

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



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This report reflects the views of the authors based on presentations by and discussions among participants at the Forum, and not necessarily those of the Advisory Group on APEC Financial System Capacity Building, APEC Business Advisory Council, Asia-Pacific Finance and Development Center, Asian Development Bank Institute, the Foundation for Development Cooperation, the Banking With the Poor Network nor of any of the other collaborating institutions. The terminology used may not necessarily be consistent with Asian Development Bank official terms.

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Abbreviations

ABAC	APEC Business Advisory Council
ADB	Asian Development Bank Institute
AFDC	Asia-Pacific Finance and Development Center
AML	Anti-Money Laundering
APEC	Asia-Pacific Economic Cooperation
ASA	The Association for Social Advancement
BCBS	Basel Committee on Banking Supervision
BOL	Bank of Lao PDR
BOM	Bank of Mongolia
BOT	Bank of Thailand
BWTP	The Banking with the Poor Network
CAM	The China Association of Microfinance
CBRC	China Banking Regulatory Commission
CDF	The Credit and Development Forum
CFT	Combating the Financing of Terrorism
CGAP	Consultative Group to Assist the Poor
CPSS	Committee on Payment and Settlement Systems
CSR	Corporate Social Responsibility
CYFI	Child and Youth Finance International
FATF	Financial Action Task Force
FCC	Financial Consumer Protection Center
FDB	The Fiji Development Bank
FDC	The Foundation for Development Cooperation
FDI	Foreign Direct Investment
FINCA	The Foundation for International Community Assistance
FSA	Financial Services Authority
G2P	Government to Person Payments
GRWG	Global Remittances Work Group
IADI	International Association of Deposit Insurers
IAIS	International Association of Insurance Supervisors
ICT	Information & Communication Technology
IFC	International Finance Corporation
INGO	International Non-Government Organization
KYC	Know Your Customer
MFI	Microfinance Institution
MNO	Mobile Network Operator

MOF	Ministry of Finance
MRA	Microfinance Regulatory Authority
MSS	Mobile Service Services
NBC	National Bank of Cambodia
NBFI	Non-Bank Financial Institution
NGO	Non-Government Organization
NID	National ID Number
OBM	Office of Banking Ombudsman
ODA	Official Development Assistance
PCB	Private Credit Bureau
PCFC	The People's Credit and Finance Corporation
PMN	The Pakistan Microfinance Network
RDB	Rural Development Bank
SBP	State Bank of Pakistan
SCC	Savings and Credit Cooperative
SEC	Office of the Securities and Exchange Commission
SECP	The Securities and Exchange Commission of Pakistan
SFI	Specialized Financial Institution
SFMC	SIDBI Foundation for Micro Credit
SHG	Self-Help-Group
SIDBI	Small Industries Development Bank of India
SME	Small and Medium Enterprise
SPTF	The Social Performance Task Force
SRI	Socially Responsible Investing
SSB	Standard-Setting Body
TAMC	Thai Asset Management Corporation

The Forum Organizers

The Asian Development Bank Institute (ADBI), located in Tokyo, is a subsidiary of the Asian Development Bank. It was established in December 1997 to respond to two needs of developing member economies: identification of effective development strategies and improvement of the capacity for sound development management of agencies and organizations in developing member economies. As a provider of knowledge for development and a training center, ADBI serves a region stretching from the Caucasus to the Pacific islands. For more details, visit <http://www.adbi.org>

The Asia-Pacific Finance and Development Center (AFDC), headquartered in Shanghai with a branch office in Beijing, is a public institution directly under the administration of the Ministry of Finance, China. APEC Finance and Development Program (AFDP), the predecessor of AFDC, was an initiative proposed by China under the APEC Finance Ministers' Meeting, which aims to strengthen capacity building in the APEC region through training workshop, forum and academic research. At the APEC Economic Leaders' Informal Meeting in Chile in 2004, Chinese President Hu Jintao announced that, the Chinese government would establish the Asia-Pacific Finance and Development Center (AFDC), in order to continue China's contribution to institutional capacity building in the Asia-Pacific region. The establishment of AFDC not only signifies regularization of the efforts of Chinese government in capacity building for the international community, but also the expansion of the target area to be covered by the efforts of Chinese government. In addition to the APEC mechanism, AFDC will also work under ASEAN+3, Forum for East Asia and Latin America Cooperation (FEALAC) and many other organizations. For more information, please go to AFDC's website: <http://www.afdc.org.cn/afdc/index.asp>

The Asia-Pacific Economic Cooperation (APEC) Business Advisory Council (ABAC) was created by the APEC leaders in 1995 to advise APEC on the implementation of its agenda and to provide the business perspective on specific areas of cooperation. ABAC is comprised of up to three members from each of APEC's 21 member economies, representing a range of business sectors. ABAC holds an annual dialogue with the APEC leaders and engages in regular discussions with APEC ministers in charge of trade, finance, and other economic matters. For more details, visit <http://www.abaconline.org>

The Forum Collaborators

The Banking with the Poor Network (BWTP) is Asia's pan-regional microfinance network that works towards building efficient, large-scale sustainable organizations, through co-operation, training and capacity building with the aim of achieving greater financial inclusion. The Network is an association of a diverse range of microfinance stakeholders committed to improving the quality of life of the poor through promoting and facilitating their access to sustainable financial services. The BWTP Network Secretariat is based in Singapore. For details, visit <http://www.bwtp.org>

The Foundation for Development Cooperation (FDC) is an independent, Australian Foundation committed to enabling better development outcomes in the Asia-Pacific region through collaboration and innovation. Through the vision and philanthropy of Bill Taylor AO, FDC was created in Australia in 1990 to harness and leverage the collective skills, knowledge, resources and passion of organisations from across the public, private, NGO and academic sectors in order to alleviate poverty and disadvantage in developing nations in the Asia-Pacific region. We achieve this by researching, piloting and promoting collaborative and innovative market-based approaches to international development. FDC's head office is in Brisbane, Australia. FDC has an Asia regional office in Singapore and a Pacific regional office in Fiji.

The China Association of Microfinance (CAM) is the only national member-based association in microfinance sector in China. CAMs mission is to offer inclusive financial services to financially under-served groups (especially the poor and low-income populations) and to promote the establishment of a harmonious society through providing services and support to its member institutions and enhancing the outreach and sustainability of MFIs as well as the overall capacity and level of the microfinance sector. Additional information may be found at www.en.chinamfi.net

The Citi Foundation is committed to the economic empowerment and financial inclusion of individuals and families, particularly those in need, in the communities where Citi operates, so that they can improve their standard of living. Globally, the Citi Foundation targets its strategic giving to priority focus areas: Microfinance, Enterprise Development, Youth Education and Livelihoods, and Financial Capability and Asset Building. The Citi Foundation works with its partners in Microfinance and Enterprise Development to support environmental programs and innovations. Additional information can be found at: www.citifoundation.com

Executive Summary

Over the past several decades, financial institutions have achieved considerable success by providing financial services to millions 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 financial inclusion and the Asia-Pacific Forum on Financial Inclusion provided an opportunity for 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).

The need for greater coordination and collective action amongst stakeholders to address the challenges of achieving financial inclusion is becoming more evident as its potential to deliver significant development impacts is better understood. The need for an increased focus on the client is one example of a common issue being highlighted at global forums and debates on the topic of financial inclusion. The convening of leading regulators, multilateral agencies, bankers, microfinance practitioners, academics and other experts in Shanghai for the 2012 Asia-Pacific Forum on Financial Inclusion, under the leadership of APEC and the Forum partners, provided a valuable opportunity to accelerate and deepen the common endeavors for greater financial inclusion.

To achieve this purpose, the Forum focused on five specific themes which reflect current challenges in the field and provided an opportunity for participants from across the region to learn and share knowledge. The specific themes of this year's Forum included: approaches to financial literacy; financial identity; microfinance regulation; consumer protection; and facilitating cross-border microfinance. Forum participants discussed these themes within the context of addressing critical issues which are currently hindering efforts to achieve greater financial inclusion in the region. These discussions yielded the following conclusions and recommendations:

Approaches to Promote Financial Literacy

- There is currently limited evidence to show that financial education leads to any consistent, positive impact on financial knowledge and/or behavior. Examples of research examined to this effect show a mix of both positive and negative results. Further development of the current evidence base, as well as continued research on the impact of financial education, are important steps going forward to better understand the potential for positive behavior changes amongst consumers and what “best practice” methodologies are needed to achieve optimum results.

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

- The provision of financial services is an important tool to increase financial inclusion and reach excluded parts of the population. The utilization 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.
- 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 products/services are examples of ways to realize 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.
- 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 one way of sharing costs and increasing outreach. Governments can 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. Similarly, financial institutions also have a vested interest in building the capacity of potential clients to access and effectively utilize financial products and services. Drawn together by mutual interests, relevant public and private sector actors should collaborate to ensure effective and efficient modes for financial education.
- 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, developing alternative structures like recourse channels 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, and where the line is drawn between the two.
- Greater involvement of financial institutions in financial education programs is needed. Financial education programs should be combined with access to adequate banking services and products appropriate for low-income segments to build both financial capability and, importantly, usage. This makes 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 cognizant of the distinction between financial education and product marketing.

Financial Identity

- There are 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 economies manage financial identity through domestic 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 proving identity over the course of many life phases (i.e. name changes after marriage and divorce, etc). Further collaboration with third-party sources (i.e. utilities, telecommunications companies, etc) is needed to explore this potential to deliver positive identity proofing.
- Access to a diverse set of microfinance services is important for poor people and household level businesses. 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 that movable assets are often not taken into account 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 apply this in practice.
- 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 (i.e. the confidentiality of personal data) also needs to be assured, making the involvement of governments equally important for the development of standards and supervision. There is also great potential for public-private partnerships in moveable assets registry development.
- Throughout the region the majority of loans provided are by MFIs, which are often unregulated. These MFIs are also far more capable of reaching the poor, which make up the overwhelming majority of the region's "financially excluded". A key issue for policy makers is to determine how to incorporate the credit information from MFIs into 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 to be a key element of the solution to this challenge.
- While some companies (i.e. telcos) or utilities (i.e. 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 support greater financial inclusion.

Microfinance Regulation

- There are an increasing number of actors entering the market to provide appropriate services to the financially excluded. This creates many opportunities as well as challenges. More specifically, there is a need to better understand the specificities of institutions that reach the un-banked populations, and further assess the informal economy to adapt existing regulations for the benefit of greater financial inclusion. New regulation for new models may need to be developed, to reach all the financially excluded rather than a continued focus on trying to modify current models which are proving inadequate to meet the needs of the financially excluded.
- 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. Equally important, 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. Self-regulations and formal regulation are both required and should complement each other. 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 such as NGO-MFIs, cooperatives or NBFIs.
- Adequate supervisory capacity to enforce regulation is of equal importance as to the focus on the needs of the financially excluded. With regard to supervising capacity, it is recommended that financial sector stability oversight bodies should have the goal of promoting financial inclusion, and specific consideration should be given to the development of domestic councils of financial inclusion to coordinate different regulators and supervisors.
- Effective prudential regulation is necessary to protect deposit taking regulated financial institutions as well as their clients. Non-prudential regulation, such as regulation for consumer protection, is also very important and a major challenge. 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, by having very strict Know Your Client (KYC) requirements which can exclude the poor. These regulations need to be adapted to the domestic context.
- The growth and development of the financial services 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 regarding

AML/CFT for agents; 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.

- 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.

Consumer Protection

- 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 are important. The Smart Campaign, the Social Performance Task Force and Microfinance Transparency are global initiatives being undertaken to achieve greater responsibility in microfinance practices. These initiatives recognize the potential of microfinance to reach out to the financially excluded and also act to identify operational 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 linkages with regulatory frameworks.
- Noting the above mentioned industry-led initiatives, it is important to recognize that self-regulation and external regulation go hand-in-hand. External regulation on consumer protection helps the ‘fair guy’ in the market from unfair competition. For example, price transparency is very hard to 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 that when regulators actively engage in relevant issues, this has a positive effect on self-regulation actions and activities.
- 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, NBFIs, 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 (i.e. \$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.

- In order to achieve a fully financially inclusive world, philanthropic funds will not be enough. Private sector capital is also needed. Therefore, it is important that microfinance makes reasonable returns to attract private sector investment. And, a balance will need to be found in order to simultaneously manage the social mission of donor/philanthropic funds and the commercial mission of private capital. Furthermore, a key challenge to overcome is how to best track both financial and social outcomes and how to best do so in an efficient and effective manner that meets the needs of diverse stakeholders. 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 recognized. Regulators can play an important role in promoting this 3rd standard by providing incentives.

Facilitating Cross-Border Microfinance

- 220 million migrants worldwide are sending money back home. In 2012 remittance flows globally were 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.
- 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 (i.e. East Asia's ageing population, increased urbanization and greater dependence on foreign workers).³ As such, cross-border microfinance following the migration patterns represents a significant opportunity for financial inclusion by formalizing the informal remittance and savings channels and developing innovative product designs based upon the actual needs of the clients (i.e. 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.

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.

- 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 offices (networks) are important partners to tap this market, as well as MFIs; 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.
- 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 recognized as banking agents and have clear regulation on KYC and 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 (i.e. license requirements to be allowed to work as an agent) and proportionate regulation regarding KYC and AML compliance requirements for agents.
- 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 economy and remittances are not considered as income (in home economies). This makes assessing credit worthy-ness of migrant workers and their families difficult, if not impossible.
- 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 billion. 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.

The past few decades have seen several new and innovative methods for providing financial services to the poor being implemented by a range of organization types. The development of financial services for the poor are developing at a rapid pace and governments can be 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 a number of recommendations to address important challenges relating to: Financial Literacy, Financial Identity, Microfinance Regulation, Consumer Protection and Cross-Border Microfinance.

Introduction

The 2012 Asia-Pacific Forum on Financial Inclusion took place in Shanghai, China from 25-27 June 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 Finance and Development Center (AFDC) in collaboration with the Foundation for Development Cooperation (FDC), the Banking with the Poor Network (BWTP) and the China Association of Microfinance (CAM). The Forum has also received long-term support from the Citi Foundation.

Over the past several decades, financial institutions have achieved considerable success by providing financial services to millions people throughout the region. Despite this, it is estimated that approximately half of the world's adults remain unbanked (2.5 billion people)⁴. Governments play a crucial role in promoting the development of financial inclusion and the Asia-Pacific Forum on Financial Inclusion provided an opportunity for 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).

Key Global Trends in Financial Inclusion

This section summarizes the opening remarks by **Robert A. Annibale, Global Director of Citi Microfinance and Citi Community Development**.

