sector authorities/supervisors, lack of capacity and often lack of will (since financial inclusion and client protection are not often regarded as a priority). Establishing a certification process would support the implementation of client protection for the poor. Another reason why general client protection laws often fail is that claims (ie $100 loan or less) are often too small to justify the transaction costs of a legal process should a case be taken to court. As such, regulation on mandatory recourse procedures/grievance channel is important to addressing this.

4. In order to achieve a fully financially inclusive world, philanthropic funds will not be enough. Private sector involvement and contribution is essential to achieving this goal. Therefore, it is important that microfinance makes reasonable returns to attract private sector investment. A key challenge to overcome is the additional cost to MFIs to track their social performance and who pays for this. Also, a balance will need to be met to manage donor/philanthropic funds, which are typically tied to a social mission, with private sector funds, which have a commercial mission. The private sector also needs to understand the long-term business case of ensuring consumer protection and social performance so that they too can weigh in their support for this cause when making investment decisions. Regulators can also support with standards for client protection such as: 1. Do no harm; 2. Ethical business practice; and 3. Do good. While all

industry standards typically observe points 1 and 2, point 3 is less recognised. Regulators can play an important role in promoting this 3rd standard by providing incentives.

SESSION 5
Facilitating Cross-Border Microfinance

1. 220 million migrants worldwide are sending money back home. In 2012 remittance flows globally totalled more than US$395 billion, 40% of which was remitted to rural areas. Most of this money is remitted cash-to-cash with relatively limited use of formal channels. It is further estimated the migrant workers globally currently save almost US$400 billion as well.[2] Both the remittances and savings of migrant workers represent a huge untapped market.

2. Remittance flows across Asia Pacific have been greatly increasing in recent years and are expected to continue increasing, particularly when taking into account the region's demographic developments (ie East Asia's ageing population, increased urbanisation and greater dependence on foreign workers).[3] As such, cross-border microfinance following the migration patterns represents a significant opportunity for financial inclusion by formalising the informal remittance and savings channels and developing innovative product designs based upon the actual needs of the clients (ie migrant and migrant family). Regulators should aim to move migrant workers from cash-to-cash transfer, to account-to-account transfers. Financial education, of both the migrant and his/her family, is crucial to accomplish this as a way to increase awareness of formal channels and strengthen financial literacy. Another important measure would be to allow recipients' remittances to be considered as an income stream, to help establish credit & credit history.

3. Linking (micro) financial services with remittances is particularly challenging. Effective partnerships are a key to addressing this challenge since remittance companies are unable to offer services to the migrant's family and financial service providers (often MFIs, NB-FI) cannot make the transfer/remit the payment transaction for the migrant living abroad. Postal office (networks) are important partners to tap this market, as well as MFIs[2]; especially for cost reduction and building sustainable business models. To reach the scale needed for the region, telecommunication/mobile money solutions are crucial as well[2].

4. To reach the necessary scale, mobile money solutions need to work through agent networks (most probably telecommunication networks). These network agents also need to be recognised as banking agents and have clear regulation on KYC & AML compliance requirements. With regard to the regulatory considerations for using mobile money to scale up to reach all pockets of society, key enablers from the private sector standpoint are: concrete regulations for telecommunication companies, clarity from financial regulators (ie licence requirements to be allowed to work as an agent) and proportionate regulation regarding KYC & AML compliance requirements for agents..

5. Another issue regarding the facilitation of cross-border financial services is the need for cross-border data flow, following migration. Cross border migration of businesses and individuals do not accumulate any credit history in the new country and remittances are not considered as income (in home countries). This makes assessing credit worthy-ness of migrant workers and their families difficult, if not impossible.

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[2] The FFR Brief: Five Years of Financing Facility for Remittances and the road ahead. *Promoting innovative remittance markets and empowering migrant workers and their families*. IFAD, February 2012.
[3] 2011 Asia-Pacific Financial Inclusion Forum. *Expanding Financial Access Through Regional Public-Private Cooperation.* Forum Report. September, 2011.

