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A Public-Private Sector Initiative

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### **2014 Asia-Pacific Financial Inclusion Forum Report**

Foundation for Development Cooperation

<b>PURPOSE</b>	For consideration
<b>ISSUE</b>	This is the final report of the 2014 Asia-Pacific Financial Inclusion Forum held on 19-20 March 2014 in Shanghai, China.
<b>BACKGROUND</b>	The 2014 Asia-Pacific Forum on Financial Inclusion was hosted by the Asia-Pacific Finance and Development Center (AFDC) and co-organized by the APEC Business Advisory Council (ABAC), the Asian Development Bank Institute (ADBI), the Foundation for Development Cooperation (FDC) and APEC China 2014, with sponsorship support from the Citi Foundation. The Forum brought together participants from the public and private sectors, including financial regulators and policy makers, multilateral institutions, financial institutions and related market players, microfinance institutions, financial inclusion experts, industry organizations and private foundations.
<b>PROPOSAL</b>	This report is now ready for wide distribution.
<b>DECISION POINT</b>	Endorse the distribution of the report.

# Realizing Financial Inclusion in Asia: Achievements and Challenges



2014 Asia-Pacific Forum on Financial Inclusion  
Shanghai, China, 19-20 March 2014

Jointly organized by



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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, Asian Development Bank Institute, the Foundation for Development Cooperation, 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  
AFDC – Asia-Pacific Finance and Development Center  
APEC – Asia Pacific Economic Cooperation  
AML – Anti-Money Laundering  
API - Applied Product Innovation  
ATM – Automated Teller Machine  
BAAC - Bank for Agriculture and Agricultural Cooperatives  
BI – Bank Indonesia  
BIS - Bank for International Settlements  
BRI - Bank Rakyat Indonesia  
BTPN - Bank Tabungan Pensiunan Nasional  
BWTP – The Banking with the Poor Network  
CBRC – China Banking Regulatory Commission  
CDA - Cooperative Development Authority  
CFT – Combating the Financing of Terrorism  
CGAP - Consultative Group to Assist the Poor  
COCA - Code of Conduct Assessment  
CSR – Corporate Social Responsibility  
DBT - Direct Benefit Transfer  
EDU - Economist Development Unit  
FATF - Financial Action Task Force  
FDC – The Foundation for Development Cooperation  
FSS - Farmers’ Service Societies  
GNI - Gross National Income  
IAIS - International Association of Insurance Supervisors  
IMF - International Monetary Fund  
M-CRIL - Micro-Credit Ratings International Ltd  
MFI – Microfinance Institution  
MSME – Micro, Small and Medium Enterprise  
NBFC - Non-Bank Financial Company  
NCB - National Credit Bureau  
NGO – Non-Government Organization  
PACS - Primary Agriculture Credit Societies  
POS – Point-of-Sale  
PSL - Priority Sector Lending  
PSBC – Postal Savings Bank of China  
PSRB – Postal Savings and Remittance Bureau  
RAROC - Risk-Adjusted Return on Capital  
RBI – Reserve Bank of India  
RMCC – Rural Mutual Credit Cooperative  
SFI - Specialized Financial Institution  
SIDBI - Small Industries Development Bank of India  
SME – Small and Medium Enterprise  
SRO - Self-Regulatory Organization  
VTB – Village and Township Bank

## 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 [www.adbi.org](http://www.adbi.org)

**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 [www.abaonline.org](http://www.abaonline.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. FDC was created in Australia in 1990 to harness and leverage the collective skills, knowledge, and resources of organisations from across the public, private, NGO and academic sectors to promote cooperation and 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 a Pacific regional office in Fiji. For more details, visit [www.fdc.org.au](http://www.fdc.org.au).

**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: [www.afdc.org.cn](http://www.afdc.org.cn).

## The Forum Sponsor

**The Citi Foundation** is committed to the economic empowerment and financial inclusion of individuals and families, particularly those in need, in the communities where we work 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](http://www.citifoundation.com).



## Executive Summary

The 2014 Asia-Pacific Forum on Financial Inclusion was hosted by the Asia-Pacific Finance and Development Center (AFDC) and co-organized by the APEC Business Advisory Council (ABAC), the Asian Development Bank Institute (ADBI), The Foundation for Development Cooperation (FDC) and APEC China 2014, with sponsorship support from the Citi Foundation. The Forum brought together participants from the public and private sectors, including financial regulators and policy makers, multilateral institutions, financial institutions and related market players, microfinance institutions, financial inclusion experts, industry organizations and private foundations. By providing a platform for high-level dialogue amongst policy makers and regulators across the region, the Forum aimed to strengthen their capacity as well as provide specific points of advice for policy related issues impacting financial inclusion in the region.

More specifically, the 2014 Forum provided an opportunity for stakeholders to review the current trends, recent achievements, ongoing challenges and opportunities within the region relative to financial inclusion and discuss how these developments are impacting different markets. Through this review process the Forum organizers identified a number of key priorities for future initiatives of the Advisory Group on APEC Financial System Capacity Building to further support financial inclusion.

The program comprised seven sessions, based on specific experiences of six economies, and the seventh addressed regional developments and key initiatives. This report follows the Forum program, providing a summary of key points for each economy and regional developments identified by participants.

### **China**

With an estimated 36 per cent of adults currently unbanked China represents one of the largest unbanked populations in the world. China's rural poor are particularly excluded with more than 60 per cent of poor adults estimated to be unbanked. This has led to a significant reliance on informal financial services in rural townships and villages.

Technology and innovation are creating enormous opportunities in China for financial inclusion with further opportunities fuelled by China's entrepreneurial boom. The challenge faced now by China is how to effectively harness these factors to move forward in a more inclusive and productive way.

In recent years China's central government has raised the priority of financial inclusion and has introduced a number of new policies in support of its goals such as piloting agent banking methods and technologies, credit information systems, creating new institutions, developing equity and bond markets and other important reforms. These actions have led to the emergence of several new institutions, an expansion of financial services, increased outreach and an acceleration of product innovation.

Despite the many examples of positive changes being made to China's financial sector to support greater financial inclusion, the challenge of reaching and providing appropriate services to the financially excluded remains significant. This gap is due largely to systemic market barriers associated with policy, regulation and human resources. The urban/industrial versus rural divide is another major factor, creating unique challenges and the emergence of "Shadow banking" now poses additional systemic risks which will increase as these methods become more widely used.

## **The Philippines**

The Philippines is well regarded within the region for its achievements in financial inclusion and particularly for developing new technologies for financial service delivery. These efforts have not gone unnoticed, with the international community taking due recognition of the success of the Philippines. In 2005, the economy was judged as having one of the best microfinance industries in the world by the United Nations during the celebration of the “Year of Microcredit.” Further, the Economist Intelligence Unit has ranked the Philippines’ regulatory framework as the best in the world for five consecutive years (2009-2013). It was also ranked 4<sup>th</sup> among 54 economies within the overall microfinance business environment in 2013.

Much of this success is attributed to the Philippines’ National Strategy for Microfinance which focuses on building bridges and linkages between the public and private sector which as a result has allowed the microfinance industry to develop and prosper. With a progressive regulatory environment, the Philippines is also regarded as an important centre for innovation in Asia. Product, service and delivery innovations are developed in close cooperation with the central bank to ensure both applicability and support from microfinance service providers and supporting stakeholders. This partnership approach between microfinance practitioners and the government has been a key factor underpinning success in the Philippines.

However, despite the remarkable success and growth experienced the Philippines’ microfinance industry, financial inclusion rates remain relatively low; suggesting that the development of microfinance services and innovative products alone are not enough to achieve financial inclusion. Saturation in local market activity of borrowers was raised as a possible contributing factor. Greater attention is needed in the Philippines on issues such as understanding the poor and their needs, and efficiency of payments systems in order to bridge these gaps and progress financial inclusion.

## **Peru**

Like the Philippines, Peru’s experience with microfinance is regarded as a great success internationally both in terms of market development and internal industry performance. Peru’s regulatory framework over the last decade has also been a key factor to its success and the economy’s experiences are now being replicated in other Latin American economies which are also seeking to increase financial inclusion.

As the region’s leader, Peru’s microfinance industry has grown at a rapid pace and this is expected to continue for at least the short-term. In order to maintain this momentum and retain its position as a world leader there are several challenges and opportunities which the economy is now preparing itself for. There is also a growing consensus for the creation of a Financial Inclusion Strategy that will further guide Peru’s microfinance sector into its next phase. Further progress on the development of sustainable business models will allow Peru’s microfinance stakeholders to take advantage of the many opportunities, particularly the use of electronic money, to expand into new markets and most importantly provide access to quality financial services to the poorest Peruvians.

## **India**

India’s microfinance sector has made significant contributions to the global microfinance industry, however, it could benefit greatly from learning from other countries within and beyond the region, with notable mention of the Philippines and Peru where regulatory reform and sector-

wide innovation have resulted from effective public-private collaboration. While India has made a considerable effort to bring about needed reform within its regulatory framework for sustainable microfinance provision, about half of the economy's population remains unbanked and beyond the reach of formal financial institutions.

Spanning more than two decades, India's microfinance sector has evolved considerably both in terms of institutional and policy development. The 2010 "microfinance crisis" in Andhra Pradesh provided a unique case study and produced several important lessons. Following the crisis, India's MFIs have placed greater emphasis on responsible practices and the sector is now beginning to regain lost ground. But pressures remain to expand beyond existing markets and reach new geographic areas.

Common perceptions within India's regulatory authorities of microfinance being a development program rather than a viable market are now beginning to change as more MFIs are demonstrating profitability, efficiency and growth. Regulators have more recently made important steps to support greater self-regulation through microfinance associations as a way to complement statutory measures. While these developments represent important progress, greater reforms are still needed in order for India to achieve its full potential for financial inclusion.

### **Thailand**

Thailand's progress towards financial inclusion has been impressive with current estimates indicating that the level of financial access is very high. However, financial inequality and issues with demand for financial services, particularly amongst the low-income population segments, are creating challenges. An important advantage that Thailand has to assist in overcoming these challenges is the amount of broad data available about its financial market. Such broad data is uncommon relative to many other economies in the region and of significant benefit in developing financial inclusion strategies.

Thailand also provides useful examples of the role of institutions such as credit bureaus and state-owned banks in achieving financial inclusion. These institutions, which have evolved significantly in Thailand over the last decade, highlight examples of strengths and weaknesses within their roles of expanding access to products and services and supporting policy development. By providing credit information on individuals and businesses the credit bureau plays a particularly important part in the overall risk management of the sector. Thailand's credit bureau has also contributed greatly to evaluating the rising levels of household debt, which is of growing concern to policy and regulators, and actively supports financial literacy to help ensure that clients are capable of using financial services.

The future of financial inclusion in Thailand looks positive with a number of opportunities currently being considered as ways to overcome challenges and further develop the market. A number of government-supported financial inclusion initiatives are currently underway to take advantage of these opportunities and enhance the quality and quantity of financial products and services to support the poorest segments of the population.

### **Indonesia**

According to a World Bank survey conducted in 2011, 68 per cent of Indonesian households have access to saving services. Meanwhile, results from a household survey conducted by Indonesia's Central Bank, Bank Indonesia (BI), in 2011 concluded that only 48 per cent of households are saving their money. With regard to credit, the World Bank estimated that 60 per cent of

households had access to credit, whereas BI's results concluded that only 45 per cent had access to credit, the majority of which (30 per cent) is provided by non-financial institutions. The different results from these two separate surveys was mainly due to different methodologies and areas adopted in the survey.

From those surveys conducted in Indonesia, the message remains clear that significant challenges and opportunities remain for Indonesia to achieve financial inclusion. Government support has been growing for financial inclusion initiatives and the private sector has also recognised its important role in this process and many steps have been taken to increase their engagement as active stakeholders.

With motivation for financial inclusion initiatives growing following a number of key achievements in recent years, Indonesia's financial sector is now producing some of the most innovative products and services in the region. These accomplishments place the economy in a strong position to make significant progress towards financial inclusion in the near future as innovative technologies and methodologies are used to overcome current challenges.

### **Regional Developments and Key Initiatives**

Achieving financial inclusion requires the efforts of a broad range of stakeholders working together with each fulfilling distinct roles. The forgoing summarises the current situation of financial inclusion in six economies. While there are more than six economies in the region, with great diversity among each of them, the intention has been to compare and contrast the progress that has been made since financial inclusion became a focus of concerted efforts in decision making fora such as APEC and the G20 a few years ago, and a better understanding of next generation issues.

Policy makers and regulators have a responsibility to address directly these issues within their respective jurisdictions by introducing, implementing and enforcing laws and regulations. It is clear, however, that in most developing economies, there is a huge need to build capacity to design effective laws, implement rules and policies, build political support for reforms, establish institutional architectures, and to develop skills and capacity to continuously adjust rules and regulations to a continuously evolving market. Providing opportunities to build this capacity remains a serious challenge for the region.

Several organisations representing public development institutions, academic institutions and the private sector outlined initiatives illustrating the diversity of approaches adopted, but also how their efforts can be complementary of each other as well as with other major institutions. This assembly of diverse approaches and experiences represents a significant opportunity to increase the effectiveness of financial inclusion programs by making greater use of the resources and knowledge available in the region.

### **Conclusions and Policy Recommendations**

The Asia Pacific Forum on Financial Inclusion is an important part of the regional efforts for financial inclusion, particularly for its role in bringing key stakeholders in financial inclusion together and facilitating an annual dialogue to support increased awareness, the identification of needed measures and the means to expand and deepen the financial inclusion network in the region. Based on the discussions of this year's Forum, the following policy recommendations have been prepared for the consideration of policy makers and regulators to support their endeavours for increasing access to financial services to the poor.