Financial inclusion is increasingly acknowledged as essential to inclusive growth. The term itself is now ubiquitous often discussed in the media, at global forums and by policy makers and central bankers across the world. As noted above, the number of those who lack access to formal financial services is significant. As we come to better understand the meaning of financial inclusion and the potential that it has to deliver important development impacts, the need for greater coordination and collective action to address the challenges relevant to it is becoming more evident.

Within the ongoing discussions and debates about financial inclusion, a number of common issues and trends are emerging. At the recent G20 meeting in Mexico the commitment to expanding financial inclusion (to both individuals and small and

4 *Measuring Financial Inclusion. The Global Findex Database.* World Bank, April 2012.

medium enterprises (SMEs)) was highlighted. Despite a significant focus by many of the meeting's participants on the current European economic and market issues, the Government of Mexico used its presidency of the G20 to launch a number of important domestic initiatives and to advance the common commitment by governments to expanding financial inclusion to both individuals and SMEs.

In May 2012, the Consultative Group to Assist the Poor (CGAP) held its annual meeting in Jordan and many of the themes that were on the agenda for this meeting were also discussed at the 2012 Asia-Pacific Forum on Financial Inclusion. Specific common themes included: the need for appropriate regulations; supervision and standards; the importance of credit bureaus; simplicity and transparency of products and services for clients; the adoption of appropriate consumer protection mechanisms and standards; technology and mobile payments/banking; and, perhaps most critically, the importance and challenges of expanding consumer's financial capabilities to make informed decisions.

While the pace of growth in the microfinance sector has slowed in many parts of the world, the sector has taken note of the experiences in some markets where there was rapid credit expansion and setbacks. The need for increased focus on the client, and more specifically, their needs, capacities, and corresponding product design, has been emphasized. For example, clients may well be availing of current products because that is what is available, but standard amortizing loan products often are not what may be required for those seeking working capital or agricultural financing.

Another important challenge is determining the appropriate material for financial education and coaching, as well as who should deliver it and pay the cost of scalable financial capability initiatives. These issues are examined by the recent Monitor report, 'Bridging the Gap', which was commissioned by the Citi Foundation.

The rapid change in delivery models for financial services has also been highlighted, especially the potential for exponential expansion of lower cost outreach, even if primarily and initially relating to transfers and payments, enabled by new mobile technology and business correspondents.

The Center for Financial Services Innovation (CFSI), which is primarily focused on financial services for the underbanked in the US, represents another example of common issues being raised, as at their recent annual meeting, many similar issues that were discussed at CGAP's annual meeting in Jordan were also discussed. For example, the CFSI meeting highlighted the issue of how clients and potential clients of financial institutions (including the 'unbanked,' 'underbanked' or 'banked') are increasingly being served by a range of alternative financial service providers since their needs are not being met by conventional providers, including banks, community development finance and microfinance institutions.

Other similar issues to those discussed by Asia-Pacific Economic Cooperation (APEC) which have been emerging include: the need for innovative and alternative credit scoring by bureaus; financial service providers setting standards (Compass

Principles); the changing regulatory landscape; and the role and challenges of technology enabled products being delivered by a range of new financial service providers, including mobile operators, retailers and prepaid card companies.

Globally, there is the emergence of new commercial entrants providing services, particularly in the areas of mobile payments. While none has matched the experience of Kenya and its famous M-PESA, there are an increasing number of new platforms emerging and, in some cases, connecting to the banking payments system. In an effort to broaden financial inclusion by fostering the rapid adoption of 'mobile money' technology, Citi and the US Agency for International Development (USAID) recently announced a partnership, initially in nine economies, to further explore how the use of mobile platforms can reduce cost, expand outreach, and provide security to make, for example, government payments such as conditional cash transfers, domestic and international remittances, salaries, microfinance disbursements and repayments. Such initiatives and collaboration between the private sector, public sector, and other organizations from civil society, can be instrumental in creating a new paradigm for financial inclusion.

The convening of leading regulators, multilateral agencies, bankers, microfinance practitioners, academics and other experts together in Shanghai for the 2012 Asia-Pacific Forum on Financial Inclusion, under the leadership of APEC and the Forum partners, provides a valuable opportunity to accelerate and deepen the common endeavors in this huge and diverse region that has long been a leader in financial inclusion.

Chapter 1: Addressing the Financial Capability Gap

This chapter summarizes the presentations and discussions in **Session One: Approaches to Promote Financial Literacy.**

Session Chair:

Julius Caesar Parrenas, Coordinator, Advisory Group on APEC and Advisor on International Affairs, Bank of Tokyo-Mitsubishi UFJ, Ltd.

Speakers:

- Jared Penner, Education Manager, Child and Youth Finance International
- Mike Kubzansky, Partner, Monitor Group

Financial inclusion can be defined as having access to appropriate financial services and the ability to effectively utilize them. It is estimated that roughly 500-800 million low income consumers globally have some form of access to formal financial services. However, it is further estimated that of these people only about 25% have had even the most basic financial education. This highlights a huge financial capability gap which is urgently in need of addressing.⁵

While access to financial services, particularly for low-income individuals, has been increasing across the globe, the financial capability of these individuals has been developing at a far slower pace; posing significant risks as well as opportunities. Financial education programs are crucial to addressing this gap, however, traditional models now require a re-think to address concerns over cost, sustainability, and overall effectiveness. Many institutions view financial education as a “cost center” rather than a strategic investment and this is likely due in part to the fact that little evidence exists to show what level of returns they might expect from such investments. This chapter explores this issue in greater depth with particular emphasis on the need for new models which are both effective at facilitating long-term behavior changes as well as being economically viable. The importance of targeting children and youth and the roles of governments and the private sector are also examined as part of a broader call for more coordination amongst stakeholders to address these important issues.

Why Financial Capability Matters

Financial capability is the ability to make informed judgments and effective decisions about the use and management of one’s money. Without this capability, individuals are left to make important decisions about their financial future, including borrowing, budgeting and saving, with no or little assistance or instruction. Recent research published by Monitor has explored this issue further; particularly looking at the role of MFIs in addressing financial capability challenges¹. For this study, about 60 MFIs were interviewed; 75% of which stated that they had an ongoing pilot or full scale financial

⁵ See Deb, A. & Kubzansky, M. (2012). *Bridging the Gap: The Business Case for Financial Capability*. Monitor.

education program. Of these, 50% used induction training programs⁶ while 56% were exploring ways to scale up or improve their existing programs. Furthermore, in a 2011 CFI/Accion survey of over 300 MFIs, financial literacy was identified as the top enabler for achieving financial inclusion⁷.

The Monitor study has also highlighted that many financial services consumers see value in financial education; however, there was also little enthusiasm amongst consumers to pay for it. While data exists on consumer issues and preferences regarding, for example, pedagogy or curriculum, more information is needed to understand what they want to learn, how they want to learn about it, and what time they are willing to invest, etc. Very few practitioners have segmented their consumer base preferences regarding capability and financial education. There is evidence which shows cases of customers willing to pay for targeted financial education programs, for instance, in Kenya; however, there remains little available data on this aspect of demand. As more attention is being paid to this issue further data is expected to become available which will help to better determine clients' financial education needs, their willingness to pay to meet these needs, and their perceived benefits from financial education.

On a general level, regulators are primarily concerned with over-borrowing or predatory lending and abuse of customers, protecting against scams and ensuring that financial institutions and government agencies educate financial services customers about products rather than simply have financial institutions "market" to them. At the core of these concerns are the poorer segments of the population, which are not only more vulnerable but also typically suffer greater impacts as a result of abusive practices. The importance of regulation which promotes greater financial education is increasingly being recognized as a priority issue, with many governments actively investing in financial education, and in some cases at the domestic strategy level⁸.

The Business Case for Financial Education

As noted earlier in this chapter, the financial capability gap is enormous and an estimated 370-690 million people with access to financial services have no financial capability⁹. One of the key challenges in addressing this is the cost, which under current approaches is often substantial. Traditional financial education models have a very high cost per learner. For example, classroom models are predominant and cost on average \$14 to \$20 per person to deliver, including both curriculum development and delivery costs. The Monitor research estimates that, depending on the combination of models used, it could cost as much as \$10 billion to provide

6 For example, the initial group training that most MFIs use with new prospective borrowers that cover a range of issues, including understanding loans and repayments.

7 Source: CFI / Accion; Monitor Analysis

8 Source: OECD-FSB Conference on Financial Education for All, Cape Town Oct 2011. Notes Taken by Monitor

9 See Deb, A. & Kubzansky, M. (2012). *Bridging the Gap: The Business Case for Financial Capability*. Monitor.

financial capability to just those who already have access to financial services. There is simply not enough grant or government funding available to cover this cost and the traditional method of providing one-off classroom style training with grant funding is an unsustainable model. To address this, new models are needed which utilize a multi-stakeholder approach where the cost of financial education programs is shared across a broad range of stakeholders (i.e. banks, MFIs, educational institutions, Government, etc). In certain cases the costs can be covered by the business case to the financial services provider, which then provides a sustainable platform for providing the service.

While addressing the financial capability gap is potentially very costly, there are also considerable issues associated with not addressing it which should also be recognized. Examples of these issues include:

- Providing access to financial services for low-income people is generally regarded as a critical development goal. However, without also providing them with adequate financial capability this exposes them to potentially further disadvantage.
- Access to finance currently greatly outpaces financial capability. More people are continually gaining access to financial products and services, however, many of them, especially the poor, have limited understanding of these services. This is particularly dangerous if the more vulnerable low-income earners begin use these products and services without adequate knowledge of the risks involved.
- Ignoring the capability gap is potentially an enormous missed opportunity for both financial institutions and low income individuals. With the growing range of products and services becoming available to consumers, the uptake and usage of these will greatly depend on how well consumers understand them.

In an effort to achieve scale, and to do so affordably and effectively, the traditional models of financial education are now being questioned. New models are needed which recognize various critical elements, the core of which centers on a multi-stakeholder approach as outlined below:

- Need to increase the involvement of financial and educational institutions in financial education as they are motivated to address the issue and some models have a positive business case for providing such capability to their customers.
- Costs to develop and deliver financial education programs can be shared amongst stakeholders through partnerships to make it more feasible (i.e. everybody pays). Involving the private sector is particularly important to achieve new economically viable models, and to tie such capability efforts to products that are affordable, accessible and appropriate.
- New modes of access, such as government-to-person payments, remittance sending and collection points and branchless/mobile banking need to also be recognized with key players (i.e. providers) involved as these new modes of access can provide new opportunities and occasions for building the capability of low-income financial services users.
- Getting good data, particularly on baseline and results, is critical to achieving financial education goals. Stakeholders need to work together to collect and share

this data which, at the moment, is in a very nascent form.

- Regulators recognize the need to work with financial institutions to address regulatory concerns to facilitate a more enabling financial education environment. However, many regulators struggle with developing a coherent vision as to roles, boundaries or collaboration.
- Over the last decade there has been a significant increase in the efforts to build financial capability, particularly for poor clients. Examples of initiatives include providing incentives for behavioral change, awareness programs for consumer rights and grievance channels, and financial literacy training. These efforts, however, have been largely disconnected and there is a need for greater coordination amongst stakeholders and amalgamation of effective programs.

Child and Youth Finance

Promoting and facilitating financial capabilities for children and youth is important to establish a culture of savings and, more broadly, ensure financially responsible citizens for the future. As the future economic actors, developing the financial decision making skills of children and youth is important for the future state of the world's economies. The financial community has a social and business responsibility to develop financial capabilities within society, particularly for future clients. Simply providing education, however, is not enough to adequately develop financial capabilities. Young people also need access to safe and appropriate financial services. This combination of financial education and access allows young people to establish healthy and enduring relationships with financial institutions early on so that they can better understand how to best utilize financial services for their benefit.

Interest in promoting and facilitating greater financial education for children and youth has grown in recent years. As a result of this, a number of specific challenges have been identified which must be overcome for effective delivery of financial education programs developed for young people. One particular challenge is the need to find ways to better integrate financial education through non-formal education channels. Financial education programs aimed at children and youth are most commonly implemented through governments (i.e. for domestic curriculums), however, accessing and working with non-formal channels are also important in order to reach greater portions of the young population, particularly in poor/poorer rural areas. Similarly, it is particularly important that the topics for financial education be made relevant to young people to capture their interest and keep them engaged.

Another challenge is often found in the willingness and capacity of teachers to teach financial education. It is also an imperative to ensure teacher training/capacity building opportunities and/or incentives are in place to ensure effective financial education learning outcomes.

To ensure that banking products for children and youth are safe and reliable, global standards for products designed for children and youth are needed. One example of such a standard has been developed by Child and Youth Finance International (CYFI), which is in the process of establishing a process for qualifying licensed financial

institutions that offer financial products to children and youth. These Certificates will be awarded based on a criteria developed to ensure the child and youth friendliness of banking products. The minimum requirements for products to be awarded Certification are as follows:

1. Availability and accessibility of Banking Product for children and youth
2. Maximum control to the child
3. Positive financial incentive for the child
4. Reach unbanked children and youth
5. Employment of child and youth friendly communication strategies
6. Financial education
7. Monitoring of child and youth satisfaction
8. Internal control

Conclusions

More data needed to assess impacts of financial education

There is currently limited evidence to show that financial education leads to any consistent, positive impact on financial knowledge and/or behavior. Examples of research examined to this effect show a mix of both positive and negative results. Further development of the current evidence base, as well as continued research on the impact of financial education, are important steps going forward to better understand the potential for positive behavior changes amongst consumers and what “best practice” methodologies are needed to achieve optimum results.

Access to financial services is not enough to achieve full financial inclusion

The provision of financial services is an important tool to increase financial inclusion and reach excluded parts of the population. The utilization 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.

The importance of children and youth as future economic actors

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 products/services are examples of ways to realize 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.

Need for new economically viable delivery models for financial education

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 one way of sharing costs and increasing outreach. Governments can 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. Similarly, financial institutions also have a vested interest in building the capacity of potential clients to access and effectively utilize financial products and services. Drawn together by mutual interests, relevant public and private sector actors should collaborate to ensure effective and efficient modes for financial education.

The importance of a multi-stakeholder approach

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, developing alternative structures like recourse channels 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, and where the line is drawn between the two.

The role of financial institutions

Greater involvement of financial institutions in financial education programs is needed. Financial education programs should be combined with access to adequate banking services and products appropriate for low-income segments to build both financial capability and, importantly, usage. This makes 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 cognizant of the distinction between financial education and product marketing.