6. An efficient financial system infrastructure is very important to enable the necessary services for safe and affordable international payments. Remittance costs are still too high for many migrant workers. A World Bank estimate highlights that if the cost of remittance transfers is reduced by 5%, migrants and their dependants could save US$ 15 million. To achieve greater financial inclusion, regulators could examine the following aspects of international remittances to determine ways by which costs might be reduced: 1. Market transparency (cost of remittance transfer); 2. Efficient infrastructure; 3. Assure remittance services are sound, predictable and non-discriminatory; 4. Create competitive market conditions; and 5. Appropriate governance.

Conclusion

The past few decades have seen several new and innovative methods for providing financial services to the poor being implemented by a range of organisation types. The development of financial services for the poor are developing at a rapid pace and Governments are often slow to keep up by finding ways to effectively include the poor within formal regulatory frameworks. Helping governments address this issue is a crucial step in reaching the estimated 2.5 billion people currently "unbanked" or "financially excluded." The Asia Pacific Forum on Financial Inclusion facilitated exchange between multiple stakeholders who share this goal and together produced five distinctive areas of policy recommendation: Financial Literacy, Financial Identity, Proportionate Microfinance Regulation, Client Protection and Cross-Border Microfinance.

Access to finance alone is not sufficient to meet the needs of the poor. They also need to be financially literate as well. Financial education requires a multi-stakeholder approach to drive costs down for greater sustainability and to reach all pockets of society. Some key points of attention are financial education being built into the curriculum of schools and educational institutions, guidelines to enforce financial education instead of pure product marketing by MFI's and coordination of funding agencies.

The challenges associated with identifying the poor need to be addressed to develop new and effective ways of establishing financial identities for the underserved and unbanked as being able to establish a financial identity is crucial to their ability to receive financial services to support their entrepreneurial behaviour or other necessities for personal development (ie savings, education, housing loans, etc). Some key points of attention are: use of alternative data (ie utilities, cell phone and rent payments), the use of multiple data sources for identification and the incorporation of informal and semi-informal institutions delivering financial services to the poor in credit reporting through appropriate incentive structures.

Proportionate regulation and supervisory capacity are equally important in order to achieve greater financial inclusion. Prudential regulation needs attention, but making non-prudential regulation proportionate (KYC, AML, for banking agents) is of equal importance. Many challenges remain, however, in determining how to best enforce regulation. Regulation such as client protection is best supervised by several different regulatory/supervisory bodies to ensure that all clients, especially the poor, are protected, including those served by non-banking institutions (ie cooperatives, NGO-MFIs).

To protect the most vulnerable parts of the population greater client protection is needed; not just to ensure that financial products are geared toward their actual (clients) needs, but to enforce transparency, prevent over-indebtedness and assure proper grievance channels/complaints procedures. This needs to be applicable to all providers of financial services to the poor, even if they are regulated and supervised by different authorities (banking, cooperatives, NGO-MFIs). Adherence to international standards and implementing a combination of self-regulation and regulation are key to addressing this.

With migration throughout the Asia Pacific region growing rapidly, cross-border microfinance service delivery needs greater attention. Particular focus should be on formalising remittances and savings by driving down cost of remittance services, stimulating account-to-account transfers (in stead of cash-to-cash) and creating the opportunity to deliver financial services based upon income coming from work abroad. Points of attention are to facilitate cross-border data transfer (so that migrants have an opportunity to build financial history and thus access formal channels), acknowledgment of remittances as income and the facilitation of partnerships (local transfer service providers in one country and financial product providers in the other country). In order to reach the required scale, utilising innovative technology such as mobile banking is important. Regulatory frameworks for agent networks (most probably telecommunication networks) also need to be developed and elaborated to provide further details and better enforcement.