1. Financial regulators clearly can play an important role to further financial inclusion by developing a framework that balances the objectives of safety, soundness, integrity, and consumer protection with those of market innovation and accelerating financial inclusion. Furthermore, consensus around the need for a framework has emerged in an environment of growing awareness that there are neglected opportunities to extend non-credit services to the financially excluded (such as savings, especially for retirement, housing for low income buyers, and remittances recipients). This suggests that a financial inclusion framework can also balance the development of these services in an economy.
2. One major lesson from the Peruvian experience is that an approach that focuses on making regulatory requirements proportionate to risk is key to developing that balance. Moreover regulators must be ready to adapt and revise the framework to promising new technologies and innovations in the market.
3. The development of a national financial inclusion strategy can be an effective way to prioritize goals, balance the development of different financial services needed to achieve financial inclusion and align the roles of and expectations for regulators. Such a formal, public strategy may also work to ensure that financially excluded populations gain access to a broad range of financial services, rather than just one kind of financial service.
4. Financial inclusion strategies often focus on providing access to financial products and services. In some economies, this is even narrower, targeting access to credit specifically. To make a significant impact on the poor, financial inclusion strategies need to encourage development and provision of a broad range of quality financial products and services, aligned to the needs of client segments.
5. By developing a financial inclusion framework through a public-private dialogue a prudential system that also retains incentives to innovate is recommended. Policy makers, regulators and private sector stake-holders should coordinate approaches for the more effective delivery of services to the underserved. Public-private sector capacity building initiatives are crucial in this process.
6. The case of the Philippines has highlighted the importance of this close dialogue and cooperation between the public and private sectors in order to develop an effective and sustainable microfinance industry. By including this participatory process within policy formation the quality and effectiveness of policies can be significantly increased. Furthermore, close cooperation between line ministries and other public stakeholders within the financial sector is also very important. Such cooperation leads to greater impact in advancing sustainable livelihoods for the poor and other important development goals such as nutrition, health and education.
7. Adequate market infrastructure, such as that related to national identification, credit information, collateral management and payments, is necessary to support greater financial inclusion in rural areas and the poorest segments. The development of this infrastructure will enable the expansion, use and functionality of microfinance products and channels, such as mobile and agent banking, savings, insurance, pensions and also expand the reach of financial education.
8. Financial inclusion markets need to be well regulated in order to mitigate risks of indiscriminate lending and other possibilities of malpractice. However, if regulation, particularly with regard to consumer protection, is too strict it will limit innovation. With this

view regulatory frameworks need to appropriately balance risk mitigation with consumer protection while still enabling experimentation with new products and delivery mechanisms.

## Introduction

Financial inclusion and poverty reduction through the provision of financial services are two issues that are closely related. Financial inclusion targets individuals and households regardless of demographic with the aim of providing financial services of equal quality available to the non-poor to the poor as a means to develop livelihoods and alleviate poverty.

In order to utilize effectively financial services as a tool for poverty reduction there are several types of financial measures that are implemented commonly across the region as part of broader financial inclusion strategies. Some examples of financial inclusion initiatives include promoting innovative financial products and services at a regulatory level, enhancing banking coverage to rural areas through innovative delivery mechanisms, guiding private lending for more favourable development outcomes, developing market infrastructure and facilitating regulatory reforms to enable access to credit for micro, small and medium enterprises (MSMEs).

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## Chapter 1: China

*Session Chair:*

Mr. Eric Duflos, Regional Representative for East Asia and the Pacific, CGAP

*Speakers:*

1. Mr. Sheng Chen, Deputy Director, Banking Innovation Supervisory Department, China Banking Regulatory Commission
2. Mr. Bai Chengyu, Secretary General, China Association of Microfinance

*Panelists:*

1. Dr. Deliang Zhang, Deputy Director, Research Division, International Poverty Reduction Center in China (IPRCC)
2. Ms. Wang Xiaolei, Deputy Director, Credit Reference Center
3. Ms. Rachel Freeman, Regional Business Line Manager, A2F Advisory Services, East Asia and Pacific, International Finance Corporation (IFC)

With an estimated 36 per cent of adults currently unbanked China represents one of the largest unbanked populations in the world. China's rural poor are particularly excluded with more than 60 per cent of poor adults estimated to be unbanked. This has led to a significant reliance on informal financial services in rural townships and villages.

Technology and innovation are creating enormous opportunities in China for financial inclusion with further opportunities fuelled by China's entrepreneurial boom. The challenge faced now by China is how to effectively harness these factors to move forward in a more inclusive and productive way.

In recent years China's central government has raised the priority of financial inclusion and has introduced a number of new policies in support of its goals such as piloting agent banking methods and technologies, credit information systems, creating new institutions and other important reforms. These actions have led to the emergence of several new institutions, an expansion of financial services, increased outreach and an acceleration of product innovation.

Despite the many examples of positive changes being made to China's financial sector to support greater financial inclusion, the challenge of reaching and providing appropriate services to the financially excluded remains significant. This gap is due largely to systemic market barriers associated with policy, regulation and human resources. The urban/industrial versus rural divide is another major factor, creating unique challenges and the emergence of "Shadow banking" now poses additional systemic risks which will increase as these methods become more widely used.

### Promoting Financial Inclusion in China

In recent years China's central government has given greater priority to financial inclusion with the aim of establishing an inclusive financial system with comprehensive and accessible services. The China Banking and Regulatory Commission (CBRC), under the guidance of the central government, is tasked with providing supervisory authority of the banking sector. In order to support the broader financial inclusion goals being promoted by the central government, the CBRC has placed specific importance on strengthening and improving the provision of financial services to agriculture, farmers and rural communities. More specifically, the CBRC has encouraged and facilitated the development of rural financial products and services and has also

urged banking institutions to increase provision of agriculture-related loans. Over the next five years the CBRC aims to continue its support to advance the development of a modern rural financial regime in China.

To achieve this, the CBRC is now focusing on three specific issues opportunities relating to financial inclusion:

- Rural finance;
- Small and medium enterprise (SME) finance; and
- Universal banking coverage.

To support greater rural finance the CBRC has facilitated the establishment of two new types of financial institutions: bank-initiated Village and Township Banks (VTBs) and member-owned Rural Mutual Credit Cooperatives (RMCCs). These institutions are primarily encouraged to develop loan products for rural enterprises and households. The CBRC has also overseen the transformation of China's Postal Savings and Remittance Bureau (PSRB) into the Postal Savings Bank of China (PSBC). The PSBC is specifically mandated to develop commercially viable loan products to rural enterprises, migrant workers and farmers. The CBRC has also undertaken several initiatives aimed to increase financial inclusion such as promoting greater diversification of service networks and approaches, raising the transparency of credit businesses, increasing fairness and availability of loans through greater disclosure and supporting the development of products that better satisfy the needs of clients.

In order to provide greater support for SME finance, China's central government issued official guidelines to encourage large, medium and small banks to set up small business units in 2005. Since then, a number of subsequent guidelines, policies, rules and opinions have been issued to further encourage banks to support SMEs. The government has also introduced greater incentives in recent years to further encourage Chinese banks to offer loans to small enterprises.

To achieve full banking service coverage the CBRC is pushing for the banking sector to provide a minimal amount of financial services to villages and rural communities by increasing the number of bank branches and also exploring innovative alternatives to physical facilities. The CBRC has also lowered the requirements for setting up rural financial institutions and is supporting the establishment of branchless access points such as mobile banking units, automated teller machines (ATMs) or setting up point-of-sales (POS) devices within retailers or other non-banking institutions operating in rural areas.

The opportunity for greater financial inclusion in China is very evident, however, significant challenges still remain. While the CBRC can facilitate and encourage banks to offer financial products and services to rural farmers and communities, it is unable to force them to do so. Most of China's banks are commercial, and as such, their credit activity is market driven. But there are signs of success and many of China's state governments have successfully facilitated these banks to offer products to the poor. The CBRC also recognises the important role that non-bank financial institutions will play in solving China's financial inclusion problems and is actively providing them with guidance and support. By encouraging the development of financial innovations within the sector the CBRC also hopes to capitalise on the significant opportunity that new technology has to offer for financial inclusion.

An important policy initiative in China was the establishment of a unified financial credit reporting system. As people move throughout the economy, particularly from rural to urban areas, their credit information needs to follow them in order to support their new life in a new location. To enable this, the PBOC set up the Credit Reference Centre with the responsibility of operating China's credit information system. All formal lenders in China report to this database which covers all financial institutions. One of the major challenges the Centre faces is how to



facilitate financial inclusion, since the message being made from the data is that the number of people that are financially excluded remains very large. Currently about 800 million people are listed in the database but only about 300 million actually have credit information included in the database. By promoting the operation of the Account Receivables Financing Servicing Platform, the Credit Reference Centre hopes to increase their ability to facilitate financial inclusion and increase their overall effectiveness.

## China's Double Dual Financial Sectors

The relationship between China's regulated (formal) financial sector and the unregulated (informal) sector is quite unique. Within the sector as a whole, access to financial resources is greatly limited to large enterprises due to a range of systematic barriers such as policy, regulation and current infrastructure constraints. Large state-owned banks only provide services to large enterprise and while farmers and SMEs have access to financial services, it is very difficult for them to access regulated financial services due to how the market regulation is currently structured. SMEs and micro, small and medium enterprises (MSMEs) are further excluded from these resources by additional market barriers such as access to technology, information and adequate human resources.

China's financial sector is further complicated due to dual financial sectors which can be categorized between urban and rural areas. These sectors are mostly divided by systematic barriers such as separate systems for household registrations, land property rights, social welfare and education. It is estimated that up to 60 per cent of savings from rural areas is currently being "pumped" into urban areas to provide credit to support larger industries, whereas only about 10 per cent of total loan capital is being provided to the rural areas. Different land right property systems between rural and urban sectors is also impacting financial inclusion. In rural areas, land belongs to the village collectively, whereas in urban areas it is owned by the state. The urban land use right can be transferred by the government to private investors for up to 70 years. This use right and the building and house assets based on land property can be traded freely on the market. But in the past, farmers were forbidden to use the collectively owned land in rural areas as collateral to access loans. Furthermore, commercial financial institutions are deterred from providing services to rural areas because it is considered high risk and costly.

To bridge this gap, a "shadow banking" system has emerged by which various non-bank financial institutions such as microcredit companies (MCCs), peer-to-peer lending companies (P2P), money lenders, wealth managers, and trust companies act as intermediaries between the formal and informal sectors to provide the necessary financial access for SMEs and farmers to develop. Since banks require collateral in order to deliver loans, they are technically not able deliver loans to SMEs as they are able to provide the necessary collateral. To solve this, banks work through the non-banking financial institutions (i.e. trust funds, MCCs, P2P, etc.) to provide loans to SMEs. This shadow banking system has grown rapidly over recent years and is currently providing access to financial resources to the majority of China's SMEs.

China's shadow banking system has resulted in several positive impacts for financial inclusion. Aside from being the primary source of finance for China's significant SME/MSME market, it has also resulted in greater product innovation specific for rural areas and farmers. The system has also created a "catfish effect" amongst service providers forcing them to improve their services as competition increases. On the downside, the system is growing rapidly and regulators are endeavoring to retain control and avoid greater systemic risks.

To solve this problem regulators are now looking for ways to transform unregulated financial institutions into formal/regulated institutions. The intent is an inclusive financial system that

will allow for benefits to “trickle down” from the large enterprises to the SMEs and MSMEs including individual households. To achieve this China’s central government has developed a national strategy for building inclusive financial systems. This strategy specifically outlines the need to further open up the financial industry and allow qualified private capital to initiate financial institutions such as small and medium sized banks, increase the proportion of direct financing, accelerate interest rate liberalization, establishing a sound social credit rating system and reforming the land right system for farmers to enable them to provide loan guarantees based on right of land management.

## Innovations to Promote an Inclusive Financial System in China

Both China’s central bank (the People’s Bank of China) and the CBRC are actively supporting the development and implementation of innovative products and services that will lead to a more inclusive financial system. As a result of this support, several new innovations have entered the market recently. One particularly popular service is internet financing. In the last few years China has experienced significant growth in internet platforms for finance including third party electronic payment platforms, P2P lending, group funding, online credit services and search engines dedicated to financial products.

Despite the growing popularity of internet-based solutions for expanding financial services, internet penetration in China is still relatively small (45.8% in the end of 2013), particularly when compared to mobile phone penetrations. While China has been investing heavily in rural infrastructure, the emphasis for accessing financial services has been mostly on agent banking through the PSBC. Due to the high penetration rates, mobile banking through phones represents a significant opportunity, however, before this can be realised China needs to address a number of regulatory issues to manage risks before it becomes widely popular.

Group lending provided by village self-help credit funds has also seen recent reforms in China with new innovative approaches being used to increase impact and efficiency. Under the traditional model microfinance institutions (MFIs) form various groups serviced by loan officers of the MFI. These groups would in turn provide the necessary loans to individual farmers. Under the new approach, village banks are established which provide products and services directly to farmers through village funds as an alternative to MFIs. This is proving to be a more effective approach in rural communities as villagers lack the financial capability to deal effectively with banks or MFIs.

## Key Points

1. Mobile banking through phones represents a significant opportunity to increase financial inclusion in China due to the high penetration rate of mobile phones in rural areas and modern telecommunication infrastructure, and scope to deliver a broad range of financial services, securely. However, currently mobile banking is mostly used by already banked populations and does not yet promote financial inclusion. China needs to address a number of regulatory issues to manage risks before promoting and supporting these services. There is an opportunity for China to learn from other economies with mobile banking experience to increase access and use.
2. While agent banking through the Postal Savings Bank of China (PSBC) and other banks is supported by the central government, some uncertainty remains around the use of agents at a regulatory level, and also on whether this can be done in a financially sustainable manner.

Greater understanding at this level will enable more effective development of agent networks and the services they can offer, including both cash-in and cash-out services.

3. Greater regulatory reforms in China offer the potential to strengthen the enabling environment for institutions to provide access and appropriate financial products and services. Currently, China's largest traditional MFI has less than 1 million users, which is considered small for an economy of its size. Enabling the microfinance environment will allow institutions to grow and extend their reach into the excluded population.
4. Achievements have been recognised in the innovative use of accounts receivables and different types of land rights and forest rights as collateral, with the regulatory framework targeting continued innovation in delivery of financial services to villages and rural areas, both to households and enterprises.
5. While there has been progress made with online providers, governance and liquidity risk management remain as priorities. The opportunity remains to encourage unregulated institutions and informal financial services providers into the regulated system for greater transparency, market stability and client confidence.
6. China's double dual financial sectors (formal vs informal and urban vs rural) have created several unique innovations and challenges. To bridge the gap between both sectors and support greater access to financial services in rural areas the "shadow banking" system, whereby financial institutions act as intermediaries between the formal and informal sectors, has led to many positive outcomes including being the primary source of MSME/SME capital in rural areas. However, the rapid rate at which this system is growing is leading to increased systemic risks which regulators are now endeavouring to manage.

## Chapter 2: Philippines

*Session Chair:*

Mr. Kazuto Tsuji, Visiting Senior Advisor, Japan International Cooperation Agency (JICA)/  
Professor, Saitama University, Japan/The Executive Committee Chair, CGAP

*Speakers:*

1. Mr. Gil S. Beltran, Chief Economist and Undersecretary, Department of Finance, Philippines
2. Ms. Mila Mercado Bunker, Chairperson, Microfinance Council of the Philippines, Inc.; President – Ahon Sa Hirap, Inc.