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 financial institutions and coordination of funding agencies.

Chapter 2: New Approaches for Establishing Financial Identities

This chapter summarizes the presentations and discussions in **Session Two: Financial Identity**.

Session Chair:

Robert A. Annibale, Global Director of Citi Community Development & Microfinance

Speakers:

- Robin Varghese, Senior Fellow & Vice President of International Operations, PERC
- Matt Gamser, Chief Operations Officer, Head, SME Finance Forum, IFC
- Sophea Hoy, General Secretary, Cambodia Microfinance Association
- Chitkasem Pornprapunt, Division Executive, Financial Institutions Strategy Department, The Bank of Thailand

Currently, over 60% of people in emerging markets remain unbanked and underserved¹⁰ and only 50% of adults worldwide have an account at a formal financial institution¹¹. However, financial inclusion isn't just about households. Businesses are also important and approximately 300 million micro, small and medium enterprises (MSMEs) are unserved with a total demand for credit over \$2 trillion¹². The largest gaps between supply and demand are found in Asia and the problems faced differ between households and business; with households the primary challenge being getting access to any form of financial services, whereas small businesses struggle specifically with access to credit. Research has shown a direct correlation between stronger legal rights and more credit information being associated with more credit. This data is increasingly showing evidence that access to finance is directly related to development and the reduction of poverty¹³ and thus there is a need to incorporate alternative forms of data with 'traditional credit reporting practices' in order to better understand consumer capacity and risks. This chapter explores this issue with specific focus on the importance of financial identity to achieve greater financial inclusion.

Credit Bureaus

Statistics show that many Private Credit Bureaus (PCBs) are expanding their data sources to include others such as employers, statistics agencies and bankruptcy agencies¹⁴. PCBs receive data from a range of sources such as commercial banks

10 Source: CGAP and World Bank Group, *Financial Access 2010*

11 Source: *Global Findex (2011)*

12 Source: IFC & McKinsey & Co. (2010)

13 Source: *Doing Business* database, World Bank, World Development Indicators (2008)

14 Source: *Doing Good Business* (2012)

(both public and private), development banks, credit unions/cooperatives, credit card issuers, retailers, and other credit bureaus. Over 50% of PCBs reportedly receive information from MFIs, however, data quality and coverage of the MFI market remains an issue, as most bureaus capture only data from regulated MFIs. The majority of MFIs which provide services for the poor are not regulated by the financial sector authority. In comparison, public credit registries are far less inclusive in obtaining data from alternative sources (i.e. retail, utilities, etc) as well as from MFIs. To address this issue, and encourage greater involvement within public and private credit agencies, appropriate incentives for MFIs and other providers of useful data should be considered.

While measures which allow for more people to be included in credit reporting, and thus have greater access to finance, are important, it is also important to remember the risks that this can create. Governments need to maintain involvement in all initiatives of credit bureaus (private, joint or public) so that regulators can effectively ensure that consumer rights are protected. This becomes especially relevant when trying to include MFIs in the reporting, since they serve their client base on other terms (i.e. often work with very sensitive personal information, often use guarantors, group dynamics, alternative sources of income, moveable assets, etc).

An advantage for PCBs is that it is easier for them to engage with potential alternative data sources that aren't regulated by central banks or Financial Services Authorities (FSAs) (i.e. utilities or major retailers). However, public credit registries also play an important role as their presence guarantees the initial development of credit information sharing processes. In terms of average coverage, Latin America and the Caribbean continues to lead while other regions such as Eastern Europe and Central Asia, East Asia and the Pacific and the Middle East and North Africa are currently in the process of large reforms for credit reporting with significant increases being achieved in the coverage of their PCBs.

The Credit Information Index is used to assess the level of credit information sharing across a region. The Index is made up of the following components:

- Both firms and individuals are listed
- Both positive and negative information
- Retailers and/or utilities submit data
- Five or more years of historical data
- All loans included above 1% GNI per capita
- Consumer right to inspect is guaranteed by law

A comparison of the Credit Information Index across emerging market regions shows that Europe and Central Asia is the leading performer with East Asia, the Pacific and Sub-Saharan Africa lagging.

For households and individuals, financial education and access to a range of financial services (i.e. savings, money transfers, etc) is the priority rather than access to credit alone. For MSMEs, however, access to credit is of particular importance. In this regard,

movable assets are critically important to MSMEs. The challenge is finding effective ways to capture data on moveable assets and having this included in credit reporting. Efficient methods to address this challenge will go a long way in making a difference in access to finance, especially for MSMEs.

Regions that have greater financial inclusion also tend to have greater private sector involvement in credit reporting. This reflects the importance of the private sector as a key stakeholder and partner. By working with the private sector, bureaus have an opportunity to access a huge wealth of 3rd party information outside of the standard domains of central banks. By accessing this data consumers, particularly the poor, will have greater access to financial services. Accessing this data can also provide important insights into general financial capability of the population and be useful in addressing that gap. Therefore, public-private partnerships have the potential to contribute substantially to credit reporting.

Establishing Financial Identity and Financial History

Matching consumer account histories from various providers and building coherent financial histories are key challenges associated with establishing a financial identity. These issues raise important questions about what data can be used and how this data can be adequately supplied. To address this, the use of non-financial data should be considered as an alternative.

Traditional data usually consists of bank loans (i.e. mortgage, automobile loans, revolving credit, installment loans, personal loans, etc) and retail credit. This traditional approach has limitations however, particularly with regard to the lower income segments. For example, it only works for borrowers already in the system and it also has the potential to create a credit “catch-22” in that you need a financial history to access money, however, you need access to money in order to develop a financial history. Migrant workers face additional challenges as their credit history may not be available for their time abroad (i.e. economies not sharing data/client histories). Also, in many economies only negative credit information is available. This further reduces inclusion, as small firms who may be “good players” cannot be “seen,” other than by the current creditor.

Using Alternative Data

“Alternative” or “non-traditional” data can be defined as non-financial information that also helps assess reputation. There is great potential for alternative data to inform lenders of clients’ credit profile and help them assess risks. Examples of alternative data include: energy and water utility payments, landline and wireless phone bills, auto liability insurance payments and rental payments (especially apartments). Consideration should also be given to income in the form of remittances and stored value cards as well as prepayment services (i.e. cell phones or education expenses).

The most common method for establishing identities is through national ID numbers (NIDs). While there are many unique methods of identification, such as birth dates,

account numbers, drivers license numbers or addresses, there remain a series of complexities associated with establishing and tracking identity. For example, it is estimated that over 13 million consumers share one of ten common surnames and that further tens of millions of consumers use nicknames or initials rather than their full names. By using multiple unique IDs it is easier to identify people through all common life phases (i.e. name changes, marriage, divorce, etc). Working with multiple, non-financial, third-party data sources delivers positive attribute and identity proofing, and historical assessments of consistent identity use and access.

Credit bureaus use a range of identifiers, including phone numbers and data derived from applications. However, they are traditionally limited to credit account applications and transactions. With new data sources (i.e. water and utility payments, phone bills or rental payments) and the recognition that NIDs are not always adequate, consumer profiles can be better established.

Companies (i.e. telcos) or utilities (water/electric) may be reluctant to share their customer data although there is growing evidence to show that many consumers are more likely to make their payments on time if they know their payments are being reported to a credit bureau and will impact their credit files and credit scores. Case studies examining the topic have further highlighted net benefits for alternative data providers to provide full reporting such as declines in accounts in arrears and improved cash flow as well as the overall costs (including for compliance) being less than anticipated. While this highlights a real business case for companies and utilities to work with credit bureaus, it is important to remember that it's not just about opening up and sharing customer information freely. Much of this data is sensitive/personal information, and as such, standards are important to ensure consumer protection. These standards should address key issues such as identifying best practice, balancing the needs of the market with the rights of consumers/businesses, determining the roles of various players, and how policy makers can improve the flow of information whilst maintaining control.

On the public policy side, credit reporting systems should aim to be safe, efficient and fully supportive of consumer rights. They should also support fair extension of credit in an economy and serve as the foundation for robust and competitive credit markets. Key considerations for public policy include:

- Information quality;
- Security, reliability and effectiveness;
- Governance arrangements to deal with operational, legal and reputational risks;
- Legal and regulatory framework; and
- Globalization and access to credit across borders.

Regulatory frameworks for the use of alternative data should consider all of the challenges relevant to that particular economy; specifically technological, economic and regulatory barriers to reporting which may hinder their effectiveness. One key challenge which many regulators have to address is how to include unregulated MFIs

in credit rating systems. MFIs make up a very high percentage of lending (particularly in Asia) and so cannot be ignored as a potential source of information; and more specifically, information on the region's poor which make up the bulk of the financially excluded. Specific challenges working with MFIs include that traditional reporting requirements are too labor intensive, making it economically unfeasible and that getting comprehensive information about informal lending is very difficult. Regulation in this regard has traditionally been focused on trying to regulate or "formalize" the informal sector. However, it is important to consider new approaches to include both formal and informal lenders in credit reporting. Finding the right incentive structure to achieve this should be part of the solution for regulators to consider.

Credit Bureau (Cambodia) Co. Ltd.

In December 2011 the Credit Bureau (Cambodia) Co. Ltd (CBC) was registered with the economy's Ministry of Commerce and obtained a license from the National Bank of Cambodia (NBC) the following month. The CBC was officially launched on 19 March, 2012. Throughout this process of establishing the CBC, technical support was provided by the International Finance Corporation (IFC). In order to mandate all banks and MFIs for membership and utilization of the bureau, the NBC issued regulation in May 2011. Through this regulation, banks and MFIs were given a 9 month grace period to adapt their system and 90 days to upload their initial 100% data. For reporting, as of May 2012 the CBC has generated 174,000 reports from banks and MFIs. This includes 105,000 standard reports (majority from banks) and 69,000 "lite" reports (majority from MFIs). A pricing schedule is also maintained which offers different rates for banks and MFIs.

The establishment of the CBC has provided significant benefits to consumers including the provision of accurate real time data, faster loan approvals, additional protection against over-indebtedness, more transparency, and more trust from investors and lenders. However, these benefits have not come without challenges. One example of a key challenge which the CBC still aims to overcome is the fact that there is no domestic standardization of ID numbers. Other issues which the CBC faces include consumers which have multiple spelling of their names or unstructured addresses (particularly in the case of rural villages), multiple use of identities, limited understanding of data providers with regards to data specifications, and limited access to internet (particularly for rural areas).

Experiences from Thailand

The regulatory structure of Thailand's financial system can be categorized into four institution types. The first is deposit-taking financial institutions, such as commercial banks, subsidiaries, full branches, specialized financial institutions (SFIs) and cooperatives. The second category consists of non-deposit taking financial institutions, such as insurance providers, the social security fund as well as certain SFIs. Stock and bond markets make up the third category, which consists of security, asset management and provident fund companies. The last category is identified

as specialized institutions for financial sector resolution such as the Thai Asset Management Corporation (TAMC).

There are multiple supervisory authorities for Thailand's financial institutions with the main ones being the Bank of Thailand (BOT), the Ministry of Finance (MOF) and the Office of the Securities and Exchange Commission (SEC). Other authorities are also responsible for supervising specific financial institutions such as the Office of Insurance Commission, the Ministry of Agriculture and Cooperatives, the Ministry of Labor and Welfare, and the Ministry of Interior.

Thailand's microfinance landscape is made up of three sectors (Formal, Semi-formal and Informal). Within the formal sector, the key players consist of commercial banks (involved in microfinance) and SFIs. However, their supervisory authorities differ, with the commercial banks being supervised by the BOT and the SFIs being supervised by the MOF. Such is the same with the semi formal sector, with key players including cooperatives, credit unions, and village and urban community funds, however, different players are supervised by different authorities¹⁵. The informal sector (i.e. NGOs and self-help groups) is unregulated.

To achieve greater financial inclusion within the economy, Thailand issued the Financial Sector Master Plan I (2004-2008). This plan aimed to increase the efficiency of the financial sector, broaden general access to financial services, and protect consumers. More specifically, the Plan utilized SFIs as vehicles to increase access to financial services, supported semi-formal and informal service providers (i.e. cooperatives and self-help groups), and supported private commercial banks to not be pressured into non-commercial business decisions.

Building on the 2004-2008 Plan, the Financial Sector Master Plan II (2010-2014) was issued with additional focus on reducing system-wide operating costs, promoting competition and financial access, and strengthening financial infrastructure. The 2010-2014 Plan recognizes that certain gaps within the sector remain to be addressed, and that some of these gaps which are not commercially viable still need to be served by SFIs. Furthermore, it acknowledged that existing regulations may not be conducive enough to allow innovations and new technology to be developed which could help commercial banks explore new markets. It is therefore hoped that an improved licensing scheme and more conducive regulation will allow a wider range of services and providers to more effectively meet gaps in the market. Key infrastructures needed to achieve this and promote financial inclusion are financial literacy and consumer protection systems. From these master plans Thailand's policy on financial inclusion is derived with the overall objective being to contribute to the financial health and well being of the economy and its consumers.

¹⁵ Cooperatives and credit unions are supervised by the Ministry of Agriculture and Agriculture Cooperatives; Saving groups for production are supervised by the Ministry of Interior; Village and Urban Community Fund is supervised by the Prime Minister's Office.

In 2010 a Financial Access survey was conducted¹⁶ to determine the level of usage of financial services across all providers. The survey found that 85% of households were using financial services with 15% not using services; in this regard only 3.5% could not access any form of services. Specifically examining savings, the survey results showed that 77% of households used savings, with the remaining 23% showing no usage; of which 6% had no access to savings products. Further to this, the survey identified several problems households encountered when accessing savings: these being¹⁷:

1. Too far/inconvenient to travel to a branch;
2. Poor services, such as long queues, impoliteness, etc;
3. The high cost of fees or high minimum deposit requirements;
4. Too high minimum maintenance requirements for dormant accounts; and
5. Skepticism about the stability of the institutions.

For credit, survey findings found that 42% of households used credit, while 58% had no usage; of which 4% had no access to credit products. The problems identified for using loan and credit services included¹⁸:

1. Fees and interest too high;
2. Insufficient credit line;
3. Product conditions being too complicated;
4. Too far/inconvenient to travel to a branch; and
5. Unsuitable repayment schedule for consumers' lifestyle.

Lastly, the survey also examined payments and remittances. The findings were that 48% of households were using payments and remittances, 52% showed no usage, with 2.4% of these reporting no access to such services. Key constraints for using payments and remittances included¹⁹:

1. Fees too high;
2. Too far/inconvenient to travel to a branch;
3. Product conditions being too complicated;
4. Poor services, such as long queues, impoliteness, etc; and
5. Insufficient information which should be provided by the financial institutions.

16 Sample size: 11,202 households

17 According to 605 households (935 answers)

18 According to 889 households (1,381 answers)

19 According to 637 households (939 answers)

Thailand's microfinance policy guidelines ensure that a credit limit of THB 200,000 (around USD 6,450) be applied to all loans for business purposes. Maximum interest rate and fees are also capped at 28% per annum. This policy also stipulates: no minimum income requirements from borrowers (with commercial banks applying self-assessment); no collateral/financial status requirements (particularly as most clients do not have financial statements); limitations on the interest rate ceiling (for consumer protection); and allowance of on-site services (to enhance the flow of financial services).

Going forward, Thailand aims to achieve full financial inclusion through a combined approach of providing financial access, financial literacy and consumer protection. The BOT's policies have been developed to reflect this by supporting greater financial access through the use of innovations and new technology to expand access to financial services (i.e. mobile banking), solving business model constraints of banks to improve access (i.e. interest rate ceiling for revenue or agent banking for costs), introducing new microfinance service providers (i.e. non-bank) to induce greater competition, and providing support to SFIs to fulfill the financial gaps left by commercial banks. To achieve greater financial literacy and consumer protection the BOT applies policy tools for enforcing consumer protection (i.e. complaints bureau, disclosure of non compliance and confidentiality of client information). The BOT has also established the Financial Consumer Protection Center to serve as a center for financial complaints and enquiries and equip consumers with greater financial knowledge.

Conclusions

The use of multiple data sources

There are 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 economies manage financial identity through domestic 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 proving identity over the course of many life phases (i.e. name changes after marriage and divorce, etc). Further collaboration with third-party sources (i.e. utilities, telecommunications companies, etc) is needed to explore this potential to deliver positive identity proofing.

Access to credit key for SMEs

Access to a diverse set of microfinance services is important for poor people and household level businesses. 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 that movable assets are often not taken into account 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 apply this in practice.

Public-private partnerships

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 (i.e. the confidentiality of personal data) also needs to be assured, making the involvement of governments equally important for the development of standards and supervision. There is also great potential for public-private partnerships in moveable assets registry development.

The importance of engaging with MFIs

Throughout the region the majority of loans provided are by MFIs, which are often unregulated. These MFIs are also far more capable of reaching the poor, which make up the overwhelming majority of the region's "financially excluded". A key issue for policy makers is to determine how to incorporate the credit information from MFIs into 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 to be a key element of the solution to this challenge.

Business case for sharing data

While some companies (i.e. telcos) or utilities (i.e. 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 support greater financial inclusion.

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 activities or other necessities for personal financial development (i.e. savings, education, housing loans, etc). Some key points of attention related to credit information systems are: use of alternative data (i.e. 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.

Chapter 3: Addressing the Regulatory Challenges of Microfinance

This chapter summarizes the presentations and discussions in **Session Three: Microfinance Regulation**.

Session Chair:

Peng Runzhong, Director, Asia-Pacific Finance and Development Center

Speakers:

- Eric Duflos, Regional Representative for East Asia and the Pacific, CGAP
- Ken Waller, Director of AASC
- Katharine McKee, Senior Policy Advisor, CGAP
- Octavio Peralta, Secretary General, ADFIAP
- Abdul Awal, Executive Director, CDF Bangladesh
- Tur-od Lkhagvajav, CEO and Secretary General, Mongolian Bankers Association

Microfinance regulation is a multi-faceted issue. It not only concerns regulatory issues but also supervisory capacity. Important challenges to address include how to regulate deposit and non-deposit taking institutions, how to enforce regulation when there is fragmentation of regulatory and supervisory bodies, how to keep prudential and non-prudential regulation proportionate and how to keep up with technology developments with the growing interest in branchless/mobile banking.

CGAP defines microfinance as providing access to a range of services to the poor (credit, savings, transfer, insurance) through a diversity of financial institutions. The GPMI White Paper defines financial inclusion as a state in which all working age adults, including those currently excluded or underserved by the financial system, have effective access to the following financial services provided by formal institutions: credit, savings, payments and transfers, and insurance. It is within this context that regulation for microfinance and financial inclusion are examined in this chapter.

Regulatory Complexities of Microfinance

The increasing number of actors in the field of microfinance is creating challenges for regulators and supervisors. From a regulatory perspective, microfinance institutions can be divided into deposit-taking and non-deposit taking MFIs. Within these two groups there are numerous types of institutions such as cooperatives, commercial banks (both state-owned and private), savings banks, rural banks and development banks, postal and policy banks, commercial finance companies (non-bank financial institutions), specialized MFIs, domestic and international non-government organizations (NGOs). There are also new non-financial institutions that are involved in providing access to financial services using technology such as Mobile Network Operators.

Given the breadth of this industry, there is often more than one body that regulates and supervises the operations of all MFIs, and in most developing economies the central banks plays a lead role in the regulation and supervision of deposit taking institutions. Financial sector stability oversight bodies increasingly include the goal of promoting financial inclusion, however, to overcome the challenges associated with the breadth and depth of the microfinance industry, consideration may be given to development of domestic councils for financial inclusion that include different agencies involved in regulating and supervising all kinds of institutions that promote financial inclusion.

There are also specific challenges for the supervision of microfinance. Indeed, a regulation will only be enforced properly if the supervisor is able to play its role. Challenges with regard to supervisory capacity include:

- the efficiency in supervisory resource allocation as it takes significant resources to supervise institutions that serve large number of small clients;
- the development of specialized knowledge within the supervision department; and
- the need to have clear understanding of the specificities of microfinance compared with traditional banking.

It's crucial to be aware of the fact that what happens with the non-regulated MFIs has effects on regulated MFIs because they often share the same clients.

The regulatory complexity related to the many types of microfinance players also concerns consumer protection. Effective consumer protection regulation is very difficult since regulation can be different according to the 'provider type' (e.g. banks, non deposit taking MFIs, cooperatives), thus making it difficult to achieve the same level of protection for all products, independent of what channel/provider is delivering the service/product. However, consumer protection regulation needs some adaptation when it comes to institutions serving low income clients who might be more vulnerable than wealthier and better educated clients.

Focus on the Client

Fundamental to the development of microfinance, and the aim for greater financial inclusion, is to focus on the needs of the client. Discussions across the sector continue about the role of, and potential to work with, the informal sector as many clients and potential clients fall within this sector . Working with the informal sector and harnessing these learning opportunities is key for regulators. Some important challenges in this regard which need to be addressed include the often higher risk when offering services to the informal sector and formal services typically being more expensive than those delivered in the informal sector.

Prudential Regulation Vs. Non-Prudential Regulation

A general distinction is made between prudential and non-prudential regulation. Prudential regulation aims to protect the financial solvency of the regulated institution.

Non-prudential regulation involves regulatory objectives not related to the financial health of the regulated institution, e.g. consumer protection regulation (other than depositor protection), regulation on financial crimes (e.g., Anti Money Laundering (AML) / Combating the Financing of Terrorism (CFT)) and domestic strategies.

Prudential regulation applicable to depository microfinance institutions requires adaptations of banking regulation, including:

- Capital requirements
- Loan provisioning (Lower risk weights for micro, small and medium enterprise loans, lower preferential loan/deposit ratios, lower non-performing loans loss provisioning rules, relaxed single borrower limits)
- Reporting
- Loan documentation

Effective prudential regulation is essential because it protects the poor. However, it is also costly to supervise due to much higher volumes and the necessary skill requirements.

Non-prudential regulation, such as AML/CFT, can slow financial inclusion, for example, by stipulating know-your-Customer (KYC). Another non-prudential regulation that needs attention is consumer protection, including:

1. *Disclosure* - Key product information needs to be disclosed clearly at appropriate points and in a way that is relevant to the consumer.
2. *Fair treatment* - Lending, collection and selling practices can vary by culture, so domestic context is important, however basic client protections are required to ensure fair treatment.
3. *Recourse procedures* - Most poor people lack effective access to conventional tribunals, so alternative recourse methods that work for poor people are needed for both government/third party and within institutions.

Another candidate for non-prudential regulation might be 'over-indebtedness'.

Important questions to be answered are:

1. How is over-indebtedness defined? Multiple borrowing does not necessarily mean over-indebtedness, and loans from the regulated (banking) sector alone do not provide full insight in total debt per family.
2. Should a debt/income ratio be imposed? How can data that includes unregulated and informal sectors (loans provided by unregulated self-help-groups, and informal income) be captured?
3. Credit reporting works but is it enough to include all? Do we need to do more? How can 'unidentifiable clients' (those without ID numbers or birth certificates) be included?

Other Policies Relevant to Financial Inclusion and Standard-Setting Bodies

Other policies relevant to financial inclusion are, amongst others:

- Financial Inclusion Strategies
- Reform of State Owned Banks
- Apexes (funding for MFIs)
- Priority Sector Lending (e.g. India)
- Government to Person Payments (G2P)

With regard to G2P payments, it has been noted in recent research produced by CGAP that only a small percentage of ‘new clients’ (for which accounts were opened for G2P payments) used the opened account to its full potential. This may have been due to lack of incentives provided or the client’s limited understanding of how to use the accounts to their full potential.

Relevant standard-setting bodies (SSBs) are:

- Basel Committee on Banking Supervision: first-ever Basel Committee publication on a financial inclusion topic;
- Financial Action Task Force: first SSB guidance paper recognizing financial exclusion as significant risk;
- Committee on Payment and Settlement Systems: launching of working group on innovative retail payments;
- International Association of Deposit Insurers: formation of Sub-committee on Financial Inclusion and Innovation;
- International Association of Insurance Supervisors: draft guidance paper on inclusive insurance markets (based on previously issued microinsurance issues papers).

Through the G20 Global Partnership for Financial Inclusion, and with support from CGAP, the SSBs are increasingly adopting financial inclusion in their mandates. For example, the Basel Committee on Banking Supervision has issued some guidance on how to adapt the core principles for banking supervision to deposit taking MFIs.

Proportionate Regulation

The proportionality principle is basically the balancing of risks and benefits against costs of regulation and supervision, both in SSB standards and guidance, and domestic-level implementation. Proportionate regulation for financial inclusion calls for putting aside preconceptions of risk based solely on the ‘already served’ and the current products, services and providers that serve them. And seeks greater consideration of a ‘test and learn’ approach with respect to new avenues to reach financially excluded customers.

Key principles of proportionate regulation for financial inclusion include:

- Regulation must encourage market competition;
- Regulatory initiatives should be subject to cost/benefit analysis;
- Incentives structures are key to promoting financial inclusion.

Proportionate regulation should also focus on alternative forms of finance, such as venture capital, managed funds and leasing products.

Protecting Branchless Banking Consumers

Branchless banking, or mobile banking, is an important method of overcoming major barriers that have prevented large parts of the population to have access to financial services. More specifically, branchless banking allows for solutions to challenges associated with long-distances or low population density, high branch/bank costs in relation to income, and poor product or channel design. CGAP defines branchless banking as the delivery of financial services outside conventional bank branches using information and communications technologies and non-bank retail agents. Through branchless banking any store has the option to become an agent which could potentially reduce costs considerably in increase outreach to the financially excluded (see table below).

Reducing the cost of banking infrastructure ²⁰					
Traditional Branch	Branch in store	ATM	Agent with POS Terminal	Agent with Mobile	No Agent (cashless)
\$250,000					
	\$50,000				
		\$10,000			
			\$2,000		
				\$400	
					\$0

The branchless/mobile banking market is huge and while it presents many opportunities there are also considerable risks which need to be recognized. A central issue to consider is agent banking regulation regarding consumer protection. For the branchless banking model to effectively meet the needs of the unbanked, responsible innovation must be permitted and promoted.

Agent Banking

Regulation determines ‘what’ agents are allowed, with a focus on the role of non-bank agents and non-bank issuers of e-money. A suitable regulatory framework for branchless banking should permit the use of agents and other third parties as a primary customer interface. In addition, it should provide for:

²⁰ CGAP presentation at APEC Financial Inclusion Forum 2012, June 25 Shanghai

- a risk-based AML/CFT regime (involving agents); and
- adequate protection of e-money issued by non-bank entities.

Who is permitted to act as an agent? In Brazil just about any retailer can act as an agent (but not individuals) so long as being an agent is not the primary function of their business. The situation in Mexico and Colombia is similar, with most retailers eligible; however, individuals may also act as agents if they operate from a fixed establishment. In India, originally only cooperatives, NGOs and post offices were eligible. More recently businesses and individuals have also been accepted.

Consumer Protection and Mobile Banking

Regulation needs to ensure that branchless banking is done in a way that is safe for the consumer, particularly for consumer risks associated with their own understanding of the products and services they are being offered as well as for data privacy and security. As such, regulation should focus on the following issues:

- Protecting the “float” (i.e. protecting funds held electronically as stored value. Fund-safeguarding, liquidity and diversification are important points to consider. Fund-isolation is also important to protect funds from the issuer’s creditors).
- Clear & effective disclosure
- Data privacy
- Fraud & financial crime
- Effective recourse

Each of the above issues becomes more complicated when applied to more complex products other than payment services, such as insurance or credit.

It’s also important to keep in mind that if the costs of financial transaction are reducing so quickly through branchless banking approaches and technology, this also means that the costs of committing financial crimes are also decreasing. Thus, the risk of theft to clients increases. It is recommended to protect consumers in such a manner that takes account of the potential increase in risk due to the use of agents and ICTs with the goal being to apply adequate risk management. New services mean new risks and regulators need to reduce risk while maintaining enough space for innovation to occur.

Examples of Non-regulatory Government Interventions to Foster Financial Inclusion

Development banks can play important role in achieving financial inclusion by:

- Accelerating long-term investment to create employment and to achieve rapid domestic growth;
- Providing financing to “engines of growth” to achieve a higher degree of productivity and efficiency in the economy;

- Supporting domestic priorities of long-term investments in certain sectors where commercial banks are reluctant to support; and
- Intervening in the financial market in cases of “market failure.”