*Panelists:*

1. Ms. Amada Dimaculangan-Pornaras, Deputy Program Manager, Sustainable Livelihood Program, Department of Social Welfare and Development
2. Mr. Lito Villanueva, Innovation, Ecosystem Build & Alliances Head, Smart e-Money, Inc
3. Ms. Leesa Shrader, Senior Consultant, Consultative Group to Assist the Poor (CGAP)

The Philippines is well regarded within the region for its achievements in financial inclusion and particularly for developing new technologies for financial service delivery. These efforts have not gone unnoticed, with the international community taking due recognition of the success of the Philippines. In 2005, the economy was judged as having one of the best microfinance industries in the world by the United Nations during the celebration of the “Year of Microcredit.” Further, the Economist Intelligence Unit has ranked the Philippines’ regulatory framework as the best in the world for five consecutive years (2009-2013). It was also ranked 4<sup>th</sup> among 54 economies within the overall microfinance business environment in 2013.

Much of this success is attributed to the Philippines’ National Strategy for Microfinance which focuses on building bridges and linkages between the public and private sector which as a result has allowed the microfinance industry to develop and prosper. With a progressive regulatory environment, the Philippines is also regarded as an important centre for innovation in Asia. Product, service and delivery innovations are developed in close cooperation with the central bank to ensure both applicability and support from microfinance service providers and supporting stakeholders. This partnership approach between microfinance practitioners and the government has been a key factor underpinning success in the Philippines.

However, despite the remarkable success and growth experienced the Philippines’ microfinance industry, financial inclusion rates remain relatively low; suggesting that the development of microfinance services and innovative products alone are not enough to achieve financial inclusion. Saturation in local market activity of borrowers was raised as a possible contributing factor. Greater attention is needed in the Philippines on issues such as understanding the poor and their needs, and efficiency of payments systems in order to bridge these gaps and progress financial inclusion.

## Policy and Regulation in the Philippines

Financial inclusion initiatives in the Philippines date back to 1997 with the formulation of the National Strategy for Microfinance. This strategy was developed around four core principles for the purpose of providing greater access to financial services to the underprivileged and disadvantaged population sectors. These core principles include:

1. Enhancing the role of the private sector (such as MFIs) in the provision of financial services.
2. Creating a more enabling policy environment that would facilitate the increased participation of the private sector.
3. Establishing market-oriented financial and credit policies such as market-oriented interest rates on loan deposits.
4. Ceasing the participation of government line agencies in the implementation of credit and guarantee programs.

Since the formulation of this strategy, several additional government rules, regulations and circulars have been issued over the years all of which reflect the principles of the National Strategy.

Presently, it is estimated that there are about 1,400 MFIs operating throughout the Philippines providing non-collateralized loans to as many as 10 million microfinance clients. These MFIs represent a range of institutions including rural banks, cooperatives and non-government organizations (NGOs). More recently, a number of commercial banks have entered the microfinance market.

In 2010 the Philippines government launched the world's first Regulatory Framework for Microinsurance. This framework was developed to support the development of a microinsurance market that would be accessible to the informal and low-income sectors and characterized by low premiums, understandable contracts, simple products and a maximum 10-day claims payment provision. The development and implementation of this framework was further complemented by a range of other government sponsored initiatives such as increasing financial education, training and advocacy campaigns and the introduction of an alternative dispute resolution mechanism that would allow consumers to avoid costly legal battles in cases of disputes.

The introduction of this framework along with its complementary initiatives have been regarded as a great success in the Philippines. As of December 2013 it is estimated that about 20 million Filipinos, along with their dependents, are receiving coverage through microinsurance products. There is also a wide range of life and non-life insurance products available, including 89 government-approved private sector microinsurance products that specifically cater to the low-income and informal sectors. These products are currently facilitated by a total of 54 licensed insurance entities, 19 of which are mutual benefit associations. A recent survey conducted by the Munich Re Foundation and the German International Cooperation (GIZ) concluded that the Philippines currently has the highest microinsurance penetration coverage in Asia with 21 per cent of the population currently covered.

Capitalizing on the momentum gained through the development of their successful microinsurance market, the Philippines is now aiming to expand the market to provide more innovative insurance products for the agriculture sector. Such developments are particularly important in light of the challenges which the Philippines faces due to climate change. As such, products are now being developed that will use weather parameters and indices as triggers for payment of benefits. It is hoped that this method will improve transparency and verification by both the insured and the insurer and thus minimize disputes in claims.

The Philippines is also exploring ways to increase the availability of insurance products at local levels through the use of POS and technology-based platforms such as mobile phones, web sites

and other electronic means. As these new platforms are identified and put into operation, the government will establish the necessary rules and regulations to ensure market conduct and consumer protection.

## **Financial Infrastructure**

Having an effective National Strategy for the development of appropriate and conducive policies and regulations is not the only major factor for the Philippines success in financial inclusion. Developing a sound financial infrastructure has also been a priority of the government. As part of this effort, work began in 2005 to establish a comprehensive credit information system that includes client information from all types of financial institutions including MFIs. The work of establishing this credit information system is expected to be completed by the end of 2014.

The credit information system will also be further supported by the establishment of a movable collateral registry, the framework for which was finalized in late 2013 in a joint effort between the government and the private sector. The movable collateral registry is being regarded as a very important milestone for financial inclusion in the Philippines as it will greatly enhance access to credit by enabling financial institutions to accept movable assets as collateral. This will impact mainly SMEs and MSMEs whose assets are traditionally in the form of movables such as inventories, contracts, purchase orders, etc. The Philippines has set a goal to have the moveable collateral registry fully established by the end of 2015 with plans to have it web-based and easily accessible to the public for greater transparency, accessibility and openness.

## **The Process of Achieving Successful Financial Inclusion Initiatives**

Key to the success of financial inclusion initiatives undertaken by the Philippines Government has been their transparent consultative process. This method has been continuously used to ensure widespread acceptance and applicability across all stakeholders. In order to be successful, the process has been refined to focus on the following steps:

1. Identifying policy and regulatory barriers that may hinder the delivery of financial products and services to the low-income sector;
2. The creation of technical working groups that include both government regulatory bodies and primary private sector representatives;
3. Drafting and formulating the framework document and the pertinent rules and regulations through a consensus building process within the working groups;
4. Undertaking regional consultations with other concerned stakeholders including the general public;
5. Finalization of the pertinent rules and regulations taking into consideration the inputs and comments gathered from the consultations; and
6. Going back to stakeholders to disseminate the final outcome through public seminars and, if necessary, conduct trainings for widespread application and acceptance of the changes in the policy and regulatory environment.

By following this method, the Philippines has managed to implement many successful financial inclusion initiatives over the years. Along the way, their experiences have also highlighted several important insights and lessons. First is the importance of public-private partnerships and collaboration. Establishing these partnerships at the outset of any initiative is important to ensure public acceptance of any reforms. It also promotes a level playing field for various financial players and stakeholders. The provision of capacity building for financial providers/entities along

with financial education and advocacy activities are also important aspects of any initiative to ensure that marginalized sectors are provided with appropriate financial products and services that adequately meet their needs. Establishing effective dialogue mechanisms between the government and the private sector is also important in order to facilitate a consultative process to discuss problems and identify solutions in a collaborative way. Lastly, it is important that policy and regulatory frameworks are transparent, cohesive, encompassing and universal in application. In doing so, it is easier to clarify the duties and responsibilities of stakeholders while also ensuring the rights and privileges of the public are protected.

### **The Microfinance Sector**

The National Strategy for Microfinance paved the way for the development of the Philippines' now thriving microfinance market. Through subsequent laws that were established as part of this strategy microfinance has been viewed as a core element of achieving financial inclusion and poverty reduction.

Microfinance in the Philippines is defined as the provision of a broad range of financial services including credit, savings, insurance and other non-finance products and services exclusively to the poor. The primary focus of microfinance activities is on the development of microenterprises and developing asset bases of poor households. In 1998 the Social Reform and Poverty Alleviation Act was established. This law, along with the National Strategy, are the only means of governing the conduct of microfinance in the Philippines. No definitive or comprehensive law has ever been created and regulatory authority of the microfinance market is also divided amongst various players. Banks are regulated by the Central Bank, cooperatives are regulated by the Cooperative Development Authority (CDA) and the Securities and Exchange Commission acts as a registering entity for NGOs. The level of regulation between these authorities also differs with the Central bank imposing strict regulations on banks whereas the CDA does not perform strict regulation for cooperatives. There is currently pressure for NGO MFIs to adopt greater self-regulation on issues such as meeting performance standards.

There are two types of MFIs in the Philippines. Retail MFIs consist of NGOs, banks, cooperatives and other private lending companies. Wholesale MFIs include government financial institutions, private financing companies or universal banks. The majority of microfinance services in the Philippines are provided by retail MFIs such as thrift banks, rural banks, cooperative banks, credit cooperatives and NGOs. Each of these MFIs have their own focus within the market and collectively offer a broad range of products and services. By the most current estimates these MFIs are reaching a combined total of more than 5 million clients.

While the MFIs focus on directly engaging with clients to provide them with financial products and services that will improve livelihoods and alleviate poverty, the government focuses on facilitating a market-oriented financial and credit policy environment to ensure that MFIs have opportunities to develop and grow. Government financial institutions also provide wholesale funds to MFIs while NGOs and line agencies provide additional assistance through capacity building for MFIs and target clients. Donors also play an important role by providing assistance for social preparation activities that will enable MFIs to broaden and deepen their products and services such as developing innovative microfinance products, providing training in microfinance technologies and upgrading performance standards, operating systems and procedures.

## Trends, Challenges and Opportunities

Since the 1990's the Philippines' microfinance sector has been developing commercially in terms of the total number of borrowers, amount of loan portfolios, the number of areas covered and the number of institutions becoming involved in microfinance activities. In comparison to other economies in Asia, the Philippines' microfinance industry is regarded as relatively developed and boasts one of the best regulatory environments in the world.

More recently, however, microfinance has come under increased scrutiny for a number of reasons. There is a growing perception amongst the public in some regions that the microfinance industry has lost sight of its social purpose of poverty alleviation and has given priority to commercial objectives such as profit and volume. Furthermore, there is growing concern that business and ethical standards are beginning to decline in the pursuit of business targets and that microfinance providers are more commonly disregarding the interests and needs of their customers. As a consequence of this shift in perception, which is often sensationalized through the media, microfinance practitioners are becoming increasingly nervous that investors and donors may become less willing to support the industry.

Despite these setbacks, the Philippines' microfinance industry has already begun to emerge from this difficult period and has made it an opportunity to learn important lessons in order to make the industry stronger. The decline in quality and standards of MFIs has been traced to the increased pressure of competition which continues to grow in most markets. Another root cause of this decline has been "mission drift" by which MFIs are shifting their focus from serving the poor to making profits. MFIs are now in the process of rectifying these issues which will see the industry emerge stronger. Several challenges remain, however, with the main risks being viewed as overindebtedness, corporate governance, management quality, credit risk and political interference. Most of these risks reflect internal or institutional issues with MFIs that are under the direct control of the institution. With this being the case, it can be implied that many of the greatest risks facing MFIs in the Philippines can be managed through greater capacity building and professionalism within the institutions.

The most serious challenge that the Philippines faces is that despite all of its success and innovative approaches usage of formal financial services remains relatively low. This is particularly the case for poor adults. More research is needed to better understand the reasons for this and to determine what the major barriers are. This research should focus on understanding the poor with cutting-edge methodologies of behavioral economics and psychology.

### Key Points

1. The Philippines is renowned for its innovation and willingness to test and adopt advanced technologies, especially with microinsurance products due to the high frequency of natural disaster situations. The Philippines has recently proven that mobile money is the quickest method to disperse funds in disaster situations. Government support for microinsurance is very broad in terms of policies, regulations, product development and also clients' literacy and protection.
2. Close dialogue and cooperation between the public and private sectors has most likely been the most critical factor in the Philippines' success in developing a thriving microfinance industry. Adopting such a participatory process when formulating policy significantly increases the quality and effectiveness of policies. Without regulator support, ideas for new products will face significant challenges. Customer protection is a key design feature that regulators should demand for any product.



3. Close cooperation between line ministries, such as the Social Welfare Ministry, and both public and private stakeholders within the financial sector is also very important. Such cooperation leads to greater impact in advancing sustainable livelihoods for the poor and contributing to important development goals in areas such as nutrition, health and education.
4. The Philippines has also greatly benefited by promoting practical, flexible, risk-based and proportional regulation, including self-regulation. Broad support for undertaking pilot experimentations has also proven to be an effective method to reduce risk.
5. Even though the Philippines' microfinance industry continues to grow and prosper, the number of financially excluded remains relatively high and financial inclusion is not increasing at expected rates. This is likely due to limited understanding of the trade-offs and decisions the poor make and further research is needed in the areas of behavioural economics and psychology in the Philippines to determine barriers to financial inclusion and how the industry can best serve the needs of the poor. Market saturation of microenterprises in certain locations and sectors was offered as another reason why financial inclusion is not increasing at expected rates.

## Chapter 3: Peru

*Session Chair:*

Dr. Robin Varghese, Senior Fellow & Vice President of International Operations, Policy and Economic Research Council (PERC)

*Speakers:*

1. Ms. Narda Sotomayor, Head of the Microfinance Analysis Department, Superintendency of Banks, Insurance Companies and Pension Funds (SBS)
2. Mr. Reynaldo Susano, President and CEO, The Universidad Peruana de Investigación y Negocios – UPEIN

*Panelist:*

1. Mr. Fermin Vivanco, Senior Specialist, Multilateral Investment Fund (MIF) - Inter-American Development Bank (IDB)

Like the Philippines, Peru's experience with microfinance is regarded as a great success internationally both in terms of market development and internal industry performance. Peru's regulatory framework over the last decade has also been a key factor to its success and the economy's experiences are now being replicated in other Latin American economies which are also seeking to increase financial inclusion.

As the region's leader, Peru's microfinance industry has grown at a rapid pace and this is expected to continue for at least the short-term. In order to maintain this momentum and retain its position as a world leader there are several challenges and opportunities which the economy is now preparing itself for. There is also a growing consensus for the creation of a Financial Inclusion Strategy that will further guide Peru's microfinance sector into its next phase. Further progress on the development of sustainable business models will allow Peru's microfinance stakeholders to take advantage of the many opportunities, particularly the use of electronic money, to expand into new markets and most importantly provide access to quality financial services to the poorest Peruvians.

### The Peruvian Regulatory Environment

Peru's regulatory framework aims to balance the objectives of stability and integrity with those of financial inclusion and consumer protection. This balance is best achieved through a risk-based approach which defines the rules taking into account the complexity of a firm's operations and the risk associated to them. Transparency is a key element within the consumer protection policies. Furthermore, the framework is designed to be dynamic and flexible enough so that new innovations and technologies that prove effective for financial inclusion can be supported. Data collection of both the supply and demand side is also an important component of the framework in order to adequately measure financial inclusion gaps at both quantitative and qualitative levels.