The underlying principle is that long-term resource allocation should be done by business-skilled financial institutions vis-à-vis direct allocation by the government. Some examples of this include:

- *SIDBI Foundation for Micro Credit (SFMC)* – Launched by the Small Industries Development Bank of India (SIDBI) in January, 1999 in India to channel funds to the poor, SFMC’s mission is to create a domestic network of strong, viable and sustainable MFIs from the informal and formal financial sectors to provide microfinance services to the poor, especially women. It is the apex wholesaler for microfinance in India providing a complete range of financial and non-financial services to the retailing MFIs.
- *The People’s Credit and Finance Corporation (PCFC)* - Philippine’s PCFC wholesales short, medium and long-term investment loans to accredited MFIs such as rural banks, NGOs, cooperatives and cooperative banks. In partnership with these MFIs, PCFC finances livelihood projects that augment the income of the poor, using proven microfinance lending methodologies.
- *The Fiji Development Bank (FDB)* – FDB’s Financial Literacy Program– Money Smart™, is a compulsory subject under the Commercial Studies syllabus in Fiji secondary schools (for third-year students) and Invest Smart™ for fourth-year students. The program, which was implemented in 162 secondary schools in Fiji, developed student skills in financial literacy and financial management at very young age to build on good saving habits.
- *Tekun Nasional Malaysia* – An agency under the Ministry of Entrepreneurial and Cooperative Development established in 1998 which positions itself as a strategic entrepreneur development partner to provide simple and quick financing facilities to Bumiputeras (indigenous Malays) to kick-start and further expand their businesses.
- *Micro Finance Development Fund* – Established in December 2002 in Mongolia as a framework of the government’s “*Sustainable Livelihoods Project*” and jointly implemented by the Government of Mongolia and the World Bank Access to Financial Services by poor and low-income households, individuals and micro-enterprises. The Fund provides wholesale loan to commercial banks and non-bank financial institutions to improve sources of livelihoods and to increase income of rural people in Mongolia.
- *Agriculture Development Support SEILA Program* – The microfinance component of the Rural Development Bank (RDB) provides funds for eligible non-government organizations (NGOs) as well as savings and credit services to households living in the communes for: (i) crop and livestock production; (ii) agro-industry and manufacturing; and (iii) trading and other services.
- *SME Development Bank of Thailand* – Supports government policies to help sectors of society such as for pensioners providing them loans for investment or business

capital, taxi drivers, serviced motorcyclists, stall vendors, peddlers with, working capital, chicken and pig growers with capital to start and grow their business and rice millers for their start-up and expansion operations.

- *Land Bank of the Philippines* – Has two programs, i.e., the *Lending Initiatives for Cooperatives and Microfinance Institutions* for the establishment and funding of community-based projects addressing issues of poverty such as livelihood, health, education, environment protection, in partnership with cooperatives and MFIs and the *Microfinance Program for Microfinance Retailers*, a special wholesale lending window that provides short-term and term-loan facilities under re-discounting and working capital windows to various MFI retailers which include cooperatives, CFIs and NGOs.
- *IDBI Bank, Ltd.* – Has leveraged the use of information and communication technologies and smart cards. Working with accredited agents in rural areas, IDBI Bank has made available its branching network and bank technology to provide financial assistance to small businesses throughout the economy.

Social Performance Regulation – The Experience of Bangladesh

It's often said that Bangladesh is the capital of microfinance, mainly due to the Nobel Prize laureate Muhammad Yunus, founder of the Grameen Bank, often being cited as the founder of microfinance. The economy provides a great wealth of microfinance experience and currently has over 1,500 active MFIs with nearly 35 million clients. Since the birth of the Grameen Bank in 1976 (and its transformation into a specialized formal bank for the poor in 1983), the growth of the Bangladesh microfinance sector has been staggering. Currently, 75% of the microfinance market is controlled by two prominent Bangladeshi organizations: BRAC (the world's largest NGO) and the Association for Social Advancement (ASA). The rest of the market is serviced by mostly small sized MFIs and relatively few medium sized MFIs. Commercial banks and the Government also commonly operate microfinance services as well. A brief overview of Bangladesh's microfinance sector is provided below:

- Number of MFIs: 1,560
- Number of branches: 18,729
- Active members: 34.6 million
- % of borrowers: 78.57%
- Net savings : US\$ 2,066.52 million
- Loan outstanding : US\$ 2,841.89 million
- Average loan size : US\$ 224.79
- Recovery rate : 98.45%
- Overdue loans : 3.15%
- HR involved : 256,592

The regulation in Bangladesh was developed from within the microfinance sector itself, rather than from the government, and it also came relatively late: only in 2000. The

Microfinance Act and Microfinance Regulatory Authority (MRA) were only formally established in 2006. The MRA was formatted as an authority to ensure accountability and transparency and issues licenses to MFIs which meet its criteria. To-date, 619 MFIs have received licenses from the MRA with several new licenses underway. Other organizations, such as the Credit and Development Forum (CDF), work closely with the MRA to ensure that no genuine license application is rejected that the Act and Rules are friendlier to MFIs.

The MRA also includes social performance in the Act as well with specific social performance issues specifically outlined to ensure things such as governance and employee commitment to social goals, client protection, the development of products and services that meet client needs, client monitoring, flexibility for MFIs working in thinly-concentrated areas, and flexibility for the MFIs working for the disabled or in remote areas. Through this Act regulation is developed to promote a range of client protection principles (or client rights) including the prevention of over-indebtedness, greater transparency, responsible pricing, fair and respectful treatment of clients, privacy of client data, and mechanisms for complaint resolution.

Through CDF, a domestic microfinance network for Bangladesh has also been established. This network plays a key role in promoting social performance, specifically by building knowledge-based capacity of MFIs on social performance, promoting and coordinating social performance reporting to the MIX Market²¹, producing domestic-level social performance reports through annual publication (Bangladesh Microfinance Statistics), ensuring quality reporting, disseminating sectoral achievement in social performance practices, and strengthening the sector's positioning.

Microfinance regulation – The Experience of Mongolia

Mongolia's population density is relatively low, which is an important factor which shapes its microfinance sector. Mongolia's informal sector makes a significant contribution to GDP and employment generation with 72% of the workforce currently employed in the informal sector, 69% of which are women. Since 1998 Mongolia has been recovering from a difficult economic transition which left eight commercial banks bankrupt. At the time, over 90% of total loans in the banking sector were concentrated within the capital city of Ulaanbaatar and only about 1% of the population was able to access loans. The majority of microfinance operations were conducted through pawn shops or individuals. These informal players have played an important role in the development of Mongolia's microfinance sector today.

On the institutional side, Mongolia's microfinance sector has developed relatively slowly, with the first non-bank financial institution (NBFI) license granted from the Bank of Mongolia (BOM) in 1999. From 1993 most micro-credit programs that were primarily financed by international donor agencies (i.e. UNDP) were implemented through formal financial institutions. By 1999 most pawnshops which had provided informal microfinance services, as well as informal money lenders, had begun transforming into

21 See: www.mixmarket.org

savings and credit cooperatives (SCCs) or NBFIs. From 2000 most commercial banks had entered the market and began developing and providing microfinance services and products. Today, Mongolia's microfinance sector consists of 170 SCCs, 192 NBFIs and 14 Commercial banks.

In December 1999 a major milestone was reached when the BOM approved the first NBFi regulation. This was closely followed by the approval of an accounting manual and regulation in prudential ratios for NBFIs approved by the BOM in 2000. Since then a number of other regulations have come into place for both NBFIs and SCCs. However, following this new regulation a SCC crisis occurred in which many SCCs were found to be violating a number of laws including violation of cooperative principals, false memberships and exceeding loan limits from single borrowers. Much of these issues were attributed to a lack of internal control and supervision as well as lack of risk management systems and processes within SCCs.

Several lessons were learned from the SCC crises which have informed the economy's development of new policy and regulation frameworks. These experiences along with several comparative success factors have helped achieve positive development of Mongolia's microfinance sector. Some of these comparative success factors include:

- Minimal government involvement in the nascent stage of micro-finance development;
- Goodwill and support of government agencies (incl. Central Bank) to actively learn and boldly experiment with microfinance;
- Overall enabling economic conditions;
- Comparatively stable political situation;
- Institutional development and capacity building with commercial focus from the beginning.

From the experiences of Mongolia's developing microfinance sector the following policy recommendations for greater financial inclusion are made:

- Prohibit charging exorbitant interest rates and unfair collection methods and practices in microfinance;
- Promote greater engagement of the broader range of stakeholders and a wider range of microfinance products and services;
- Properly manage rapid commercialization of the microfinance industry with certain critical infrastructure;
- Balance between commercial returns and social performance;
- Encourage the downscaling of commercial banks to microfinance;
- Include financial literacy & education in each and every microfinance product.

Conclusions

New regulation for new models needed

There are an increasing number of actors entering the market to provide appropriate services to the financially excluded. This creates many opportunities as well as challenges. More specifically, there is a need to better understand the specificities of institutions that reach the un-banked populations, and further assess the informal economy to adapt existing regulations for the benefit of greater financial inclusion. New regulation for new models may need to be developed, to reach all the financially excluded rather than a continued focus on trying to modify current models which are proving inadequate to meet the needs of the financially excluded.

Renewed focus on client needs, especially the financially excluded

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. Equally important, 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. Self-regulations and formal regulation are both required and should complement each other. 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 such as NGO-MFIs, cooperatives or NBFIs.

Supervisory capacity

Adequate supervisory capacity to enforce regulation is of equal importance as to the focus on the needs of the financially excluded. With regard to supervising capacity, it is recommended that financial sector stability oversight bodies should have the goal of promoting financial inclusion, and specific consideration should be given to the development of domestic councils of financial inclusion to coordinate different regulators and supervisors.

Impact of non-prudential regulation

Effective prudential regulation is necessary to protect deposit taking regulated financial institutions as well as their clients. Non-prudential regulation, such as regulation for consumer protection, is also very important and a major challenge. 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, by having very strict Know Your Client (KYC) requirements which can exclude the poor. These regulations need to be adapted to the domestic context.

Mobile/Branchless banking regulation: a cry for specific agent banking regulation

The growth and development of the financial services 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 regarding AML/CFT for agents; 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.

Sanity check on proportionality

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.

Proportionate regulation and supervisory capacity are equally important in order to achieve greater financial inclusion. Both prudential and non-prudential regulation (i.e. KYC, AML, for banking agents) should be proportionate. Many challenges remain, however, in determining how to best enforce regulation. Regimes for market conduct regulation such as that aimed at client protection need to evolve over time to extend rules and oversight to non-banking institutions as well as banks to ensure that all clients are protected. This may require expanded authority for supervisory bodies and coordination among multiple supervisors.

Chapter 4: Industry Responses to Consumer Protection

This chapter summarizes the presentations and discussions in **Session Four: Consumer Protection**

Session Chair:

Yuqing Xing, Director, Capacity Building and Training, ADBI

Speakers:

- Michael Schlein, President & CEO, Accion International
- Katharine McKee, Senior Policy Advisor, CGAP
- Giorgio Trettenero Castro, Secretary General, FELABAN
- Aban Haq, Chief Operating Officer, Pakistan Microfinance Network
- Muhammad Aslam, Deputy Secretary, Ministry of Finance, Pakistan.
- Amphone Aliyavongsing, Deputy Director General, Financial Institution Supervision Department, Bank of the Lao PDR

The microfinance industry faces a number of complex issues and obstacles as it learns and grows, and while microfinance services have the potential to significantly impact the lives of the poor, they can also do a great deal of damage if they are not delivered and managed responsibly. In recent times, the industry has struggled with issues of over-indebtedness, allegations of harsh collection practices, concern of high interest rates and fees, and debate on its overall impact on poverty alleviation. To overcome these challenges and create responsible access to high-quality financial services, at fair and transparent prices for all people regardless of location or living conditions, consumer protection principals and policies are needed. In this chapter, this issue is explored and examples provided of regulation practices, international movements and partnership opportunities to achieve greater consumer protection.

Defining Responsible Finance

Defining responsible finance differs for retail banks and MFIs, simply because MFIs deliver services to a much more vulnerable part of population (lowly educated, often informal) and their products are different (i.e. low-value loans and savings, higher volumes). In general, responsible finance for all providers can be defined as the delivery of financial services in a way that is fair and respectful to clients and avoids harming them. Successful responsible finance is achieved through a balance of three elements (or “pillars”), these being:

1. Consumer protection regulation and supervision;
2. Financial education and capability; and
3. Standards and codes of conduct for the industry.

The bottom line is that responsible finance should lead to positive client outcomes by delivering financial services which are fair and respectful, adhere to a “do no harm” approach and include systems to measure and monitor performance.

When responsible finance measures are effectively applied they provide important benefits to consumers. These benefits are particularly useful to the poor and/or less experienced clients who are more vulnerable and can least afford financial mistakes. By practicing responsible finance, incidences of unfair or deceptive practices are reduced, consumers are protected from harmful products (i.e. debt beyond their means), improved products and services which better fit the needs of consumers are promoted, fair competition and efficiency are improved, and providers are discouraged from excess risk taking.

Road Map for Responsible and Client-Centered Microfinance

Collective action for the further development and support of strong industry standards, with a specific focus on the unbanked/underserved clients, is key to achieving effective consumer protection across the microfinance industry. These standards must support robust consumer protection practices, meaningful pricing transparency, a suite of tailored and appropriate products and tools that help organizations measure their social goals as much as their financial ones, and effective recourse mechanisms. Even though industry players may have varying approaches to microfinance, those which maintain the belief that financial services have the power to help improve the lives of the poor can find common ground. There are growing examples of industry standards for responsible microfinance which have been developed by the industry itself. With these standards gaining traction, now is the time they need support and promotion from a regulatory level as well.

The Microfinance CEO Working Group is an example of industry players working together to promote and expand responsible microfinance practices. The Working Group, which was established in 2011, currently includes CEOs of FINCA, Freedom from Hunger, the Grameen Foundation, Opportunity, Pro Mujer, VisionFund, Women’s World Banking and Accion. The Working Group members recently developed a Road Map²² for how they could best use their collective voice to help the industry evolve in a positive manner. Through this, it was determined that their best way to start would be to focus their support for three industry-led initiatives which aim to achieve greater responsible industry practices, these being:

1. The Smart Campaign,
2. MicroFinance Transparency and
3. The Social Performance Task Force (SPTF).

²² *Road Map for the Microfinance Industry: Responsible and Client-Centered Microfinance*. The Microfinance CEO Working Group (2012).

These initiatives are already making significant headway and represent an unprecedented effort by the industry to improve the quality and breadth of the financial services it provides.