Financial inclusion in Peru is defined as access and use of appropriate financial services by all segments of the population. To achieve this, a financial inclusion strategy has been developed which focuses on facilitating a conducive and enabling regulatory environment, including prudential and consumer protection regulation, and adequate supervision, including prudential and market conduct supervision. Financial education is also an important element in the strategy and underpins the whole process.

Stemming from this strategy are five key principles for regulation that Peru aims to adhere to:

- Not allowing the State to directly participate in the market;
- Allowing practitioners the freedom to assign resources;
- Prevention of any discriminatory treatments;
- Allowing practitioners the freedom to set prices; and
- Promoting transparency on information.

With these principles, Peru has systematically built a strong regulatory environment over the years with initiatives undertaken to continually support the improvement of financial inclusion and proactively mitigate risks. Examples of initiatives implemented over the years include the improvement of the credit bureau (2001-2003), establishing guidelines for microinsurance products (2007) and introducing proportional Anti-Money Laundering (AML) and Combating the Finance of Terrorism (CFT) regulation (2011) to ease the access to small deposits. Most recently, the focus for regulators has been on the industry's most recent developments with electronic money.

One of the earliest and most important regulatory initiatives undertaken in Peru in 1997 has been the legal recognition that lending to micro and small enterprises was a special case, and as such, required special regulation. To support this micro and small enterprises are categorized based on their total debt within the financial sector, whereas large and corporate enterprises are categorized based on their total sales and other criteria. The maximum indebtedness of the entrepreneur in the financial system to qualify for the microcredit category is about 7,000 USD, whereas the correspondent number for a credit to small enterprise is 100,000 USD. Through this system micro and small enterprises are more easily able to access loans through any type of financial institutions, particularly through microfinance institutions offering small and micro enterprise loans specifically tailored to them. This is possible because the regulation allows these smaller enterprises to provide less documentation at the time of loan origination and debtor risk is classified based on the total number of days overdue. Such regulation has resulted in a sustained increase in funding to more micro and small enterprises over the years.

As part of the financial inclusion strategy, Peru's regulators have also placed great emphasis on increasing access points throughout the economy. Since 2008 there has been a steady increase in the number of banking agents (allowed in 2005), ATMs and branches established, with the greatest increase being with banking agents, which have increased from about 8,000 to more than 33,000 over the last five years alone. These retail agents are also the most significant channel for reaching the poorest population segments and so represent a very important aspect of Peru's financial inclusion achievements.

While increasing access points such as branches, ATMs and banking agents have proven to have significant impact for financial inclusion in Peru, there is also a great opportunity to expand access through banking services delivered through mobile phone platforms. It is estimated that up to 99 per cent of districts currently have mobile phone coverage which is larger than the current outreach of the financial system. This has created a major opportunity for mobile phones to be used as an additional channel to access financial services, in particular payments and transfers. Regulators are currently examining the prospects and risks of this with the hope of increasing the use and benefits of mobile phone banking and other electronic money products and services in the near future.

## Regulatory Challenges and the Future Ahead

An ongoing challenge in Peru's efforts to achieve financial inclusion has been the lack of effective integration of the actions of public organizations with the actions of private sector organizations. Better integration of these actions would lead to greater efficiency in overcoming current barriers for financial inclusion from both the supply and demand side. To achieve this Peru has established a Multisectoral Financial Inclusion Commission that will specifically facilitate better cooperation between the public and private sectors and the implementation of a National Inclusion Strategy.

Peru also currently faces a need to scale up and develop more appropriate business models to increase outreach to remote and less-populated areas. Careful consideration is also needed to ensure that products and services are designed to be suitable to meet the needs of the unserved and underserved segments of the population. Furthermore, how these products and services work to alleviate poverty needs greater focus amongst practitioners and regulators.

## Peru's Microfinance Market

Peru's microfinance market is made up of a diverse set of both regulated and unregulated institutions. Both types of institutions supply various forms of microfinance products and services and combined have an outreach of approximately 4.1 million clients. The growth of Peru's microfinance industry has increased considerably over the last nearly 20 years. The estimated value of microfinance loans in 1997 was about USD 100 million whereas the most current estimate for 2014 is nearly USD 10 billion. Today Peru's microfinance industry represents about 32 per cent of GDP.

One of the reasons for the exceptional growth of Peru's microfinance industry is believed to be the great entrepreneurial spirit which is evident within a large portion of the population. As a consequence of this entrepreneurial drive the demand for microfinance services, particularly for micro and small businesses, has been significant. The influence of Peru's regulatory framework is also believed to have played a significant role in the positive development of Peru's microfinance industry. By facilitating an enabling environment this framework has allowed financial institutions to grow and adopt alternative low-cost distribution channels.

According to the Global Microscope, developed by the Economist Development Unit (EDU), Peru has been the leader of microfinance in the region for several years and its microfinance development framework for this industry is the best in the world. Replicating this framework could thus be a valuable initiative for other economies globally. The Global Microscope has further indicated that there are four major factors of Peru's microfinance development framework that have made it so successful. These four factors are:

1. The regulatory environment which is well suited for, and supportive of, microfinance activities;
2. A competitive and innovative market;
3. Emphasis on consumer protection; and
4. Peru's own economic stability.

The main regulator for microfinance in Peru is the Superintendency of Banking, Insurance and AFP (or Superintendencia de Banca Seguros y AFP) (SBS). Over the years the SBS has implemented a number of regulations aimed at creating a fair and competitive market. Specific examples include no interest rate caps, reasonable capital requirements with low entry barriers and prioritization of transparency for MFIs.

Supporting innovation is also a critical aspect and Peru experience in implementing a wide range of innovative services and has introduced several new technologies to the market. Most of these innovations are facilitated through partnerships with third party stakeholders to deliver products such as microinsurance, remittance transfers, electronic and mobile money, renewable energy, etc.).

In terms of consumer protection, Peru has gone beyond the implementation of best practices and has put significant emphasis on the education of microfinance customers. By building their capacity they are better able to understand financial concepts and also become more aware of their rights. The SBS and Ministry of Education have been particularly supportive of financial capability initiatives and have overseen the implementation of a financial education curriculum for Peruvian schools.

Peru's economic stability has also been a crucial factor enabling the success of their microfinance industry. In this regard, Peru boasts a number of favorable characteristics such as solid macroeconomic fundamentals, a strong domestic market, high international reserves and a profitable and well-capitalized financial sector. Together, each of these factors act to mitigate risks and provide Peru with greater resilience against external "shocks."

### **The Future of Microfinance in Peru**

These developments within Peru's microfinance industry are set to continue. This trend is supported greatly by the increasing participation of new players, particularly within the economy's informal sector, and is driving GDP, investment and employment opportunities. The trend is further bolstered by the rapid growth of financial institutions which is supporting the continuous evolution of the industry. Peru's overemphasis on credit has also left several untapped opportunities for the sector to grow and include larger segments of the population such as people with no savings for retirement, housing for low-income buyers, recipients of government payments and remittances recipients.

One of the major challenges that Peru's microfinance industry currently faces is the growing pressure on MFIs to remain profitable. This has been a result of market competition which has pushed interest rates down. Recent estimates on profitability show a trend of decreasing profitability amongst MFIs. The slowdown of credit and the saturation of some markets are also identified as important factors of this decline. Another challenge is the increasing rate of debt amongst microfinance clients. Competing institutions targeting the same population segments is leading to a growing number of cases clients with multiple loans which has resulted in an increased delinquency rate for the sector.

In order to overcome these challenges, Peru's financial institutions will need to further develop their monitoring capabilities to better keep informed about their existing clients. They will also need to continue expanding outreach to find new clients and expand into new markets. Accessing new markets in rural and underserved areas is of particular importance and the development of new technologies for delivery channels such as electronic money, mobile phones or internet banking are expected to enable greater efficiencies and increased outreach. However, at this stage more progress is needed to develop sustainable business models for these new channels.

### **Key Points**

1. An approach that regulates financial activity in proportion to risk (relative to the size and complexity of the transaction or capability of clients), combined with a unified regulatory framework has dramatically expanded access to finance, especially microcredit. Regulations, such as know your customer requirements, often vary depending on the risk associated with

the loan, notably its volume and complexity. Where early innovative approaches to the provision of services have yet to be adopted, regulators maintain an open view. For example, regulatory possibilities for interoperability in the context of mobile finance remain open.

2. Peru's approach to promoting financial services for the underserved centers regulations on activities rather than on institutions, and prioritizes transparency for private sector actors (such as publishing full prices of services) and consumer protection. The approach is cautious at the early stages of the development of a financial service for the excluded as the foremost concern is about potential harms. For example, providing licenses to e-money issuers has been characterized by a mix of caution at higher levels and a simplified regime with respect to documentation and monitoring. This measured approach is seen as a key to the success of financial inclusion in Peru.
3. Peru has achieved significant gains in access to finance with an approach that can be characterized as 'credit first'. Peru legally recognizes the difference in lending to micro and small and medium enterprises. The emphasis on credit has meant that some 'prior' services are not as developed for the poor as could be, for example payment services and inclusive savings. A robust system of credit information sharing in microfinance works in tandem with risk-appropriate KYC and AML/CFT requirements. This combination may explain much of the success in the provision of credit services for the underserved.
4. Regulations have also been successful at promoting low-cost distribution channels that provide access to lower income segments and increasingly to those in remote regions of Peru. A robust agent based system for the delivery of financial services has dramatically increased access over the last five years, especially among the bottom two quintiles. Financial institutions are responsible for the oversight of agents, keeping with the principle of limiting the number of intermediaries between regulators and providers.
5. Mobile banking and e-money promise to further expand access to finance, especially in regions without any access points in the form of agents or branches. E-money for prudential and consumer protection reasons remains a distribution channel, meaning that value stored in these devices cannot take the form of interest generating deposits. By keeping e-money a distribution channel, regulators can proceed cautiously, waiting to identify e-money specific issues around safety and soundness and consumer protection, before any expansion of e-money into banking.
6. Challenges remain as rising competition in the sector is leading to decreasing profit margins which in turn may be encouraging increased lending to already indebted borrowers, i.e., leading to over indebtedness. There is a tension between the tools that enable access and the mechanisms that prevent reckless lending. It is the role of regulators to monitor the system and respond effectively to maintain market equilibrium.

## Chapter 4: India

*Session Chair:*

Ms. Nina Nayar, Associate, The Foundation For Development Cooperation (FDC)

*Speakers:*

1. Mr. Arvind Kumar, Joint Secretary, Department of Financial Services, Ministry of Finance, Government of India
2. Mr. Alok Prasad, CEO, Micro Finance Institutions Network (MFIN)

*Panelists:*

1. Mr Sanjay Sinha, Managing Director, Micro-Credit Ratings International Ltd.

India's microfinance sector has made significant contributions to the global microfinance industry, however, it could benefit greatly from learning from other countries within and beyond the region, with notable mention of the Philippines and Peru where regulatory reform and sector-wide innovation have resulted from effective public-private collaboration. While India has made a considerable effort to bring about needed reform within its regulatory framework for sustainable microfinance provision, about half of the economy's population remains unbanked and beyond the reach of formal financial institutions.

Spanning more than two decades, India's microfinance sector has evolved considerably both in terms of institutional and policy development. The 2010 "microfinance crisis" in Andhra Pradesh provided a unique case study and produced several important lessons. Following the crisis, India's MFIs have placed greater emphasis on responsible practices and the sector is now beginning to regain lost ground. But pressures remain to expand beyond existing markets and reach new geographic areas.

Common perceptions within India's regulatory authorities of microfinance being a development program rather than a viable market are now beginning to change as more MFIs are demonstrating profitability, efficiency and growth. Regulators have more recently made important steps to support greater self-regulation through microfinance associations as a way to complement statutory measures. While these developments represent important progress, greater reforms are still needed in order for India to achieve its full potential for financial inclusion.

### Priority Sector Lending

As part of the Indian government's efforts to increase financial inclusion they have established the Priority Sector Lending (PSL) role. The PSL role is administered by the Reserve Bank of India (RBI) and is given to banks to dedicate a specific amount of their lending portfolio to specific development, or priority, sectors. These specific sectors, which include agriculture, MSMEs, education, housing and export credit, are identified as sectors which may not get timely and adequate credit without the PSL. In most cases the PSL helps to support the delivery of small value loans to low income groups and aims to provide a more balanced development of the economy rather than specific focus on the financial sector.

For example, for the agriculture sector PSL has enabled direct finance through micro loans to individual farmers including for the purchase of land or to distressed farmers that are indebted

to non-institutional lenders. Loans are also provided to corporates including farmers' producer companies, partnership firms and co-operatives of farmers directly engaged in agriculture activities. Bank loans are also provided to Primary Agriculture Credit Societies (PACS), Farmers' Service Societies (FSS) ceded to or managed by the banks for on-lending to farmers for agricultural and allied activities.

## **The Evolution of India's Microfinance Sector**

The start of India's microfinance sector evolution began in the mid 1990's in what can be regarded as the "exploratory phase." Throughout this period NGOs began to emerge and receive funding for microfinance activities. However, at the time microfinance was perceived as high risk and limited support from the credit bureau and the collateral free assistance proved to be major challenges.

From 2000 to 2009 the sector experienced a "growth phase" in which the Small Industries Development Bank of India (SIDBI) emerged as the first lender to MFIs and a full range of need based products for clients was developed. Some major achievements during this period include the successful implementation of India's National Microfinance Support Programme which provides direct support to financial institutions under the guarantee of the central government, developments in the operational and financial sustainability of MFIs and the use of standardized rating tools for MFI capacity assessments. Key learnings that emerged during this phase were the needs for adequate regulation, greater transparency and stronger governance models.

Since 2009 the sector has shifted its focus to responsible lending and greater emphasis on managing growth and reaching underserved population segments. In 2010, India established its Lenders Forum to promote transparent, responsible and commercially sustainable industry practices and codes of conduct in order to better safeguard the interests of the poor and unbanked. This initiative is led by SIDBI and its members account for approximately 80 per cent of all microfinance support to India's MFIs including ICICI Bank, HDFC Bank, Union Bank of India, IDBI Bank, Axis Bank, Rabo India, RBS, HSBC, IndusInd Bank and Syndicate Bank. In order to promote better codes of conduct amongst MFIs, Micro-Credit Ratings International Ltd (M-CRIL) developed a Code of Conduct Assessment (COCA) tool. This tool has allowed an independent agency to conduct assessments on MFIs to determine their adherence to the established code of conduct. The establishment of the Lenders Forum and COCA tool has paved the way for India's microfinance sector to further acknowledge the need for client focused strategies and greater collaboration amongst stakeholders.

Following India's "microfinance crisis" in Andhra Pradesh the RBI developed several new initiatives in an attempt to limit inappropriate practices and quell the growing uncertainty about the viability and impact of the microfinance market. Some of these initiatives included adding MFIs under the PSL, creating a new institutional category for non-bank financial company (NBFC) MFIs along with guidelines and a code for fair practice and the establishment of margin and interest rate caps for all MFIs. Currently the margin cap for MFIs stands at 12 per cent whereas the interest rate cap on individual loans is 26 per cent (to be calculated on a reducing balance basis) for it to be classified under PSL. Otherwise, the interest rate cap is 2.75 times the average base rate of the 5 largest commercial banks.

India's government has continued its attempts to further financial inclusion with varied results. In 2012, the Microfinance Institutions (Development and Regulation) Bill was introduced. The overall goal of this Bill was to provide a statutory framework for the development, promotion, orderly growth and regulation of MFIs and to bring them under a uniform regulatory framework. Some of the major provisions of the Bill include regulation of microfinance services to be subject to registration with the RBI, introducing an upper ceiling on loan amounts, setting a maximum



interest rate/cap, the appointment of an Ombudsman for the microfinance sector, the creation of microfinance development funds and the establishment of a State Microfinance Council. This Bill has since lapsed with the dissolution of the lower house of Parliament, however, several other initiatives are underway including support for the expansion of physical bank branches, increasing ATM installations, a Direct Benefit Transfer (DBT) of Government Schemes, the establishment of the India Micro Equity Fund for MFIs and Credit Guarantee Funds for SMEs, skill development and education.

### India's Microfinance Sector Today

India's finance sector contains a plethora of institutions and policies aimed at driving greater financial inclusion. However, despite the wide range of active stakeholders current estimates indicate that up to half of India's population remains unbanked. The sector is further characterized by an extremely high number of dormant accounts and limited access to credit facilities.

As part of the government's response after the "microfinance crisis" in Andhra Pradesh, the RBI agreed to formally recognize microfinance associations as a way to increase self-regulation within the sector. As a self-regulatory organization (SRO), these associations can establish code of conducts for their member MFIs. SROs are not intended to be a replacement for statutory regulation, but to complement it. There are several specific expectations from RBI for SROs which include:

- Exercising surveillance over the industry to ensure compliance with RBI's regulatory prescriptions and industry code of conduct. As part of this, SROs are also expected to appoint a dedicated Compliance Officer who will have a direct reporting relationship with RBI;
- Formation of an Enforcement Committee to deal with MFI members who breach the code of conduct;
- Providing grievance redressal and dispute resolution mechanisms for MFI clients;
- Conducting investigations into areas of concern and provide data as required to the RBI; and
- Performing development functions such as providing capacity building, awareness programs and conducting research for the microfinance sector.

While the government's support for SROs has been regarded amongst stakeholders as a positive development, greater reforms are still needed in order for India to achieve its full potential for financial inclusion. In this regard, introduction of a Micro Finance Bill should be a priority immediately after the new government takes over by May-June 2014. There is also a growing concern that the increased emphasis on consumer protection following the crisis has led to a stifling of innovation within the sector. Another challenge stems from the growing number of general purpose institutions and not enough specialization. This is particularly important for policy makers as specialist institutions will be better able to provide credible and higher quality advice pertaining to specific issues impacting the sector. Reaching scale is another common issue with many proposed financial inclusion solutions not able to support the needed scale. Lastly, solutions need to be sustainable and make economic sense in order to be viable.

## Key Points

1. Indiscriminate lending in an un-organised environment and without the necessary checks and balances or due diligence by MFIs, especially in the mid and later half of the first decade of 21st century, and the coercive practices adopted for recovery led to the microfinance crisis in India in 2010 – with continuing consequences. The need for an appropriately regulated MFI market is evident, and underscores the importance of the current MFI Bill.
2. Among the various factors stifling financial inclusion is a key concern that the amplified commitment to consumer protection may be constraining potential innovation. Going forward India's regulatory reform needs to balance risk mitigation and consumer protection with taking up the challenge of experimenting with new products and delivery mechanisms, especially for savings.
3. Specialization, scale and sustainability are integral pillars for achieving financial inclusion. The challenge of financial inclusion can only be met if delivery mechanisms are customised to meet the needs and respond to the constraints of different niche markets and regional variations in institutional models and transaction costs. Further, meeting the outreach targets will require the overhaul or review of existing institutions, supporting the design of innovative delivery mechanisms leveraging the potential of modern information technology, and focusing on consumer service-oriented approaches, including developing specialized operations staff. Sustainability will require a realistic costing and pricing of financial products and services based on the actual cost of funds, institutional models and transaction costs in specific geographic locations rather than a one-size-fits-all approach.

## Chapter 5: Thailand

*Session Chair:*

Dr. Luxmon Attapich, Senior Country Economist, Thailand Resident Mission, Asian Development Bank

*Speakers:*

1. Mr Chanachai Prayoosin, Director, Bureau of Financial Inclusion Policy and Development, Fiscal Policy Office, Ministry of Finance, Thailand
2. Mr. Surapol Opasatien, CEO, National Credit Bureau Co., Ltd.

*Panelists:*

1. Mr. Eric Duflos, Regional Representative for East Asia and the Pacific, CGAP
2. Mr. Kazuto Tsuji, Visiting Senior Advisor, Japan International Cooperation Agency (JICA)/ Professor, Saitama University, Japan/The Executive Committee Chair, CGAP

Thailand's progress towards financial inclusion has been impressive with current estimates indicating that the level of financial access is very high. However, financial inequality and issues with demand for financial services, particularly amongst the low-income population segments, are creating challenges. An important advantage that Thailand has to assist in overcoming these challenges is the amount of broad data available about its financial market. Such broad data is uncommon relative to many other economies in the region and of significant benefit in developing financial inclusion strategies.

Thailand also provides useful examples of the role of institutions such as credit bureaus and state-owned banks in achieving financial inclusion. These institutions, which have evolved significantly in Thailand over the last decade, highlight examples of strengths and weaknesses within their roles of expanding access to products and services and supporting policy development. By providing credit information on individuals and businesses the credit bureau plays a particularly important part in the overall risk management of the sector. Thailand's credit bureau has also contributed greatly to evaluating the rising levels of household debt, which is of growing concern to policy and regulators, and actively supports financial literacy to help ensure that clients are capable of using financial services.

The future of financial inclusion in Thailand looks positive with a number of opportunities currently being considered as ways to overcome challenges and further develop the market. A number of government-supported financial inclusion initiatives are currently underway to take advantage of these opportunities and enhance the quality and quantity of financial products and services to support the poorest segments of the population.

### Financial Inclusion in Thailand

Access to financial services in Thailand is very high, however, rather than financial exclusion being a major issue the financial sector is characterized by financial inequality. This is a growing issue for the economy with the most recent data indicating that nearly 90 per cent of total accounts hold less than 50,000 baht each and make up only 4 per cent of the total deposits. On the other hand, accounts with more than 1 million baht account for about 70 per cent of total deposits but are held within about 4 per cent of the total accounts. Even though bank accounts are widespread and generally easily accessible, most accounts remain dormant and are only used

for occasional transfers. However, Thailand considers the total number of active bank accounts as only one aspect of financial inclusion.

Using the definition established by the United Nations, Thailand views financial inclusion as the “provision of access to a wide range of convenient and affordable financial services, including savings, credit, insurance, pensions, payments and remittances to all categories of the population, including the low-income and most vulnerable.” Following this definition, Thailand’s financial inclusion goals are broad and include the provision of universal access to a range of financial services with reasonable prices and costs and that these products and services are provided in a sound and sustainable manner, both financially as well as institutionally.

### **Supply of Microfinance Services**

The supply of microfinance services in Thailand is provided through a range of institutions including formal providers such as commercial banks, finance companies, credit fonciers, specialized financial institutions (SFIs) and non-bank financial institutions. There are also a number of cooperatives and village funds which make up the semi-formal sector as well as informal providers such as savings groups and money lenders. Regulation for the formal financial sector is provided by both the Central Bank and Ministry of Finance (prudential regulation) whereas the semi-formal sector is regulated by the Ministry of Agriculture and Cooperatives and the National Village and Urban Community Fund Office (non-prudential regulation). Thailand’s semi-formal sector is particularly important as the number of members within cooperatives and village funds is significant with more than 20 million cooperative members and 12 million village fund members.

With its diverse range of institutions Thailand’s financial sector has several supply options. However, several supply limitations also exist; particularly for reaching lower income segments. For formal institutions, cost is a major issue, particularly for commercial banks as low-value transactions are viewed as too costly, especially with the current cap on interest rates. Other supply limitations stem from the inability to adequately evaluate the performance and impact of financial institutions (i.e. evaluating the microfinance outreach of SFIs) or working with alternative collaterals (i.e. moveables).

Supply limitations for the semi-formal sector include the lack of a credit information system for borrowers of community-based financial institutions and incomplete information on the coverage of community-based financial institutions. Access to capital and the lack of a systematic or unified regulation scheme are also challenges for Thailand’s community-based financial institutions.

### **Demand of Microfinance Services**

In terms of demand of financial services the Central Bank conducted a survey of over 11,000 households in 2010 to better understand the usage of financial services. The results showed that nearly 60 per cent of respondents used the services of commercial banks (both local and foreign) followed by nearly 20 per cent who used SFIs. Cooperatives and village funds totalled about 4 per cent whereas the informal sector (money lenders or local savings groups) had about 3 per cent. About 12 per cent of households did not use any financial services, despite having access, and about 4 per cent had no access to financial services at all.

One of the key findings of this survey was regarding the use of bank accounts. Of the households surveyed, 74 per cent of them reported having a bank account. The remaining 26 per cent did not, with the primary reasons being no need due to lack of income or assets or not having any money

left over after paying other expenses. This information highlighted that the most major reason people were not using bank accounts was simply because they had inadequate income streams to warrant a deposit. Further to this, despite not using formal bank accounts, the ability to save money even outside of financial institutions is also not feasible for many due to lack of income or having left over funds after expenses.

According to recent data<sup>1</sup>, the most prominent methods of borrowing are from village funds and SFIs, taking about 30 per cent of total borrowers each. These two methods outperform other methods significantly, with commercial banks only lending to 9 per cent followed by savings groups or community banks with 7 per cent. Of those that do receive loans the majority do so for agricultural investments. However, a significant portion of the population (nearly 60 per cent) does not borrow due to a range of reasons such as fear of indebtedness, worry about inability to repay, see no necessity to borrow or feel that interest rates are too high. This data presents an argument that loan products should cater more towards the agricultural sector and short-term borrowers. Furthermore, Thai people generally remain fearful of borrowing and this is likely due to a perception of high interest rates.

Transfers and payments are other uses for bank accounts in Thailand. The 2010 survey indicated that the majority (about 35 per cent of respondents) used commercial bank accounts for these services. The most prominent uses include utilities payments, remittances and credit card payments. However, about 50 per cent of the respondents stated that they choose not to use any service (formal or informal) for transfers or payments.

While access to financial services in Thailand is very high, there are still a number of challenges relating to the demand for these services. The distance to banks is a common physical problem, however, this is slowly being overcome with the establishment of more bank branches and the implementation of new mobile banking services. People's confidence is another issue as many are fearful of debt and uncertain about their ability to repay loans. Their actual ability to repay loans is also a problem since many simply don't have sustainable incomes. Other demand problems include interest levels (i.e. people not seeing the need for financial services) or the quality of products, particularly for low-income population segments.

### **The Role of Thailand's Credit Bureau in Financial Inclusion**

Following the 1997 Asian Financial Crisis Thailand set up the National Credit Bureau (NCB) with support from the International Monetary Fund (IMF). The NCB only collects credit information from financial loan agreements and does not collect alternative data such as utility payments or phone numbers of borrowers. Members of the NCB are made up of formal sector institutions such as commercial banks, SFIs (excluding the Bank for Agriculture and Agricultural Cooperatives (BAAC)), consumer finance companies, and hire-purchase/leasing companies, but not semi-formal institutions such as cooperatives or village funds. In case of BAAC, it is currently in the member application process and plans to submit data to the NCB by year 2014. At the end of 3<sup>rd</sup> quarter of 2013, household debt in Thailand was 80.1 per cent of GDP (latest update: 4<sup>th</sup> quarter of 2013 is 82.3 per cent of GDP). Approximately one-third of this debt is from bank loans and the debt service ratio of households in Thailand has been experiencing a sharp rise recently.

Thailand's credit analysis process changed dramatically after the 1997 crisis. Prior to the crisis, much of this process was handled by individual branches and loans were mostly based on collateral. Branch staff would analyse and review credit by themselves and pricing was usually based on relationships. Today, this process has been reformed dramatically to significantly reduce risks. To provide additional oversight, risk management committees are now appointed

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<sup>1</sup> Source: FinScope Thailand, 2013

along with relationship managers and sales teams to handle customer acquisition. Customer information is then passed to the bank's headquarters for credit review and approval. The analysis is conducted using tools such as internal credit rating and internal credit scoring. Large loans are decided by a special credit reviewing committee and pricing is now formula-based with the risk-adjusted return on capital (RAROC) method. After credit is approved, operation of the loan can be facilitated by other regional centres.

The NCB plays an important role in Thailand's financial inclusion strategy. For its financial institutions members, the NCB provides credit information on individuals and companies for professional credit analysis and statistic reports as a risk management tool. The NCB also supports the public by providing warnings about increases in bad debt and also supports educational programs to improve financial literacy, particularly aspects such as creditworthiness, overindebtedness and saving. Within this role, NCB aims to be more than just a data provider but an integral part of Thailand's financial infrastructure for credit risk governance.

### **The Role of State-Owned Financial Institutions**

One of the several reasons why Thailand has achieved such a high level of financial inclusion is the role of state-owned financial institutions, particularly their role in expanding microfinance services to rural areas. Thailand's Bank for Agriculture and Agricultural Cooperatives (BAAC) provides a very good example of the potential impact state-owned financial institutions can have on financial inclusion.

In terms of governance, BAAC has followed a general overall policy by the government but have kept operational independence of political interference. While government banks in many other economies are more commercialized or have ended up bankrupt, BAAC's governance is well balanced between policy and independence for operations.

BAAC mainly depends on savings, not subsidized government funds, for fund mobilization, and its fund usage has been based on due diligence and financial discipline. BAAC's financial health, financial products for farmers, institutional enhancement of cooperatives and non-financial services have been highly respected.

BAAC started their operations in the market of the "moderately poor" but under the current circumstances the bank may decide to become more commercialized or instead shift their focus more towards the poorest segments of the society. The particular direction BAAC takes could lead to significant impacts on financial inclusion in terms of both policy and practice.

### **The Future of Financial Inclusion in Thailand**

With access to financial services less of a concern, Thailand's efforts will in future focus more on solving demand challenges and ensuring that appropriate products are available. Community-based financial institutions are seen as an important part of this future as they are already well established throughout the economy. The next step is to make these community-based financial institutions more stable and sustainable with a systematic, yet flexible, regulatory system. This regulatory framework should ensure that the same regulation is used for the same types of activities and more stringent regulation be applied to institutions with greater number of deposits and those serving the wider public.