The Smart Campaign, which was established in 2008, represents an industry-led, industry-wide consumer protection effort based on a “do no harm” approach and plays a fundamental role in ensuring that MFIs operate responsibly. The Campaign specifically promotes seven Client Protection Principles with the aim of having them embedded into institutions across their processes, practices and people:

1. Appropriate product design and delivery
2. Prevention of over-indebtedness
3. Transparency
4. Responsible pricing
5. Fair and respectful treatment of clients
6. Privacy of client data
7. Mechanisms for complaint resolution

The Campaign is currently endorsed by more than 3,000 individuals and organizations spanning 130 economies and representing all stakeholder groups. It is currently in the final stage of launching of a certification program, which will allow MFIs to demonstrate their commitment to the Client Protection Principles through third-party verification. By achieving certification, MFIs have an opportunity to publicly demonstrate to donors, investors, regulators and clients that it takes its responsibility to clients seriously.

Microfinance Transparency focuses on promoting pricing transparency and provides a forum for MFIs to share their pricing information with a variety of interested stakeholders, such as practitioners, investors and clients. This information is provided on a voluntary basis and to date over 400 MFIs from 26 economies are providing data. Microfinance Transparency has already had a significant impact on the industry, particularly on what is perceived as fair and transparent information, and over time its impact is expected to become greater as widespread transparency puts pressure on players to compete and reduce prices.

The third initiative, the SPTF, is a participatory effort by over 1,000 practitioners. Its focus is to develop common tools to measure social performance and mission fulfillment and builds upon the foundation of client protection and transparency. It helps organizations with social missions by elevating the issue of social performance management so that they can better translate their social missions into practice. Recently, the SPTF released the *Universal Standards for Social Performance Management*, which were developed through a multi-year process involving hundreds of microfinance experts and practitioners. The development of these standards highlight an important industry achievement toward broader consensus on what “best

practice” is for pursuing social missions and, ultimately, how social impact should be determined.

In order to achieve a fully financial inclusion at a global scale, philanthropic funds will not be enough. Private sector involvement and contribution is required. In order to attract private sector investment it is important that microfinance makes reasonable returns. However, the private sector also needs to understand the long-term business case of ensuring consumer protection and social performance as well, and international, industry-led movements such as those outlined above can help achieve this.

Consumer Protection and Regulation

Industry-led initiatives as described above are of immense importance and have the potential to drive significant impact within the sector. However, regulation (combined with effective supervision) is required as well. Regulation for consumer protection helps the “fair guy” in the market from unfair competition. It is important to note that regulation and self-regulation go hand-in-hand. The effectiveness of each type of regulation depends on the specific issue. For example, it is difficult for an individual MFI to be completely transparent when its competitors are not required to do the same, thus making it potentially disadvantageous for them to be transparent. As such, self-regulation is likely not enough to achieve full transparency amongst financial service providers.

Standard financial regulations are meant to protect all citizens, however, at times they are not adequate for protecting the poor. Furthermore, standard financial regulations are only as good as the ability of regulators to enforce to them. Often this is challenging due to capacity constraints or even lack of will (i.e. financial services not viewed as a priority) within regulatory agencies and/or governments. The bottom line is that regulators have the authority to enforce regulation, but are often not doing so. Enforcing regulation is important to protect consumers.

An important regulatory challenge stems from the fact that MFIs are often regulated and supervised by several different authorities depending on the type of MFI. This makes it a complex process to regulate and supervise all MFIs on specific consumer protection principles. When developing regulation for consumer protection, regulators should start by identifying the main problems in the market, prioritize them, and then progress gradually. By monitoring the market, regulators can better understand the situation of consumers and where risks/issues remain. When aiming to address these risks, working with the industry is vital to ensure workable solutions are found that both support the industry and protect the consumers. By using/adhering to industry-led standards, regulators can improve self-regulation enormously.

The Role of Networks in Promoting Consumer Protection

Networks as industry representatives are playing a crucial role in the area of self regulation and also advocating with regulators and policymakers on strengthening consumer protection laws and frameworks. Associations and networks are

uniquely positioned to create information around best practices, support institutions in institutionalizing healthy and transparent practices and build capacity of all stakeholders in these areas. Associations are also taking on active roles in promoting financial literacy and capabilities amongst microfinance clients.

Example of the Pakistan Microfinance Network:

The Pakistan Microfinance Network (PMN) consists of 28 members which represents 98% of the economy's microfinance market. PMN also heads the Asia sub-group of the SPTF for associations. The Network endorses the view that microfinance is a “double bottom line industry” i.e. that it aims for both financial sustainability and positive social outcomes. To support this view PMN has developed a consumer protection initiative which focuses on four activities: dissemination, standardization, monitoring, and grievance redress. These four activities are governed by a code of conduct for consumer protection, developed by the Network in collaboration with its membership.

Through *dissemination* the aim is to create awareness, at the client level, about rights and responsibilities. By utilizing the outreach made possible through the Network's member base, PMN achieves this mainly through the distribution of print and electronic mediums.

The *standardization* activities focus on improving disclosures in pricing. PMN achieves this by encouraging its members to become partners of Microfinance Transparency and also providing a “best practice” template for repayment schedules.

Monitoring ensures that values are being translated into practice. Specific actions taken by PMN to support this include developing a monitoring toolkit, engaging with audit firms and technical assistance providers to build their capacity in social performance measurement and monitoring and being an active partner of the Smart Campaign, including carrying out member assessments.

Effective complaint and resolution mechanisms are provided through *grievance redress* activities. These include strengthening the systems of MFIs to handle complaints and the development of a third-party complaint resolution mechanism for those MFIs that are not regulated (regulated MFIs use the government's consumer complaint department)

Experiences from Pakistan

In order to protect the rights of consumers, Pakistan's consumer protection laws are present at both the federal and provincial levels. Through these laws, consumers are given channels and mechanisms for redress and protection against abuse or dominance is provided. For example, the Competition Act supports consumer protection by outlawing predatory pricing and other abusive conduct. The responsibility for supervising consumer protection, however, rests with several authorities/regulatory or supervision bodies, these being:

- The Competition Commission of Pakistan
- The Securities and Exchange Commission of Pakistan

- The State Bank of Pakistan (banking sector)
- The Consumer Rights Commission of Pakistan
- The Network for Consumer Protection.

The Securities and Exchange Commission of Pakistan (SECP) is an important player in Pakistan's consumer protection environment. SECP has directed each stock exchange to set up a monitoring and surveillance wing for market abuse and works to promote greater corporate social responsibility (CSR) and socially responsible investing (SRI) amongst companies to help them better contribute to sustainable economic development.

Pakistan's Central Bank, the State bank of Pakistan (SBP), also provides a range of consumer protection services and measures such as guidelines for timely and effective resolution of customers' grievances, an online complaint system and a "Customer Education" function on the SBP website. The SBP has also established the Office of Banking Ombudsman (OBM), an independent body which aims to resolve the complaints of banks' clients. And, appeals against decisions made by the OBM are handled by an appeal committee constituted by SBP.

Over time, the SBP has taken several important steps to strengthening consumer protection within the economy. In 2002 the Prudential Regulations for Consumer Finance was established to minimize consumer inconveniences, and in 2006 a Complaint Tracking System was introduced to allow the SBP to follow up on complaints more efficiently. In this same year, the New Consumer Protection Department was also created within the SBP. The SBP also issues a review on "Complaint Redressal" twice a year. This review is an important activity undertaken by the Bank as through it, the types, patterns and trends of complaints are analyzed and recommendations made for key operational and policy issues.

Pakistan progresses its efforts for greater consumer protection through three main strategies. The first strategy is to develop and enforce consumer protection regulation. To do this, the SBP provides guidelines for consumer protection regulation. The establishment of the OBM was also part of this strategy. The SBP is currently working to revise the prudential regulations for microfinance banks to incorporate more stringent regulations on specific issues, such as financial literacy. The second strategy is to promote codes of conduct and standards, which is primarily done through a partnership with the PMN. The third strategy focuses on consumer awareness and financial capability. A key activity of this strategy has been the SBP Nationwide Financial Literacy Program which was launched in January 2012. This program provides methods for the dissemination of basic education about financial concepts, products and services to the general population. The program specifically focuses on budgeting, savings, investments, banking products and the use of branchless banking services.

Going forward, the SBP plans to implement a range of new initiatives to continue strengthening the practice and culture of consumer protection across the economy. Some examples of the types of initiatives currently being planned include:

- The introduction of a new Consumer Protection Act which is consistent with international best practices;
- The introduction of a new Financial Crimes Act to better define financial crimes;
- Encourage the Pakistan Bank's Association to adopt a Banking Code of Ethics;
- Continue supporting and strengthening the role and functions of the Consumer Protection Department of SBP as well as the OBM;
- The introduction of new transparency rules in the pricing of deposit and credit contracts;
- The introduction of a depositor Protection Scheme to provide protection to all bank depositors up to an established limit amount; and
- Conduct research on consumer protection policies in other economies to identify useful lessons.

Experiences from Latin America

Latin America is commonly regarded as a world leader in consumer protection policies and practice. Within the region, financial inclusion is the main aim of financial regulators. This policy is in-line with the broader objectives of consumer protection and financial literacy, with an overarching goal of ensuring financial stability. Latin American banks primarily value consumer protection as a way to improve their perception amongst clients/potential clients, greater market transparency and financial stability²³. An analysis of Latin American economies found that the majority of issues facing regulation for consumer protection were supervision and financial stability.

Microfinance in Latin America is a prosperous industry inside the banking sector, with microfinance loans representing 10% of the total loans in the region (US\$5.5 billion). The microfinance sector contains 333 MFIs, 70% of which are unregulated, with an estimated client base of 6 million. The average loan size of these MFIs is US\$659 per customer²⁴. The principles within MFIs for improving consumer protection are improving, with particular focus on over indebtedness, transparent pricing, appropriate collection practices, ethical staff behavior, mechanisms for redress of grievances and privacy of client data.

Examples of the region's experiences with consumer protection can be highlighted from Peru, which has in place a domestic system for consumer protection and policy for fee transparency; Chile, where financial political action is addressed to empower consumers; and Brazil, which has implemented a consumer protection code and other consumer protection rules and principals.

23 FELABAN 2011 Opinion poll to sample Latin American banks,

24 Source: Navajas, S. Tejeria A. (2007) Las microfinanzas en America Latina y el: Caribe Cual es la magnitud del Mercado. Interamerican Development Bank. Washington DC.

Experiences from Lao PDR

According to 2010 data, it is estimated that about 23% of the total population of Laos is living under the poverty line, with only 21% of the total population having access to formal financial services. The remainder of the population either depends on informal or semi-formal financial services (33%) or has no access to financial services at all (46%). To help close these gaps, Laos has received the support of a number of agencies with the aim of improving the economy's microfinance sector; particularly in increasing the outreach of MFIs in rural areas. Examples of this support include the UNDP/UNDCF Rural and Microfinance Development (1997), support from GIZ to assist the Bank of Lao PDR (BOL) with rural microfinance development and the ADB-piloted Savings and Credit Model (2004) as well as other various ADB technical Assistance and Grant support.

Over time, Laos has developed a number of consumer protection goals. These goals focus on promoting transparency and improved goods and services, increasing fair competition between consumers and providers, and protecting consumers from harmful products. To achieve these goals, a number of specific actions were initiated such as setting up the Depositor Protection Funding to protect consumers (1999), issued official regulation for commercial banks and raised awareness about legislation amongst regulators and consumers, and established the Microfinance Working Group, which includes BOL, MOF, MOIC (as committee members), and MFIs (as Board of Directors).

Many challenges remain for Laos' financial sector, which hinder the progress of achieving greater consumer protection as well as financial inclusion more broadly. One key challenge stems from the fact that the Depositor Protection Funding is currently in the process of updating its processes and making improvements, which as a result is slowing the registration process for MFIs. Other more general challenges include limited access to microfinance of the rural poor due to reasons such as limited road access and educational levels, limited access of the poor to public information, and weak coordination/collaboration and information sharing (i.e. private data of consumers) amongst MFIs.

Going forward, Laos is continuing to grow and evolve by building on important lessons from their experiences thus far. One of these lessons is that by improving regulations, they can encourage more MFIs to become Depositor Protection Funding members. Laos also recognizes the important role that the economy's Microfinance Working Group can play by consulting the government on issues related to the development of microfinance. Financial education is also a priority, with an official Microfinance Curriculum aimed to be included in schools and universities by 2013. In order to strengthen the Information Credit Bureau, MFIs can be encouraged to join by reducing registration fees. Lastly, improved public-private coordination and collaboration is key to raising awareness on the development policies of the Government.

Conclusions

Supporting international standards

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 are important. The Smart Campaign, the Social Performance Task Force and Microfinance Transparency are global initiatives being undertaken to achieve greater responsibility in microfinance practices. These initiatives recognize the potential of microfinance to reach out to the financially excluded and also act to identify operational 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 linkages with regulatory frameworks.

Self-regulation and regulation go hand-in-hand

Noting the above mentioned industry-led initiatives, it is important to recognize that self-regulation and external regulation go hand-in-hand. External regulation on consumer protection helps the 'fair guy' in the market from unfair competition. For example, price transparency is very hard to 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 that when regulators actively engage in relevant issues, this has a positive effect on self-regulation actions and activities.

Challenges of supervising regulation

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, NBFIs, 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 (i.e. \$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.

Role of the private sector

In order to achieve a fully financially inclusive world, philanthropic funds will not be enough. Private sector capital is also needed. Therefore, it is important that microfinance makes reasonable returns to attract private sector investment. And, a balance will need to be found in order to simultaneously manage the social mission of donor/philanthropic funds and the commercial mission of private capital. Furthermore, a key challenge to overcome is how to best track both financial and social outcomes and how to best do so in an efficient and effective manner that meets the needs of diverse stakeholders. 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 recognized. Regulators can play an important role in promoting this 3rd standard by providing incentives.

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 and fair treatment, prevent over-indebtedness and assure proper grievance channels/complaints procedures. To the extent feasible, this needs to be applicable in a consistent manner to all providers of financial services to the poor, even if the providers 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.

Chapter 5: Tapping into the Remittances Market

This chapter summarizes the presentations and discussions in **Session Five: Facilitating Cross-Border Microfinance**.

Session Chair:

Chandula Abeywickrema, Chairman, Banking with the Poor Network (BWTP)

Speakers:

- Meliadi Sembiring, Deputy Minister for Financial Services, Ministry of Cooperatives and SMEs, Indonesia
- Pedro de Vasconcelos, Manager of Financing Facility for Remittances, IFAD
- Philip Yen, Group Head – Emerging Payments for Asia-Pacific, Middle East & Africa, MasterCard
- Joachim Bartels, Managing Director, BIIA
- Isaku Endo, Financial Sector Specialist, The World Bank

With migration throughout the Asia-Pacific region growing rapidly, the importance of cross-border microfinance service delivery is also growing and requires greater attention. Particular focus should be placed on formalizing remittances and savings by driving down the cost of remittance services, stimulating account-to-account transfers (instead of cash-to-cash) and creating the opportunity to deliver financial services based on income coming from work abroad. Key points of attention are the facilitation of cross-border data transfer (so that migrants have an opportunity to build financial histories and thus increase their access formal channels), acknowledgment of remittances as income, and building cross-border partnerships between transfer service providers and financial service providers. In order to reach the required scale, utilizing innovative technology such as mobile banking is important. Regulatory frameworks for agent networks also need to be developed and elaborated to provide detailed clarity for market players and better enforcement.

Facilitating Cross Border Microfinance

Remittances are a lifeline for 700 million people around the world. In 2012, over 250 million migrants worldwide are estimated to have sent home US\$395 billion, with over US\$220 billion to Asia alone²⁵. This does not even include domestic remittances which are estimated to surpass international flows. Further to this, there is also a significant amount of unknown remittance flows being transferred through informal channels. The World Bank estimates that in 2011 international remittances to developing economies amounted to more than US\$372 billion (up 12.1% from \$325 billion in 2010). Remittance flows to developing economies are expected to continue to grow at 7%-8% annually during 2012-14.

²⁵ International Fund for Agricultural Development, *The FFR Brief: Five years of the Financing Facility for Remittance*, Rome, February 2012

In most developing economies remittances surpass both Foreign Direct Investment (FDI) and Official Development Assistance (ODA) combined. Up to 40% of remittances go to rural areas and the costs for remittances transfer range from 5% (competitive markets) to a high 20% (where market distortions exist, particularly in rural areas). On top of this, next to remittances migrants save an estimated US\$400 billion as well. The combination of remittances and savings of migrant workers represents a huge untapped market.

On the domestic economy level, remittances provide a significant source of foreign capital as well as form a stable flow/buffer during financial crisis which usually increases after disaster situations. On a meso economic level, remittances increase demand for goods and services and can drive local economies if saved in local formal institutions. On the micro economic level (i.e. family or household level), remittances not only lift millions of people out of poverty by improving living standards, they also decrease the demand on government services and can help families on the road to financial independence through financial education, savings & investment.

By increasing the impact of remittances, a pathway to financial inclusion can be created. This pathway is as follows:

1. Shift transactions from “cash to cash” to “account to account”;
2. Encourage financial education for senders and recipients;
3. Allow for saving of surplus funds in interest bearing deposit accounts;
4. Allow recipients’ remittances to be considered as an income stream to help establish credit and a credit history;
5. This will allow recipients to invest their surplus funds in assets such as housing, or in small business;
6. Reinvestment of deposited funds in the local community.

In order to address the challenges associated with realizing the development impact of remittances, institutions must be stimulated and tools developed to bridge the urban-rural divide. Financial infrastructure is important to serve both access to finance and financial stability, making international payments more complex as they have to rely on the financial infrastructure of both economies involved. Crucial to addressing issues like these is the building of partnerships, for example, between payment transfer providers and (micro) financial service providers in different economies. Another key challenge is determining how to link the credit history of migrants and their families back home and making the (often) informal income formally visible. To put it simply, the focus in addressing these challenges needs to move about access to finance rather than ‘remittances’ only.

Some specific strategies and solutions which are recommended to achieve greater financial inclusion through remittances related (micro)financial services include:

1. Market development: regulatory framework creating an open market, aiming to drive costs down;
2. Innovative business models: through MFIs, postal networks and community banks;
3. New technology: such as mobile money, cash card solutions and integration of systems;
4. Financial access and services: complementing savings with loan and other financial services, including financial education;
5. Migrant investment and entrepreneurship: by enabling productive investment (savings and enterprise loans) and development funds.

Within these strategies, particular focus should be applied to enhancing competition to drive costs down, increasing the geographical scope of financial services, empowering migrant workers and their families through financial education, promoting a full range of services to migrant workers and their families (not just remittances), encouraging diaspora investment (in agriculture) and working with postal networks to increase access to remittances in rural areas. Promoting and enabling mobile money solutions is also an important focus area to enhance the impact of remittances. However, mobile solutions are extremely complex and the business case is weak. Part of the solution for this is private-public collaboration which can accelerate deployment and help reach scale. In order to achieve this level of collaboration an enabling regulatory environment is needed, of which specific challenges include:

- Developing regulations for issuance of electronic money instruments;
- Supporting participation by banks and non-bank financial institutions;
- Risk based approach that weighs licensing, capital and Anti Money Laundering (AML) and Know Your Customer (KYC) requirements based on risk.

Governments can help address these issues by: providing clarity on e-money and stored value account regulations; implementing programs to reduce cash transactions; structuring KYC and licensing requirements to facilitate new eco-systems; facilitating both Mobile Network Operator (MNO) and Bank-led models; leveraging and supporting technology evolution; and engaging with private sector stakeholders. Governments can also play an important role by promoting electronic payments. In many cases, governments are in a position to lead by example, for example through distribution of payroll and benefits to prepaid accounts (and providing tax incentives for businesses to do the same) and supporting community outreach and education programs. Governments are also responsible for ensuring that appropriate regulations are in place to protect the integrity of electronic payment systems.

Standard Setting on Cross-border Credit Data Transfers

One of the five General Principles of Credit Reporting²⁶ is that cross-border credit data transfers should be facilitated where appropriate, provided that adequate requirements are in place. It is important to adhere to such a standard on cross-border credit data transfer for many reasons. One important reason is that cross-border migration of businesses and individuals result in no credit history in the new economy, creating a situation of virtually no access to finance. As noted before, this issue is becoming relevant for a growing number of people as migration increases. To address this, and make cross border data transfer feasible, a cooperative framework is required which helps to facilitate the involvement of a multitude of players (i.e. financial institutions, service providers and regulators) as well as different legal systems.

The standardization of data formats and procedures is also considered to be an important pre-condition to allow cross-border remittances to be included in credit reporting. The focus should be on mandatory data inputs and procedures for the collection and updating of data. When data transfer occurs it should be possible to interpret the data correctly to be able to identify and manage potential risks. In essence credit applicants will be subject to domestic risk assessment practices which rely on data coming from a different jurisdiction. When dealing with data transfer from multiple economies to a central repository located in another economy, this could entail higher risk unless the parties involved in the different jurisdictions adopt the general principles which have been outlined. This reinforces the case for the adoption of general principles and standards.

Standards for international remittances services

With regards to the role of standards there is currently a lack of interconnectivity between Mobile Service Services (MSSs) and mainstream payment processors and a lack of interoperability between various providers of MMS. Public authorities and regulators need to evaluate this situation and determine what necessary actions are needed in order to achieve public policy objectives. To assist with this, the World Bank has developed a set of principals published by the Committee on Payment and Settlement Systems (CPSS). The CPSS General Principles for International Remittances Services are:

1. The market for remittances should be transparent and have adequate consumer protection
2. Improvements to payment system infrastructure that have the potential to increase the efficiency of remittance services should be encouraged
3. Remittance services should be supported by a sound, predictable, non-discriminatory and proportionate legal and regulatory framework

²⁶ See: http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/Credit_Reporting_text.pdf

4. Competitive market conditions, including appropriate access to domestic payments infrastructures, should be fostered in the remittance service industry
5. Remittance services should be supported by appropriate governance and risk management practices

These General Principles stem from a multilateral effort to address a global challenge. The implementation of these principles could further facilitate financial inclusion directly, by improving the remittance markets and, indirectly, by bringing remittances to regulated channels (i.e. through competition, cost reduction, financial literacy and education, technology and innovation). On both sides of the remittance corridor, in both sending and receiving economies, the challenges which are addressed by the General Principles exist. It is important to note that this is not a matter for developing economies alone.

Global Remittances Work Group

In early 2009 the World Bank established the Global Remittances Work Group (GRWG), a multi-year platform aimed at increasing the efficiency of the remittances market and facilitating the flow of remittances by providing guidance and policy options to the global community. The efforts of the GRWG were successful in securing the commitment of the G8 Heads of State to: “...*achieve the objective of a reduction of the global average costs of transferring remittances from the present 10% to 5% in 5 years through enhanced information, transparency, competition and cooperation with partners*”. Reduction in cost would generate a net increase in income estimated at US\$15 billion for migrants and their families in the developing world. The GRWG has helped to develop a number of initiatives to help achieve this, including:

- The Pacific Remittance Initiative
- Send Money to Asia
- Guidance Note for the Implementation of the GPs. To be issued in autumn 2012.
- Launch of the “Send Money Service” platform. New platform for remittance price database websites that will allow to easily create, customize, and publish remittance price websites.

MFIs and small scale cross border transactions - Indonesia

With a population of over 237 million and 59% of adults “unbanked,” financial inclusion remains a major challenge for Indonesia. Of the adult population which do have a bank account, 31% do not save. On the borrowing side, the informal sector plays a significant role with only 17% borrowing from formal banks compared to 32% borrowing from the informal institutions. Almost 40% do not borrow at all.

Indonesia’s MFIs are made up of two types: banks or non-banks. Bank MFIs are categorized as rural banks (BPR/BPRS), micro-unit of commercial banks (BRI, DSB, Mandiri) or village credit agencies (BKD). Non-banks are categorized as either formal or non-formal with the formal non-bank MFIs consisting of cooperatives (KSP), pawnshops and village funds and Credit Institutions (LDKP). The non-formal non-bank

MFIs consist of NGOs, self-help-groups and BMT (microfinance based on Islamic principles). The average value of non-bank MFIs savings and loans are relatively small, as outlined in the table below:

	Bank MFIs		Non-Bank MFIs		
			Formal		Informal
	Rural Bank (BPR)	Village Credit Agency (BKD)	Savings and Loans Cooperative (KSP)	Credit Union (CU)	Baitul Mal Wat Tamwil (BMT)
Data from yr	2011	2011	2009 (Jakarta sample)	2009 (Jakarta sample)	2009 (Jakarta sample)
Average loans borrowers (USD)	1,306.90	102.30	192.35	737.34	359.05
Average savings/savers (USD)	455.23	22.75	224.41	630.48	128.23

Indonesia's total number of Savings and Loans Cooperatives is 74,636, reaching out to 7.15 million people with total savings equivalent to US\$1.36 billion and total loans amounting to US\$2.13 billion.

The revolving fund management agency for cooperative, micro, small and medium enterprises (RFMA-CMSME) aims to increase the productivity and competitiveness of the people's economy, to develop new entrepreneurial opportunities and create new employment. It is a Government developed program which provides revolving fund loans without collateral requirements, has low interest rates and is easy to access. The revolving fund program is geared towards Cooperatives and SMEs (KUKM) and specifically targets those who are not yet bankable. The revolving fund is managed by the Public Service Board (BLU) of the Ministry which is The Revolving Fund Management Agency (LPDB-KUKM). Total disbursement of revolving fund loans in 2011 was IDR 1,700 billion (eq. US\$181.66 million) with 812 partners.

KUR is a credit/financing program for cooperatives and MSMEs in the form of working capital and investment which is supported by guarantee facility for productive enterprises of which the source of funding comes entirely from banks. The government gives insurance against the risk of KUR by 70% while the remaining 30% is borne by the bank. KUR guarantee is given for the purpose of improving SME access to financing sources in order to promote domestic economic growth. KUR is distributed by six implementing domestic banks (Mandiri, BRI, BNI, Bukopin, BTN, and Mandiri Islamic Bank) and 26 Regional Banks. In 2011, disbursement was up to IDR 29,002.7 billion (US\$3,099.24 million).

Numerous SMEs, particularly those in rural areas, do not have access to banking services. Rural Bank contribution to SME financing is very low compared to commercial banks and the lending rate is relatively high. The future mission regarding

rural banks is to make the rural bank industry as a sound, strong, productive “community bank” which focuses on simple, accessible and efficient financial services to small and rural communities.

There are three main initiatives to develop the microfinance sector in Indonesia: establishing a legal form of MFIs, linkage program between commercial banks and MFIs and technical assistance to local MFIs. The challenges of these initiatives are summarized in the table below.

Challenge	Short description
Credit risk	The problem of over indebtedness of the debtors (mostly poor people) will affect the debtors’ repayment capacity, thus increase the potential of MFIs to suffer from heavy loan losses.
Reputational risk	Comes from, among others, the unethical practices as evidenced by the huge growth in indebtedness among MFIs’ customers, will create bad reputation of MFI in general.
Corporate governance	Comes from the limited knowledge and expertise of the MFI’s owners, the possibility of conflicts of interest, the lack of independence, and poor accountability.
Competition risk	The low rates and better services create good competition, but could also cause market disruption, squeezed margins, and the MFIs to take greater risks.
Political Interference	Comes from a political interference, such as in interest rate capping, product limitations, directed lending to “priority sectors”, and subsidized government loan programs.
Limited source of funding	When MFIs provide credit, at some points there is limited source of funds due to the limited financial capacity of the shareholders.

The number of Indonesian migrant workers is estimated around 4.03 million (March 2012), of which most are working in the Asia-Pacific region (73%), followed by the Middle East region (23%) and the remaining 4% in the United States and Europe. Around 55% of these migrants are working in the informal sector. The table below further outlines the spread of Indonesia’s migrant workers across Asia-Pacific.

Migrant Workers in Asia-Pacific, March 2012						
Malaysia	Chinese Taipei	Singapore	Hong Kong	North Korea	Brunei	Others
35%	21%	17%	15%	7%	4%	1%

In March 2012 remittances reached around US\$561.9 million, most of which came from the Asia-Pacific (59%) and the Middle East & Africa (36%). The below table provides a further breakdown of the remittances inflow from within Asia-Pacific.

Indonesian Workers Remittances inflow from Asia-Pacific, March 2012

Malaysia	Chinese Taipei	Singapore	Hong Kong	North Korea	Brunei	Others
57%	13%	7%	13%	3%	2%	5%

The value of Indonesian migrant workers' remittances through commercial banks in March 2012 was US\$157.3 million. From this it can be concluded that the largest part still goes through informal channels. Remittance inflows also show a seasonal pattern in which more is sent home during Lebaran (fasting months) in July and August.

Conclusions

The untapped market of remittances

220 million migrants worldwide are sending money back home. In 2012 remittance flows globally were 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.²⁷ Both the remittances and savings of migrant workers represent a huge untapped market.

Formalizing remittance channels

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 (i.e. East Asia's ageing population, increased urbanization and greater dependence on foreign workers).²⁸ As such, cross-border microfinance following the migration patterns represents a significant opportunity for financial inclusion by formalizing the informal remittance and savings channels and developing innovative product designs based upon the actual needs of the clients (i.e. 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.