The development of mobile/electronic banking platforms is not regarded as a priority in Thailand, but is still seen as a positive development. As these platforms are developed and implemented, they are expected to reduce the cost of cash and also the costs for clients who would

otherwise need to travel to access banks or SFIs. Mobile/electronic money services will also provide a useful method for community-based financial institutions to gather information from transactions and possibly result in the credit information system becoming more inclusive.

Microinsurance is also regarded as an important aspect of Thailand's financial inclusion goals and efforts are underway to support the development of these products. More specifically, Thailand aims to create products that accommodate risks linked to income generation (i.e. accidents, extended illness, job loss, etc.), broaden options for microinsurance distribution and premium payments and to rethink the design of microinsurance products rather than simply providing micro versions of traditional products. Awareness raising programs are also necessary in order to help people better understand the concepts of premiums and benefits.

Underscoring all of these efforts to improve financial inclusion in Thailand will be the Financial Inclusion Master Plan which is currently being drafted by the Ministry of Finance. The Master Plan aims to support the supply and demand of financial services by focusing on building the capacity of both the financial service providers as well as the recipients. To support service providers the Master Plan intends to facilitate greater sustainability for community-based financial institutions, upgrade the network of village funds to full-fledged financial institutions, improve linkages between community-based financial institutions and their respective networks, expand the role of SFIs to better serve low-income population segments and support commercial banks and non-bank institutions to have bigger roles in the microfinance sector. The recipients of financial services will benefit from the Master Plan through the systematic and continuous capacity building for financial management skills, enhanced mechanisms for tools used to educate the people, improved ways to education people about illegal financial activities and enabling people to have stable income streams through career-training. The Master Plan will also focus on improving Thailand's financial infrastructure. Some important aspects of this focus will include drafting and amending laws relating to microfinance to better accommodate the existing demands of microloans and provide greater consumer protection, establishing regulatory bodies to supervise the Master Plan's implementation and to solve problems with informal loans (i.e. loan sharks), the development of a database to collect information to support effective policy-making and to re-model regulatory structures of microfinance activities.

## Key Points

1. Access to financial services in Thailand is very high, however, most of this is limited to access to credit only. Access to other important products, such as savings, is far more limited. While expanding the range of products and services will be important for Thailand in the near future it is also important that the quality of these products and services be assessed.
2. By addressing the issues of quantity as well as quality, Thailand will be better placed to make a positive impact within the financial sector. This will be especially important in overcoming some serious challenges currently being faced such as emerging over-indebtedness and growing financial inequality in a highly developed market due to years of subsidized credit from government banks.
3. The data collected by the National Credit Bureau (NCB) is useful for informing financial policy in Thailand. However, since currently only the commercial banks, specialised financial institutions (SFIs) (except BAAC), consumer finance companies, and hire-purchase/leasing companies provide data to the NCB, this role is limited. With the semi-formal sector becoming increasingly important for financial inclusion in Thailand, NCB needs support from the government, regulators as well as the semi-formal sector itself to realize the significance of the single database. Once semi-formal institutions and village funds become NCB's members

and submit data, this database can be used alongside the formal sector data for policy recommendations.

4. The case of Thailand's semi-formal sector, particularly the village funds, is of particular interest as they have managed to operate continually for many years, whereas most village funds in other economies typically only last for a few years. This demonstrates the strength and importance of Thailand's semi-formal sector and further highlights the potential for useful lessons to understand the reasons for the longevity of these village funds.
5. In order to ensure continued innovation in and the sustainability of Thailand's microfinance sector, greater private sector participation is needed, however, the current regulatory framework is not conducive for this. As such, regulatory reforms will be necessary to make the microfinance market more appealing and encourage greater private sector involvement, as well as the redefinition of the roles of SFIs.



## Chapter 6: Indonesia

*Session Chair:*

Dr. Aladdin D. Rillo, Senior Economist, Asian Development Bank Institute (ADBI)

*Speakers:*

1. Mr. Parjiono Ciptowidarto, Director, Center of Regional and Bilateral Policy, Fiscal Policy Agency, Ministry of Finance, Indonesia
2. Mrs. Eni V. Panggabean, Executive Director, Financial Access and SME Development Department, Bank Indonesia
3. Mr. Budi Satria, Regional Manager, Bank Rakyat Indonesia

*Panelists:*

1. Ms. Leesa Shrader, Senior Consultant, Consultative Group to Assist the Poor (CGAP)
2. Panelist 2: Mr. Ivan Mortimer-Schutts, Leader for Retail Payments and Mobile Banking in East Asia, International Finance Corporation (IFC)

According to a World Bank survey conducted in 2011, 68 per cent of Indonesian households have access to saving services. Meanwhile, results from a household survey conducted by Indonesia's Central Bank, Bank Indonesia (BI), in 2011 concluded that only 48 per cent of households are saving their money. With regard to credit, the World Bank estimated that 60 per cent of households had access to credit, whereas BI's results concluded that only 45 per cent had access to credit, the majority of which (30 per cent) is provided by non-financial institutions. The different results from these two separate surveys was mainly due to different methodologies and areas adopted in the survey.

From those surveys conducted in Indonesia, the message remains clear that significant challenges and opportunities remain for Indonesia to achieve financial inclusion. Government support has been growing for financial inclusion initiatives and the private sector has also recognised its important role in this process and many steps have been taken to increase their engagement as active stakeholders.

With motivation for financial inclusion initiatives growing following a number of key achievements in recent years, Indonesia's financial sector is now producing some of the most innovative products and services in the region. These accomplishments place the economy in a strong position to make significant progress towards financial inclusion in the near future as innovative technologies and methodologies are used to overcome current challenges.

### Overview of Indonesia's Financial Sector

According to an assessment undertaken by the World Bank in 2011 only 20 per cent of Indonesia's adults have accounts in formal financial institutions and 17 per cent of the total population is regarded as underserved or unbanked. 52 per cent of the population is believed to have access to financial services through the formal sector, whereas 31 per cent receive services through the informal or semi-formal sectors.

Indonesia's equity market has developed steadily over the last several years with an average annual growth of 15.4 per cent. However, in comparison to other Asian economies, Indonesia's

financial sector still ranks very low in terms of total financial assets, credit to the private sector, equity market capitalization and gross national income (GNI) per capita.

Despite these low rankings, Indonesia has a robust and resilient market with significant opportunities to grow. Major challenges for the market include supply-side barriers such as high transaction costs, suitable regulatory frameworks, inequality of development and geographical barriers. On the demand-side, key challenges include low levels of financial literacy and financial capacity, lack of a formal identification system and the inability to monitor an individual's track history.

### **Developing an Inclusive Financial Sector**

In order to develop an inclusive financial sector that supports the real economy, a number of priorities have been identified. The first of these priorities is to create further "financial deepening" within the market. Specific initiatives being considered to achieve this include the development of a government bond market, development of an electronic trading platform, harmonizing monitoring and regulation, developing a regional bond market and reforming taxation. Increasing financial inclusion is another priority and the Indonesian government plans to focus on six key issues, these being financial education, financial eligibility, policy and regulation, distribution channels, consumer protection and public finance. The third priority for the development of the sector is to strengthen financial stability. This will be done by establishing a Financial System Stability Coordination Forum that will include key stakeholders such as the Ministry of Finance, BI, Indonesia's Financial Service Authority (Otoritas Jasa Keuangan) and Indonesia's Deposit Insurance Corporation (Lembaga Penjamin Simpanan). Other initiatives as part of this priority will be the establishment of a special Investor Relation Unit within the government and further strengthening of the current bond stabilization framework.

Indonesia's framework for financial inclusion aims to improve access to the financial system through enhancing economic and financial capability as well as people's awareness of the importance of the financial system. This framework is designed specifically address income equality, poverty alleviation and financial system stability. Migrant workers and people living in remote areas are part of the primary target and the framework incorporates a range of distribution channels and products and services delivered by both the public and private sectors.

### **Achievements and Challenges in Indonesia's Progress towards Financial Inclusion**

One of the major achievements in Indonesia has been the establishment of bank offices and ATMs, the number of which have steadily increased each year. As of January 2014 the total number of bank offices reached 35,931 and the number of ATMs reached 76,348. In terms of usage, savings accounts still make up the largest portion of bank's total deposits (95.7 per cent as of January 2014). The dominance of savings accounts continues to increase gradually each year.

BI is a major supporter in Indonesia's efforts to achieve financial inclusion and has initiated a number of financial inclusion programs. One significant initiative that BI has been working on is the implementation of digital financial services. Currently, Indonesia has an estimated 240 million mobile phone connections. Once digital financial services have been made possible it is expected that this will greatly enhance access to financial and payment services for urban and rural areas. To prepare for broader roll out of digital financial services BI conducted a pilot project which specifically targeted rural areas and examined their interactions with digital services. The results of this pilot project were very positive and over the course of the program the frequency of transactions through agent banks increased significantly. Based on these findings, BI has now begun preparing appropriate regulation to accommodate these needs. Other programs that have

been initiated by BI include support for MSMEs and food security commodities. BI is also supporting the development of a financial inclusion index of which the content usage and access dimensions will be based on international best practice.

For Indonesia to continue successfully progressing financial inclusion there are a number of challenges that will need to be addressed. One significant challenge is the diverse demographic and geographic environment. Greater collaboration amongst stakeholders is also needed to increase the effectiveness and efficiency of financial inclusion programs. Other important challenges include levels of financial literacy which is resulting in the slow uptake of new technology and innovative financial services and changing people's negative perceptions of using formal financial services.

To overcome these challenges and move forward Indonesia plans to put greater emphasis within its strategies on a number of issues. The first is to recognize the importance of strong collaboration and coordination among stakeholders to achieve synergy and avoid redundancy for efficiency and effectiveness. Another important aspect is to improve financial literacy with the aim of increasing financial capability and assist in the effectiveness of financial inclusion through financial education programs. Greater focus is also needed on initiatives that will help to facilitate social reengineering to change people's perceptions of using financial services. Lastly, greater support for the development and implementation of innovative delivery channels will increase and broaden the outreach of financial services to the unbanked.

### **The Experiences of Bank Rakyat Indonesia**

Bank Rakyat Indonesia (BRI) has a strong focus on expanding financial access throughout Indonesia. The bank's strategy behind this is to create suitable products and establish outlets that are equipped with effective IT systems. Currently, BRI offers a broad range of products relating to credit, savings, insurance and payments. BRI's loan products are specifically designed to meet the needs of all types of clients with the financing model based on entrepreneurship maturity. The bank's savings products are equipped with modern IT solutions to offer more dynamic experiences and to make them more accessible.

In its attempts to broaden financial access, BRI has established Indonesia's largest and most extensive network of financial outlets. This network includes conventional outlets such as regional offices, branches and cash offices. It also includes a wide range of electronic channels such as ATMs, electronic data capture machines and Kiosks. To bring financial access to their clients BRI has employed a number of innovative methods such as mobile banking services brought to rural areas by a fleet of vehicles, or a traveling bus that provides school children with financial education training. To reach clients on Indonesia's many remote islands BRI is currently developing a boat that will be capable of traveling between islands to provide financial services.

BRI recognizes that its own human capital is an important aspect of its financial inclusion strategy. With over 100,000 employees, BRI aims to continuously increase the capabilities of its staff by requiring each of them to attend at least one RBI-facilitated training course per year.

### **CGAP's Applied Product Innovation Program**

Customer-centric design methodologies are commonly used in a range of industries to better tailor their products and services to their clients. With this approach, the insights from clients are gathered through a series of consultations. These client insights are then featured heavily in the design process of products and services. With the Applied Product Innovation (API) program, the Consultative Group to Assist the Poor (CGAP) aims to test these methodologies to see how they

can be tailored specifically to branchless banking and improve financial products and services for the poor.

In partnership with Bank Tabungan Pensiunan Nasional (BTPN), the overall approach of the API program has focused on identifying human needs, market and technology possibilities and then finding ways to turn these into business opportunities and concepts that BTPN could take to market. This process begins with research and synthesis, conducted in collaboration with a broader range of stakeholders to extend shared knowledge, to better understand underserved or unbanked potential clients. This included primary data collection through interviews with agents and customers. In total, 72 in-depth interviews were conducted. Based on each of the responses a number of personas, or stylized abstractions of typical consumers found within the target market, were developed for assessment. These personas provide an overview of the unique characteristics of individuals such as names, ages, family, income and expenses. But more importantly, they provide a more in-depth view of the individual's needs, priorities and ambitions in life. The development of rich personas is a valuable tool for product design as it helps to inject the voice of the client within the innovation process.

Following the completion of the synthesis of these personas, a series of brainstorming sessions were held to formulate ideas for ways in which products and services could be improved based on BTPN's customer experience from acquisition to retention. These concepts were then shortlisted and further developed with the focus being on optimizing user satisfaction. With low fidelity prototypes developed from the concepts a series of tests were conducted in order to continue refining the concepts.

The API program led to a number of important human-centered insights that were later used as part of BTPN's product design for branchless banking. The insights have been particularly useful in strengthening BTPN's understanding of their clients/potential clients' needs. Specific issues which were highlighted through the analysis included the relationship between individuals and their community, how trust is gained and maintained, the importance of informal social channels for financial literacy and how to attract customers to new products and services.

## Key Points

1. Financial inclusion strategies need to take into account the various interests of all stakeholders. Effective partnerships are particularly important and in the case of Indonesia more needs to be done to ensure that there are policies and proportionate regulations in place to create space and flexibility for financial inclusion initiatives. The private sector also needs to ensure that the market infrastructure is adequately developed for financial inclusion initiatives to be successful.
2. Financial inclusion needs to be examined as a means by which other development objectives can be addressed. This requires a balance of financial inclusion strategies with other policy objectives. In the case of Indonesia there are a number of structural issues that need to be addressed before this can be achieved.
3. CGAP's Applied Product Innovation (API) program has highlighted how customer-centric design methodologies can be used to improve the suitability and attractiveness of financial products and services, particularly with branchless banking services aimed at the poor. Through this approach the design process of innovative products and services can be enhanced by including the "voices" of individuals which these products and services intend to support.

## Chapter 7: Regional Developments and Key Initiatives

*Session Chair:*

Dr. Julius Caesar Parrenas, Advisor on International Affairs, The Bank of Tokyo-Mitsubishi UFJ, Ltd.

*Speakers:*

1. Prof. Naoyuki Yoshino, Chair of Financial System Council and Professor of Economics, Keio University, Japan
2. Ms. Briony Wood-Ingram, Projects and Programs Coordinator, Australian APEC Study Centre, RMIT University
3. Dr. John Barry, Senior Vice President of Government Affairs and Public Policy for Asia-Pacific, Europe, the Middle East and Africa (APCEMEA), Visa Inc.