Importance of partnerships

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 offices (networks) are important partners to tap this market, as well as MFIs; especially for cost reduction and building sustainable business models.

27 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.

28 2011 Asia-Pacific Financial Inclusion Forum. *Expanding Financial Access Through Regional Public-Private Cooperation*. Forum Report, September, 2011.

To reach the scale needed for the region, telecommunication/mobile money solutions are crucial as well.

The role of agent networks

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 recognized as banking agents and have clear regulation on KYC and 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 (i.e. license requirements to be allowed to work as an agent) and proportionate regulation regarding KYC and AML compliance requirements for agents.

Cross-border data flow

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 economy and remittances are not considered as income (in home economies). This makes assessing credit worthy-ness of migrant workers and their families difficult, if not impossible.

Importance of financial infrastructure

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 billion. 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.

With migration throughout the Asia-Pacific region growing rapidly, cross-border microfinance service delivery needs greater attention. Particular focus should be on formalizing remittances and savings by driving down cost of remittance services, stimulating account-to-account transfers (instead of cash-to-cash) and creating the opportunity to deliver financial services based upon income coming from work abroad. Points for 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 economy and financial product providers in the other economy). In order to reach the required scale, utilizing innovative technology such as mobile banking is important. Regulatory frameworks, including market conduct rules for agent networks (most probably telecommunication networks) and innovative technology-assisted models such as mobile banking, also need to be developed and elaborated to provide further details and better enforcement.

Chapter 6: China's Strategy for financial Inclusion

This chapter summarizes a special presentation on **China's strategy and implementation experience in Financial inclusion.**

Speaker:

- Luo Ping, Training Department, China Banking Regulatory Commission

China Banking Regulatory Commission's Policy and Strategy for Financial Inclusion

Financial inclusion is defined in China as the delivery of financial services at affordable cost to the disadvantaged and low income segments of society. It can also include provision of services to small and micro business. A clear definition from a regulatory perspective is yet to be developed, however; and with the scale of China's overall population and the sharp contrasts between income disparity, effort is justified to achieve financial inclusion for the benefit of society. As such, the economy is taking several steps through regulation and policy development to achieve greater financial inclusion.

The China Banking Regulatory Commission (CBRC) is the regulator for China's banking institutions. CBRC's strategy to achieve financial inclusion is to both improve the full coverage and quality of rural finance and to promote financial services for small and micro businesses. In CBRC's overall policy, small and micro businesses are considered priority recipients of financial services with 20% of its total loan portfolio consisting of small businesses in 2011. To be eligible as small and micro businesses they need to operate in line with government policies, generate employment opportunities, and be able to service bank loans. There is generally a higher risk tolerance to small and micro business lending and advisory services are made available from banks in support of small businesses. Regulatory policy which has been developed to facilitate greater financial inclusion by enabling rural bank licensing also favors banks which intend to provide lending services to small businesses.

In 2009 CBRC issued guidelines for the promotion of banking services in under-banked areas. These efforts have led to a continual increase in the outreach of financial services with more townships and villages being covered by banking outlets. In 2011 banking institutions were also targeted for an additional 500 unbanked townships and more licenses have been issued for township and village banks with regulatory support provided for small lending corporation and rural funding cooperatives. New rural financial institutions have also been established under the sponsorship of banks and interest rates are controlled centrally. Concerns remain, however, about the financial sustainability of remote rural finance institutions as compliance and operating costs remain relatively high.

In conclusion, financial inclusion is an important new concept for financial services in China. Financial inclusion initiatives are still in the early stages of implementation as a precursor to appropriate regulatory reform by the CBRC and it is recognized that both prudential and non-prudential regulation will be required. It will also be important to find the right business models and regulatory approaches to assist remote rural institutions to be financially sustainable due to their limited customer base and relatively high operating costs.

Summary and Conclusions

The past few decades have seen several new and innovative methods for providing financial services to the poor being implemented by a range of organization types. The development of financial services for the poor continue at a rapid pace and governments are at times slow to find 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 a number of recommendations to address important challenges relating to: Financial Literacy, Financial Identity, Microfinance Regulation, Consumer 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 financial institutions 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 activities or other necessities for personal financial development (i.e. savings, education, housing loans, etc). Some key points of attention related to credit information systems are: use of alternative data (i.e. 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. Both prudential and non-prudential regulation (i.e. KYC, AML, for banking agents) should be proportionate. Many challenges remain, however, in determining how to best enforce regulation. Regimes for market conduct regulation such as that aimed at client protection need to evolve over time to extend rules and oversight to non-banking institutions as well as banks to ensure that all clients are protected. This may require expanded authority for supervisory bodies and coordination among multiple supervisors.

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 and fair treatment, prevent over-indebtedness and assure proper grievance channels/complaints procedures. To the extent feasible, this needs to be applicable in a consistent manner to all providers of financial services to the poor, even if the providers 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 formalizing remittances and savings by driving down cost of remittance services, stimulating account-to-account transfers (instead of cash-to-cash) and creating the opportunity to deliver financial services based upon income coming from work abroad. Points for 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 economy and financial product providers in the other economy). In order to reach the required scale, utilizing innovative technology such as mobile banking is important. Regulatory frameworks, including market conduct rules for agent networks (most probably telecommunication networks) and innovative technology-assisted models such as mobile banking, also need to be developed and elaborated to provide further details and better enforcement.

Appendix: Forum Program

25 June 2012, Monday	
08.30 – 09.00	Registration
09.00 – 09:15	<p>OPENING REMARKS</p> <ul style="list-style-type: none"> ▪ Li Kouqing, Deputy Director-General of Asia-Pacific Finance and Development Center ▪ Wang Lili, Executive Director and Senior Executive Vice President, Industrial and Commercial Bank of China (ICBC) ▪ Jae-Ha Park, Deputy Dean for Special Activities, Asian Development Bank Institute (ADBI)
09.15 – 09:35	<p>KEY GLOBAL TRENDS IN FINANCIAL INCLUSION</p> <p>Robert A. Annibale, Global Director, Citi Community Development & Microfinance</p>
09.35 – 10:20	<p>SESSION 1: APPROACHES TO PROMOTE FINANCIAL LITERACY</p> <p>This session will focus on approaches to promote financial literacy through web-based education and information dissemination and collaboration and allocation responsibilities among financial institutions, government agencies, trade associations, civil society organizations and educational institutions.</p> <p>Session Chair: Julius Caesar Parrenas, Coordinator, Advisory Group on APEC and Advisor on International Affairs, Bank of Tokyo-Mitsubishi UFJ, Ltd.</p> <p>Speakers:</p> <ul style="list-style-type: none"> ▪ Jared Penner, Education Manager, Child and Youth Finance Intl – (Focus: Multi-Stakeholder Cooperation from a Development Perspective) ▪ Elie Beyrouthy, Head of WSBI Institutional Relations Department (Focus: Banking Industry-Government Cooperation) ▪ Mike Kubzansky, Partner, Monitor Group (Bridging the Gap: the Business Case for Financial Capability)
10:20 – 11:00	Open Discussion
11:00 – 11:20	Group Photo and Coffee Break

11:20 – 12:20	<p>SESSION 2: FINANCIAL IDENTITY</p> <p>Session Chair: Robert A. Annibale, Global Director, Citi Community Development & Microfinance</p> <p>Session two will focus on financial identity through regulations on sharing customers' information among private credit bureaus/ financial institutions and accessing customer's information collected by non-financial institutions.</p> <p>Some technical considerations, guidelines and regulations for integration into credit reporting of microfinance institutions and popular savings and loans sectors will be discussed on this session. Some questions will be addressed such as what is the role of public credit bureaus and domestic microfinance associations in promoting financial inclusion or how central banks and regulators can use credit bureau data to monitor financial inclusion, guard against over-indebtedness challenges in lower income segments?</p> <p>Speakers:</p> <ul style="list-style-type: none"> ▪ Robin Varghese, Senior Fellow & Vice President of International Operations, PERC (Focus: Alternative Data) ▪ Matt Gamser, Chief Operations Officer, Head, SME Finance Forum, IFC (Focus on Including Non-bank Financial Institutions; Particularly MFIs) ▪ Sophea Hoy, General Secretary Cambodia Microfinance Association, CMA (Focus: Credit Bureau Reporting Requirements for MFI's) ▪ Chitkasem Pornprapunt, Division Executive, Financial Institutions Strategy Department, The Bank of Thailand (Focus: Domestic Experience)
12:20 – 13:00	Open Discussion
13.00 – 14:30	Lunch

14.30 – 15:30	<p>SESSION 3: MICRO-FINANCE REGULATION</p> <p>Session Chair: Peng Runzhong, Director, Asia-Pacific Finance and Development Center</p> <p>Key issues to be explored during this session include:</p> <ul style="list-style-type: none"> ▪ Rationale for micro-finance specific regulations ▪ Impact of Basel III on financial inclusion ▪ Branchless and mobile banking and recognition of mobile e-money ▪ Regulation and promotion of deposit-taking MFIs; recommended best practices, regulatory principles and proportionate regulatory arrangements ▪ Incentive structures for banks and MFIs to operate viable business models acceptable to banking regulators ▪ Regulatory aspects involved in broadening of financial services through major utilities and mobile phones ▪ Domestic experiences <p>Speakers:</p> <ul style="list-style-type: none"> ▪ Eric Duflos, Regional Representative for East Asia and the Pacific, CGAP (Focus: Key Regulation Issues Important for Promoting Financial Inclusion) ▪ Ken Waller, Director of AASC, (Focus: Implementing Best Practice Regulatory Principles and Proportionate Regulation to Support MSME Access to Finance) ▪ Katharine McKee, Senior Policy Advisor, CGAP (Focus: Protecting Branchless Banking Consumers: Policy Objectives and Regulatory Options) ▪ Octavio Peralta, Secretary General, ADFIAP (Focus: Asian Experience)
15:30 – 15:45	Coffee Break
15:45 – 16:15	<p>Economy Presentations</p> <ul style="list-style-type: none"> ▪ Abdul Awal, Executive Director, CDF Bangladesh (Focus: Regulation on Social Performance - Domestic Experience) ▪ Tur-od Lkhagvajav, CEO and Secretary General, Mongolian Bankers Association (Focus: domestic experience)
16:15 – 17:15	Open Discussion
18:00 – 20:00	Cocktail Dinner

26 June 2012, Tuesday

09.30 – 10:30

SESSION 4: CONSUMER PROTECTION**Session Chair:**

Yuqing Xing, Director, Capacity Building and Training, ADBI

Questions and key elements to be explored during the session:

- Smart Campaign's Client Protection Principles
- Consumer protection regulations
- Transparency issues
- Information disclosures
- Codes of Conducts
- Arguments for new special consumer protection regulations governing MFIs
- Domestic experience presentations

Speakers:

- Michael Schlein, President & CEO, ACCION International (Focus: Road Map for the Microfinance Industry: Responsible and Client-Centered Microfinance)
- Katharine McKee, Senior Policy Advisor, CGAP (Focus: Responsible Finance - Putting Principles to Work)
- Giorgio Trettenero Castro, Secretary General, FELABAN (Focus: Latin American Experience)
- Aban Haq, Chief Operating Officer, Pakistan Microfinance Network (Focus: Asian Chair of Social Performance Task Force - Domestic Experience)

10:30 – 10:45

Coffee Break

10:45 – 11:15

Economy Presentations

- Muhammad Aslam, Deputy Secretary, Ministry of Finance, Pakistan (Focus: Domestic Experience)
- Amphone Aliyavongsing, Deputy Director General, Financial Institution Supervision Department, Bank of the Lao PDR (Focus: Domestic Experience)

11:15 – 12:15

Open Discussion

12:15 – 13:45

Lunch

13:45 – 14:15

GUEST SPEAKER**FINANCIAL INCLUSION: CHINA'S STRATEGY**

Luo Ping, Director General, Training Department, China Banking Regulatory Commission (CBRC)

14:15 – 15:30	<p>SESSION 5: FACILITATING CROSS-BORDER MICROFINANCE</p> <p>Session Chair: Chandula Abeywickrema, Chairman, Banking with the Poor Network (BWTP)</p> <p>The growing international labor mobility among economies in Asia has amplified the necessity to develop pertinent policies in cross-border microfinance. In order to address this issue, economies in the region should activate the financial cooperation both in public and private sectors in this area.</p> <p>Question and issues to be explored during the session will include:</p> <ul style="list-style-type: none"> ▪ Possibility/regulations on cross-border cooperation of microfinance institutions ▪ Facilitating product development for migrant families, securitization of migrants’ remittances and diasporas bonds ▪ Regulations/policies on internet/mobile phone remittances ▪ Legal recognition of electronic and mobile money ▪ Transnational implications of electronic money ▪ Pilot on cross-border credit information flows with focus on select economies with large migrant labor force <p>Speakers:</p> <ul style="list-style-type: none"> ▪ Meliadi Sembiring, Deputy Minister for Financial Services, Ministry of Cooperatives and SMEs, Indonesia (Focus: Domestic Experience) ▪ Pedro de Vasconcelos, Manager of Financing Facility for Remittances IFAD (Focus: Innovative Remittance Markets) ▪ Philip Yen, Group Head – Emerging Payments for Asia-Pacific, Middle East & Africa, MasterCard (Focus: Mobile Prepaid Regulatory Solutions) ▪ Joachim Bartels, Managing Director, BIIA (Focus: Cross Border Credit Information Flows) ▪ Isaku Endo, Financial Sector Specialist, The World Bank (Focus: World Bank-CPSS General Principles for International Remittance Services and their Implications for Financial Inclusion)
15:30 – 16:45	Open Discussion

16:45 – 17:00	<p>CONCLUDING REMARKS SESSION</p> <ul style="list-style-type: none"> ▪ Li Kouqing, Deputy Director-General, Asia-Pacific Finance and Development Center ▪ Miao Jianmin, Executive Chairman, China Life Asset Management Company Limited ▪ Yuqing Xing, Director, Capacity Building and Training, Asian Development Bank Institute (ADBI)
17:30 – 19:30	Closing Dinner
27 June 2012, Wednesday	
09:00	<p>FIELD TRIPS</p> <p>Visit Microfinance Institutions – Participants are encouraged to choose only 1 MFI that they would like to visit among those listed below:</p> <ul style="list-style-type: none"> ▪ China Risk Finance ▪ Zendai Wealth Management Ltd ▪ Shanghai ChangNing DongHongQiao Microcredit Co., Ltd. ▪ SongJiang JunHe Microcredit Company