Achieving financial inclusion requires the efforts of a broad range of stakeholders working together with each fulfilling distinct roles. The forgoing summarises the current situation of financial inclusion in six economies. While there are more than six economies in the region, with great diversity among each of them, the intention has been to compare and contrast the progress that has been made since financial inclusion became a focus of concerted efforts in decision making fora such as APEC and the G20 a few years ago, and a better understanding of next generation issues.

Policy makers and regulators have a responsibility to address directly these issues within their respective jurisdictions by introducing, implementing and enforcing laws and regulations. It is clear, however, that in most developing economies, there is a huge need to build capacity to design effective laws, implement rules and policies, build political support for reforms, establish institutional architectures, and to develop skills and capacity to continuously adjust rules and regulations to a continuously evolving market. Providing opportunities to build this capacity remains a serious challenge for the region.

Several organisations representing public development institutions, academic institutions and the private sector outlined initiatives illustrating the diversity of approaches adopted, but also how their efforts can be complementary of each other as well as with other major institutions. This assembly of diverse approaches and experiences represents a significant opportunity to increase the effectiveness of financial inclusion programs by making greater use of the resources and knowledge available in the region.

### **Financial Inclusion and Financial Education: Japan's Experience and Its Lessons to Asian Countries**

Nearly 60 per cent of all assets managed in Japan are from cash and deposits and the total amount of marketable securities and shares is very small; particularly in comparison with other developed economies like the USA or Germany. The majority of household assets in Japan (around 80 per cent) are considered "safe assets" such as currency and deposits, insurance or pension reserves. Only a very small percentage of households take on risky assets such as investment trusts or shares and other equities. This conservative culture is further highlighted in how customers in Japan choose financial institutions. It is estimated that 50 per cent of people using financial services choose their financial institutions based on safety rather than the prospective of high rate of return.

Over the last two decades the ratio of household savings in Japan has steadily declined. Traditionally, the Japanese culture has supported the view that hard work and accumulating savings was key to improving wellbeing. This mindset was reinforced at home, schools and work places and enforced perceptions that “easy money” (i.e. money earned from investments) was unworthy. This perception is now slowly changing and more Japanese are now engaging in investment. However, their average earnings on investment are still very low when compared with other developed economies.

Due to the cultural views of finance, financial education, particularly education on topics such as investment, have rarely been included within the primary and secondary school systems. Due to this lack of foundational knowledge at young ages, most school teachers would also be considered not fully prepared to teach subjects on financial education even if it were formally integrated into school curriculum. To overcome this, one idea that is currently being explored is to have schools employ retirees from financial institutions to provide some basic financial education to pupils.

Following the most recent financial crisis, there has been growing consensus within Japan of the need to promote greater financial education. To achieve this Japan’s Financial Services Agency, which provides oversight for banking, securities and exchange and insurance, established the Study Group on Financial Education in 2012. This group, which is made up of financial experts, government ministries and other key organizations, was tasked with undertaking a comprehensive review of the status of Japan’s financial education and to develop a strategy for the future. The outcomes of the Group’s review were published in a report in 2013.

This report has highlighted a number of factors that should be the basis of a financial education framework. The first is the need for greater emphasis on behavior aspects, such as changing the negative perceptions within the general population about investment. Secondly, the framework should facilitate a common minimum level of financial literacy. These targets should be shared amongst relevant stakeholders so that they can be supported within educational activities. The establishment of standards for systematic educational content is also an important aspect of the framework. These standards would help to develop specific content for financial education programs based on age groups and other relevant categories. In relation to working with the recipients of financial education programs, the framework should facilitate an appropriate balance between working adults and senior citizens as well as students.

## **Evaluating Regulatory Frameworks for Financial Inclusion**

In 1998 the Banking with the Poor Network (BWTP) publish a report titled *Getting the Framework Right: Policy and Regulation for Microfinance in Asia*. This report provided a review of regulatory environments in Asia and examined factors which were hindering their development, and subsequently the development of the microfinance sector. In 2010, BWTP revisited this report and provided an update, this time highlighting the progress in regulatory frameworks in the region since the initial review 12 years earlier. The case studies provided within the updated report provide a thorough understanding of how regulatory frameworks had developed and also provided important insights into the strengths and weaknesses of these frameworks.

In 2013 the Foundation for Development Cooperation (FDC) engaged with the Australian APEC Study Centre (AASC) to conduct a review of the 2010 report with the aim of identifying new and practical applications for it to further enhance its value to the microfinance industry. The first key finding of this review was that the report could be used to establish an effective benchmarking tool to measure the quality of financial inclusion prudential and supervisory arrangements in an economy and across economies. The review also concluded that the report could be used as the basis for a training program for regulators and policy makers in agencies within the Asia Pacific

region. This training would specifically target those that are responsible for developing and implementing regulatory arrangements to promote financial inclusion.

The benchmarking tool would comprise a number of dimensions which would form a matrix to assess strengths and weaknesses of various regulatory aspects. These specific dimensions would include the policy environment in which financial inclusion is to be achieved, the set of products and services provided to consumers, the type of entity that provides products and services, the set of product provider issues which need to be addressed or managed in order to support delivery, consideration for issues relevant from the perspective of consumers and consideration of a range of aspects relating to infrastructure.

For the training program, the participants would focus on examining current practices and issues as they affect the regulation and supervision of financially inclusive products and services, particularly microfinance products. This examination would be conducted with an awareness of international best practices, the primary source of which would be derived from key institutions such as the G20, the Bank for International Settlements (BIS), the Financial Action Task Force (FATF), the International Association of Insurance Supervisors (IAIS) and CGAP. The regulatory principals examined within the training will be further enhanced through discussion of implementation issues and recognition of the practicalities of the varying environments in which both regulators and private sector operate.

To further test the feasibility of these two potential applications of the report, the AASC engaged with a number of regulators and other stakeholders through a survey to gather feedback about how they would value the proposed assessment tool for financial inclusion frameworks and training program to support capacity development. The feedback gathered through this process was very positive, with the majority of respondents indicating that the assessment tool and training program would be of high value.

As part of the survey, the respondents were also asked to provide specific feedback on how the proposed assessment tool and training program could be improved. A number of key recommendations were put forward, the most important being that the framework needs to be flexible enough so that it can be tailored to meet the specific needs and circumstances of each economy and also that further consultations are needed to ensure that the framework complements any existing work which may already be undertaken by other stakeholders. With regard to the training program, specific feedback was also received on specific topics which would be of most value to potential participants as well as suggestions for format.

To continue progressing the development of these initiatives plans are currently underway to incorporate them as activities within the ABAC Advisory Group on APEC Financial Sector Capacity Building. Further development of the framework and implementation of the training are expected to take place in the near future as part of the Advisory Group's work plan for financial inclusion.

### **Public-Private Partnership: Building a Foundation for Innovative Growth**

By enabling money to move electronically, payments and related mobile money services can be delivered with more convenience, greater reach and efficiency. As facilitators of electronic funds transfers, companies such as Visa play an important role in financial inclusion. Visa's support for financial inclusion is also much broader in that the company openly shares its payment expertise with leading organizations with the aims of developing best practices and building capacity. Visa also works directly with governments and NGOs to assist with the delivery of programs that target the underserved. Financial literacy is another core focus of Visa's financial inclusion strategy to ensure that as access to financial services expands the capability of consumers to effectively use these services also expands.

As an international leader on financial inclusion, Visa has co-founded several public-private partnerships globally including the Financial Inclusion 2020 initiative and the Better Than Cash Alliance. Some examples of initiatives that Visa has undertaken in partnership with NGOs to deliver financial services to the underserved include providing village savings and loan associations access to both group and individual savings accounts, enabling low-income women to use mobile phones to access financial services, developing localized financial solutions and education and empowering underserved women through access to commercially-viable savings products tailored to their specific needs.

By sharing their payment expertise, Visa aims to go beyond the typical mobile money offering to deliver products that meet the needs of the underserved. An example of this is Visa's mVISA product which is an interoperable mobile device based solution developed specifically for the Rwandan market that enables the access and exchange of electronic funds. With mVISA clients can access varied financial services relevant to their needs including services for pensions, microloans, refugee aid or farmer subsidiaries. Visa aims to leverage its experience in developing mVISA in Rwanda to accelerate the penetration of financial services within underserved population segments in other countries around the world.

Visa's goals for financial literacy are broad and aim to influence positive growth for individuals, businesses and economies. Through Visa's global financial literacy initiative the company plans to provide free, relevant, accessible and innovative financial education to individuals and their communities with a methodology that emphasizes tailored solutions based on economy, culture and other priorities. Recognizing the importance of other stakeholders in the financial education process Visa actively engages with a range of institutions including governments, schools, banks, credit unions and NGOs to form strategic partnerships and improve reach, awareness and impact of educational programs.

To support its financial inclusion policy, Visa has developed a set of key public policy principles and priorities to guide their strategy and implementation. The first principle is to achieve clarity on macro-policy goals. Without such clarity it is difficult for any policy to be effective. The second principal is to ensure close integration with other government policies so that financial inclusion initiatives can effectively contribute to broader policy objectives. Transparency is the third principal with regulators being held accountable to both other government agencies and private sector stakeholders. The last principal is neutrality. This entails that regulation should be flexible enough to respond to technological and economic changes and opportunities. Regulation should also be stable in order to ensure the predictability and security required by the providers and users alike.

Based on these four principals, five specific priorities are also critical to ensure sound regulation. The first of these priorities is interoperability across various types of financial products, transactions and providers to enable financial inclusion to happen at scale. Developing a tiered/variable approach to know your customer requirements (KYCs) is another priority to account for the challenging circumstances the unbanked and service providers face while still mitigating fraud and abuse. Increasing the financial capability of individuals to move them into the formal financial sector is the third priority. This is best achieved through NGOs and the private sector working together to create systematic education programs while leveraging technology to build relevant products and services. The fourth priority is to establish an effective reporting system to promote access to credit while also protecting customers. The last priority is consumer protection. The responsibility to protect consumers is shared amongst financial service providers, regulators and the consumers themselves. To achieve effective consumer protection a balanced framework is needed that promotes transparency and positive behaviors.



## Key Points

1. Japan's experience with financial education has highlighted the impact that culture can have on financial inclusion. Here, the cultural views of finance, most notably views that "easy income" such as money earned through investments is shameful, have resulted in financial education rarely being included within mainstream processes such as school systems. Changing these cultural perceptions takes time and government support is required to create greater awareness.
2. Best practice policy and regulatory guidelines for financial inclusion are becoming more widely available through a range of global and regional initiatives aimed at increasing access to finance<sup>2</sup>. However, policy makers and regulators also require adequate capacity in order to implement what is regarded as best practice. As such, it is important that initiatives which support the development and dissemination of best practice frameworks can subsequently be executed, highlighting the need for appropriate capacity building programs.
3. As the use of electronic funds increases in popularity throughout the region, electronic fund facilitators such as Visa will continue to play an important role in shaping the market and developing and deploying products and services that improve the lives of poor and the financially underserved. Interoperability is seen as a priority in achieving scale, and financial literacy essential for effective financial inclusion. The case of Visa has highlighted the importance of strategic partnerships as a way of overcoming barriers and improving the reach and impact of financial inclusion programs.

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<sup>2</sup> See: A Guide to Regulation and Supervision of Microfinance, CGAP <http://www.cgap.org/publications/guide-regulation-and-supervision-microfinance>

## Chapter 8: Conclusions and Policy Recommendations

The region has made a great deal of progress towards financial inclusion and this is most likely due to the significant attention the issue has received from major global initiatives including APEC and G20. Financial inclusion now receives considerable political support and also benefits from private sector involvement, not just in terms of corporate social responsibility (CSR) initiatives, but also in terms of actual commercial activity. A number of international platforms for collaboration have been established to bring together the various stakeholders that are active in this field, including institutions such as CGAP and IFC that have been involved from the very beginning.

In general, awareness amongst key stakeholders of the importance of financial inclusion appears quite high. This level of awareness is particularly evident in the most important elements of the enabling environment such as proportionate regulation, financial identity and data, financial literacy, consumer protection, the role of state financial institutions and the use of new technology and modes of delivering financial services. Many of these elements can be found in current financial inclusion strategies that have been adopted by various economies.

The approaches being taken by regulators and governments have improved significantly in recent years and important regulatory reforms have been established in many economies. While these developments represent positive progress, more needs to be done to address difficult and complex issues such as developing market infrastructure, including infrastructure related to credit information, collateral management and payments. In many cases in order to sufficiently address these issues new legislation is required. There are also challenges related achieving greater progress in terms of clients. Not only is greater innovation needed to expand outreach to rural areas and the poorest segments, but the range and quality of services being made available to them is equally as important. Specifically, more needs to be done to support the provision of products such as savings, insurance and pensions to the underserved. There also remains much to do in financial education, and in some markets, promoting the adoption of new technologies to reduce costs and ensure sustainability.

These challenges underscore the importance of capacity building and collaboration, especially in view of the limited resources available to policy makers and regulators in developing economies. Regional public-private sector collaboration and greater coordination of efforts offer opportunities to increase the effectiveness and efficiency of capacity building. Within APEC, for example, the Finance Ministers have launched the Asia Pacific Financial Forum where private sector firms and industry associations, international agencies, standard setters and ministries and agencies collaborate to help interested governments introduce, implement and enforce reforms in the legal and institutional architecture. That is one example and a greater number of similar targeted activities are needed to achieve tangible deliverables within a realistic time frame in the future. The Asia Pacific Forum on Financial Inclusion has identified a number of areas where this kind of attention will need to be focused and which have been outlined in this report.

The Asia Pacific Forum on Financial Inclusion is an important part of the regional efforts for financial inclusion, particularly for its role in bringing key stakeholders in financial inclusion together and facilitating an annual dialogue to support increased awareness, the identification of needed measures and the means to expand and deepen the financial inclusion network in the region. Based on the discussions of this year's Forum, the following policy recommendations have been prepared for the consideration of policy makers and regulators to support their endeavours for increasing access to financial services to the poor.

1. Financial regulators clearly can play an important role to further financial inclusion by developing a framework that balances the objectives of safety, soundness, integrity, and consumer protection with those of market innovation and accelerating financial inclusion. Furthermore, consensus around the need for a framework has emerged in an environment of growing awareness that there are neglected opportunities to extend non-credit services to the financially excluded (such as savings, especially for retirement, housing for low income buyers, and remittances recipients). This suggests that a financial inclusion framework can also balance the development of these services in an economy.
2. One major lesson from the Peruvian experience is that an approach that focuses on making regulatory requirements proportionate to risk is key to developing that balance. Moreover regulators must be ready to adapt and revise the framework to promising new technologies and innovations in the market.
3. The development of a national financial inclusion strategy can be an effective way to prioritize goals, balance the development of different financial services needed to achieve financial inclusion and align the roles of and expectations for regulators. Such a formal, public strategy may also work to ensure that financially excluded populations gain access to a broad range of financial services, rather than just one kind of financial service.
4. Financial inclusion strategies often focus on providing access to financial products and services. In some economies, this is even narrower, targeting access to credit specifically. To make a significant impact on the poor, financial inclusion strategies need to encourage development and provision of a broad range of quality financial products and services, aligned to the needs of client segments.
5. By developing a financial inclusion framework through a public-private dialogue a prudential system that also retains incentives to innovate is recommended. Policy makers, regulators and private sector stake-holders should coordinate approaches for the more effective delivery of services to the underserved. Public-private sector capacity building initiatives are crucial in this process.
6. The case of the Philippines has highlighted the importance of this close dialogue and cooperation between the public and private sectors in order to develop an effective and sustainable microfinance industry. By including this participatory process within policy formation the quality and effectiveness of policies can be significantly increased. Furthermore, close cooperation between line ministries and other public stakeholders within the financial sector is also very important. Such cooperation leads to greater impact in advancing sustainable livelihoods for the poor and other important development goals such as nutrition, health and education.
7. Adequate market infrastructure, such as that related to national identification, credit information, collateral management and payments, is necessary to support greater financial inclusion in rural areas and the poorest segments. The development of this infrastructure will enable the expansion, use and functionality of microfinance products and channels, such as mobile and agent banking, savings, insurance, pensions and also expand the reach of financial education.
8. Financial inclusion markets need to be well regulated in order to mitigate risks of indiscriminate lending and other possibilities of malpractice. However, if regulation, particularly with regard to consumer protection, is too strict it will limit innovation. With this view regulatory frameworks need to appropriately balance risk mitigation with consumer protection while still enabling experimentation with new products and delivery mechanisms.

## Appendix: Forum Program

<b>DAY ONE</b>	<b>Wednesday 19 March</b>
<b>09:00 – 09:30</b>	<b>OPENING SESSION</b>
	<p><b>Session Chair:</b> Dr. Li Kouqing, <i>Director-General, Asia-Pacific Finance and Development Center (AFDC)</i></p> <p><b>Opening Remarks:</b></p> <ul style="list-style-type: none"> <li>• Ms. Zheng Quan, Deputy Director-General, International Department, Ministry of Finance, P.R. China</li> <li>• Madame Wang Lili, <i>ABAC China, Executive Director and Senior Executive Vice President, Industrial and Commercial Bank of China</i></li> <li>• Dr. Yuqing Xing, <i>Director of Capacity Building and Training, Asian Development Bank Institute (ADBI)</i></li> <li>• Mr. Jie Huang, <i>Executive Vice President, Citibank (China) Co., Ltd.; Head of Government Affairs, Citi China.</i></li> </ul>
09:30 – 09:45	<b>PHOTO SESSION</b>
09:45 – 10:00	<b>BREAK</b>
<b>10:00 – 11:30</b>	<b>SESSION 1: China</b>
	<p><b>Session Chair:</b></p> <ul style="list-style-type: none"> <li>• Mr. Eric Duflos, <i>Regional Representative for East Asia and the Pacific, CGAP</i></li> </ul>
10:00 – 10:05	<b>Session Chair's opening remarks</b>
10:05 – 10:25	<p><b>Presentation 1:</b></p> <ul style="list-style-type: none"> <li>• Mr. Sheng Chen, <i>Deputy Director, Banking Innovation Supervisory Department, China Banking Regulatory Commission</i></li> </ul>
10:25 – 10:45	<p><b>Presentation 2:</b></p> <ul style="list-style-type: none"> <li>• Mr. Bai Chengyu, <i>Secretary General, China Association of Microfinance</i></li> </ul>
10:45 – 11:00	<p><b>Panel Discussion</b></p> <p>Panelist 1: Dr. Deliang Zhang, <i>Deputy Director, Research Division, International Poverty Reduction Center in China (IPRCC)</i></p> <p>Panelist 2: Ms. Wang Xiaolei, <i>Deputy Director, Credit Reference Center</i></p> <p>Panelist 3: Ms. Rachel Freeman, <i>Regional Business Line Manager, A2F Advisory Services, East Asia and Pacific, International Finance Corporation (IFC)</i></p>
11:00 – 11:25	<b>Open forum</b>
11:25 – 11:30	<b>Session Chair's closing remarks</b>
11:30 – 13:30	<b>LUNCH</b>
<b>13:30 – 15:00</b>	<b>SESSION 2: Philippines</b>
	<p><b>Session Chair:</b></p> <ul style="list-style-type: none"> <li>• Mr. Kazuto Tsuji, <i>Visiting Senior Advisor, Japan International Cooperation Agency (JICA)/ Professor, Saitama University, Japan/The Executive Committee Chair, CGAP</i></li> </ul>
13:30 – 13:35	<b>Session Chair's opening remarks</b>
13:35 – 13:55	<p><b>Presentation 1:</b></p> <ul style="list-style-type: none"> <li>• Mr. Gil S. Beltran, <i>Chief Economist and Undersecretary, Department of Finance, Philippines</i></li> </ul>
13:55 – 14:15	<p><b>Presentation 2:</b></p> <ul style="list-style-type: none"> <li>• Ms. Mila Mercado Bunker, <i>Chairperson, Microfinance Council of the Philippines, Inc.; President – Ahon Sa Hiras, Inc.</i></li> </ul>
14:15 – 14:30	<b>Panel Discussion:</b>

	<p>Panelist 1: Ms. Amada Dimaculangan-Pornaras, <i>Deputy Program Manager, Sustainable Livelihood Program, Department of Social Welfare and Development</i></p> <p>Panelist 2: Mr. Lito Villanueva, <i>Innovation, Ecosystem Build &amp; Alliances Head, Smart e-Money, Inc</i></p> <p>Panelist 3: Ms. Leesa Shrader, <i>Senior Consultant, Consultative Group to Assist the Poor (CGAP)</i></p>
14:30 – 14:55	<b>Open forum</b>
14:55 – 15:00	<b>Session Chair’s closing remarks</b>
15:00 – 15:30	<b>BREAK</b>
<b>15:30 – 17:00</b>	<b>SESSION 3: Peru</b>
	<p><b>Session Chair:</b></p> <ul style="list-style-type: none"> <li>• Dr. Robin Varghese, <i>Senior Fellow &amp; Vice President of International Operations, Policy and Economic Research Council (PERC)</i></li> </ul>
15:30 – 15:35	<b>Session Chair’s opening remarks</b>
15:35 – 15:55	<p><b>Presentation 1:</b></p> <ul style="list-style-type: none"> <li>• Ms. Narda Sotomayor, <i>Head of the Microfinance Analysis Department, Superintendency of Banks, Insurance Companies and Pension Funds (SBS)</i></li> </ul>
15:55 – 16:15	<p><b>Presentation 2:</b></p> <ul style="list-style-type: none"> <li>• Mr. Reynaldo Susano, <i>President and CEO, The Universidad Peruana de Investigación y Negocios – UPEIN</i></li> </ul>
16:15 – 16:30	<p><b>Panel Discussion:</b></p> <p>Panelist 1: Comments from the Session Chair</p> <p>Panelist 2: Mr. Fermin Vivanco, <i>Senior Specialist, Multilateral Investment Fund (MIF) - Inter-American Development Bank (IDB)</i></p>
16:30 – 16:55	<b>Open forum</b>
16:55 – 17:00	<b>Session Chair’s closing remarks</b>
19:00 – 21:00	<b>DINNER</b>
<b>DAY TWO</b>	<b>Thursday 20 March</b>
<b>09:00 – 10:30</b>	<b>SESSION 4: India</b>
	<p><b>Session Chair:</b></p> <ul style="list-style-type: none"> <li>• Ms. Nina Nayar, <i>Associate, The Foundation For Development Cooperation (FDC)</i></li> </ul>
09:00 – 09:05	<b>Session Chair’s opening remarks</b>
09:05 – 09:25	<p><b>Presentation 1:</b></p> <ul style="list-style-type: none"> <li>• Mr. Arvind Kumar, <i>Joint Secretary, Department of Financial Services, Ministry of Finance, Government of India</i></li> </ul>
09:25 – 09:45	<p><b>Presentation 2:</b></p> <ul style="list-style-type: none"> <li>• Mr. Alok Prasad, <i>CEO, Micro Finance Institutions Network (MFIN)</i></li> </ul>
09:45 – 10:00	<p><b>Panel Discussion:</b></p> <p>Panelist 1: Comments from the Session Chair</p> <p>Panelist 2: Mr Sanjay Sinha, <i>Managing Director, Micro-Credit Ratings International Ltd.</i></p>
10:00 – 10:25	<b>Open forum</b>
10:25 – 10:30	<b>Session Chair’s closing remarks</b>
10:30 – 11:00	<b>BREAK</b>
<b>11:00 – 12:30</b>	<b>SESSION 5: Thailand</b>
	<p><b>Session Chair:</b></p> <ul style="list-style-type: none"> <li>• Dr. Luxmon Attapich, <i>Senior Country Economist, Thailand Resident Mission, Asian Development Bank</i></li> </ul>

11:00 – 11:05	<b>Session Chair's opening remarks</b>
11:05 – 11:25	<b>Presentation 1:</b> <ul style="list-style-type: none"> <li>Mr Chanachai Prayoosin, <i>Director, Bureau of Financial Inclusion Policy and Development, Fiscal Policy Office, Ministry of Finance, Thailand</i></li> </ul>
11:25 – 11:45	<b>Presentation 2:</b> <ul style="list-style-type: none"> <li>Mr. Surapol Opasatien, <i>CEO, National Credit Bureau Co., Ltd.</i></li> </ul>
11:45 – 12:00	<b>Panel Discussion:</b> Panelist 1: Comments from the Session Chair Panelist 2: Mr. Eric Duflos, <i>Regional Representative for East Asia and the Pacific, CGAP</i> Panelist 3: Mr. Kazuto Tsuji, <i>Visiting Senior Advisor, Japan International Cooperation Agency (JICA)/ Professor, Saitama University, Japan/The Executive Committee Chair, CGAP</i>
12:00 – 12:25	<b>Open forum</b>
12:25 – 12:30	<b>Session Chair's closing remarks</b>
12:30 – 14:00	<b>LUNCH</b>
<b>14:00 – 15:30</b>	<b>SESSION 6: Indonesia</b>
	<b>Session Chair:</b> <ul style="list-style-type: none"> <li>Dr. Aladdin D. Rillo, <i>Senior Economist, Asian Development Bank Institute (ADB)</i></li> </ul>
14:00 – 14:05	<b>Session Chair's opening remarks</b>
14:05 – 14:20	<b>Presentation 1:</b> <ul style="list-style-type: none"> <li>Mr. Parjiono Ciptowidarto, <i>Director, Center of Regional and Bilateral Policy, Fiscal Policy Agency, Ministry of Finance, Indonesia</i></li> </ul>
14:20 – 14:35	<b>Presentation 2:</b> <ul style="list-style-type: none"> <li>Mr. Budi Satria, <i>Regional Manager, Bank Rakyat Indonesia</i></li> </ul>
14:35 – 14:50	<b>Presentation 3:</b> <ul style="list-style-type: none"> <li>Mrs. Eni V. Panggabean, <i>Executive Director, Financial Access and SME Development Department, Bank Indonesia</i></li> </ul>
14:50 – 15:00	<b>Panel Discussion:</b> Panelist 1: Ms. Leesa Shrader, <i>Senior Consultant, Consultative Group to Assist the Poor (CGAP)</i> Panelist 2: Mr. Ivan Mortimer-Schutts, <i>Leader for Retail Payments and Mobile Banking in East Asia, International Finance Corporation (IFC)</i>
15:00 – 15:25	<b>Open forum</b>
15:25 – 15:30	<b>Session Chair's closing remarks</b>
15:30 – 16:00	<b>BREAK</b>
<b>16:00 – 17:15</b>	<b>SESSION 7: Regional Developments and Key Initiatives</b>
	<b>Session Chair:</b> <ul style="list-style-type: none"> <li>Dr. Julius Caesar Parrenas, <i>Advisor on International Affairs, The Bank of Tokyo-Mitsubishi UFJ, Ltd.</i></li> </ul>
16:00 – 16:05	<b>Session Chair's opening remarks</b>
16:05 – 16:20	<b>Presentation 1: Financial Inclusion and Financial Education ---Japan's Experience and Its lessons to Asian Countries</b> <ul style="list-style-type: none"> <li>Prof. Naoyuki Yoshino, <i>Chair of Financial System Council and Professor of Economics, Keio University, Japan</i></li> </ul>
16:20 – 16:35	<b>Presentation 2: Evaluating Regulatory Frameworks for Financial Inclusion</b>

	<ul style="list-style-type: none"> <li>Ms. Briony Wood-Ingram, <i>Projects and Programs Coordinator, Australian APEC Study Centre, RMIT University</i></li> </ul>
16:35 – 16:50	<p><b>Presentation 3: Public-Private Partnership: Building a Foundation for Innovative Growth</b></p> <ul style="list-style-type: none"> <li>Dr. John Barry, <i>Senior Vice President of Government Affairs and Public Policy for Asia-Pacific, Europe, the Middle East and Africa (APCEMEA), Visa Inc.</i></li> </ul>
16:50 – 17:10	<b>Open Forum</b>
17:10 – 17:15	<b>Session Chair’s closing remarks</b>
<b>17:15 – 18:00</b>	<b>CLOSING SESSION: Panel Discussion on Key Messages and Closing Remarks</b>
17:15 – 17:20	<p><b>Panelist 1:</b></p> <ul style="list-style-type: none"> <li>Dr. Julius Caesar Parrenas, <i>Advisor on International Affairs, The Bank of Tokyo-Mitsubishi UFJ, Ltd.</i></li> </ul>
17:20 – 17:25	<p><b>Panelist 2:</b></p> <ul style="list-style-type: none"> <li>Mr. Eric Duflos, <i>Regional Representative for East Asia and the Pacific, Consultative Group to Assist the Poor (CGAP)</i></li> </ul>
17:25 – 17:30	<p><b>Panelist 3:</b></p> <ul style="list-style-type: none"> <li>Ms. Nina Nayar, <i>Associate, The Foundation For Development Cooperation (FDC)</i></li> </ul>
17:30 – 17:35	<p><b>Panelist 4:</b></p> <ul style="list-style-type: none"> <li>Dr. Li Kouqing, <i>Director-General, Asia-Pacific Finance and Development Center (AFDC)</i></li> </ul>
17:35 – 17:50	<b>Open Forum</b>
17:50 – 18:00	<b>Closing Remarks from the Panelists</b>