Financial Inclusion

Regulating nonbank deposit-taking activities

October 2011

CGAP: Who we are

CGAP is an independent policy and research center dedicated to **advancing financial access for the world's poor**.

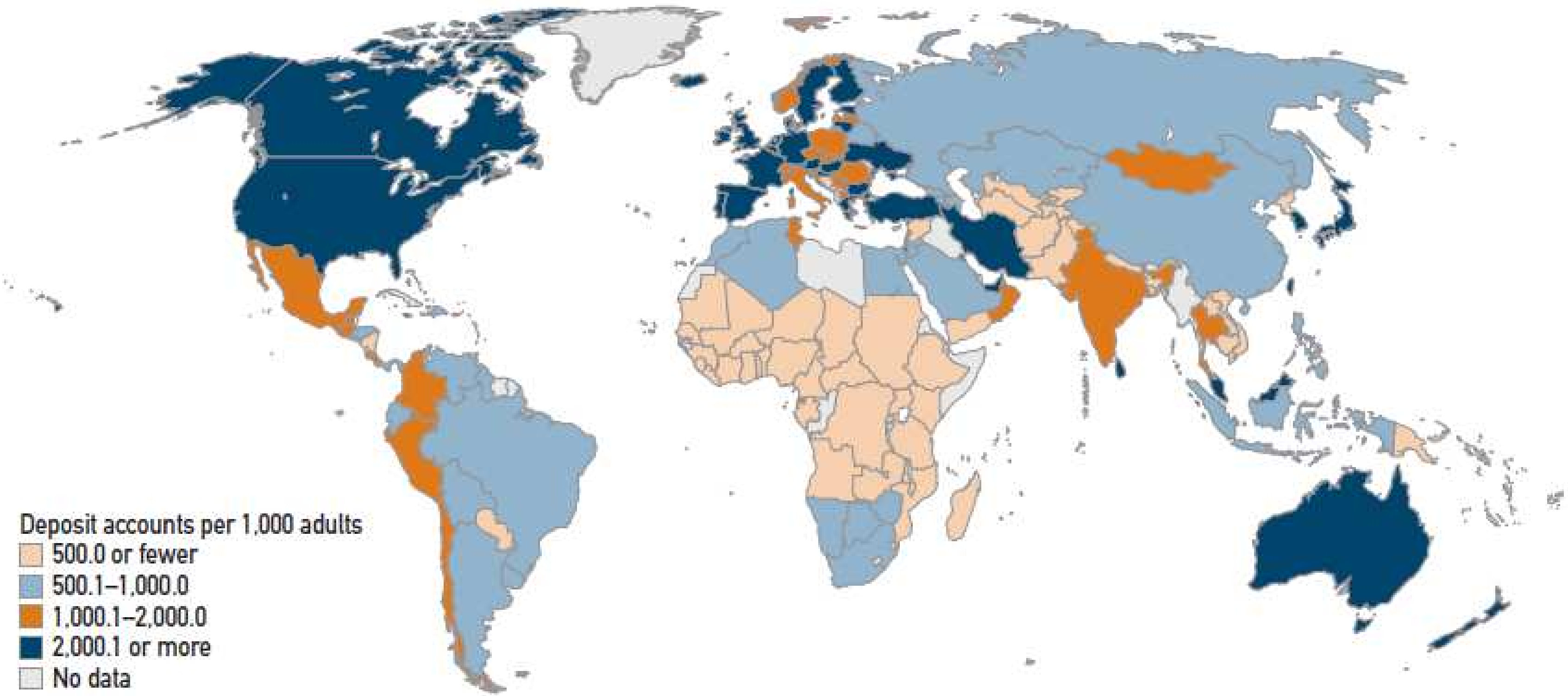
It is supported by over 30 development agencies and private foundations who share a common mission to alleviate poverty.

Housed at the World Bank, CGAP provides market intelligence, promotes standards, develops innovative solutions and offers advisory services to governments, microfinance providers, donors, and investors.

At a glance:

- **7** locations: offices in Washington DC and Paris, with 5 regional representatives based in Abidjan, Dhaka, Ramallah, Nairobi, and Moscow
- **28** million dollar annual budget
- **50** staff
- **70** countries with CGAP activities
- **150,000+** copies of CGAP publications distributed globally in 2009

~ 70% of adults in developing countries don't have deposit account with regulated financial institution (~ 20% in developed countries)



Note: Estimates for countries that did not report the number of accounts in commercial banks were generated from a statistical model that uses income per capita and various features of the financial system—such as the number of bank branches per 100,000 adults and the value of deposits per adult—to predict the number of commercial bank accounts. Where the number of accounts in nonbanks was not reported, an attempt was made to fill in data from other sources. The estimates for bank and nonbank categories were summed by country to estimate the total number of deposit accounts in each country. See the methodology appendix for more details.

Source: Financial Access database.

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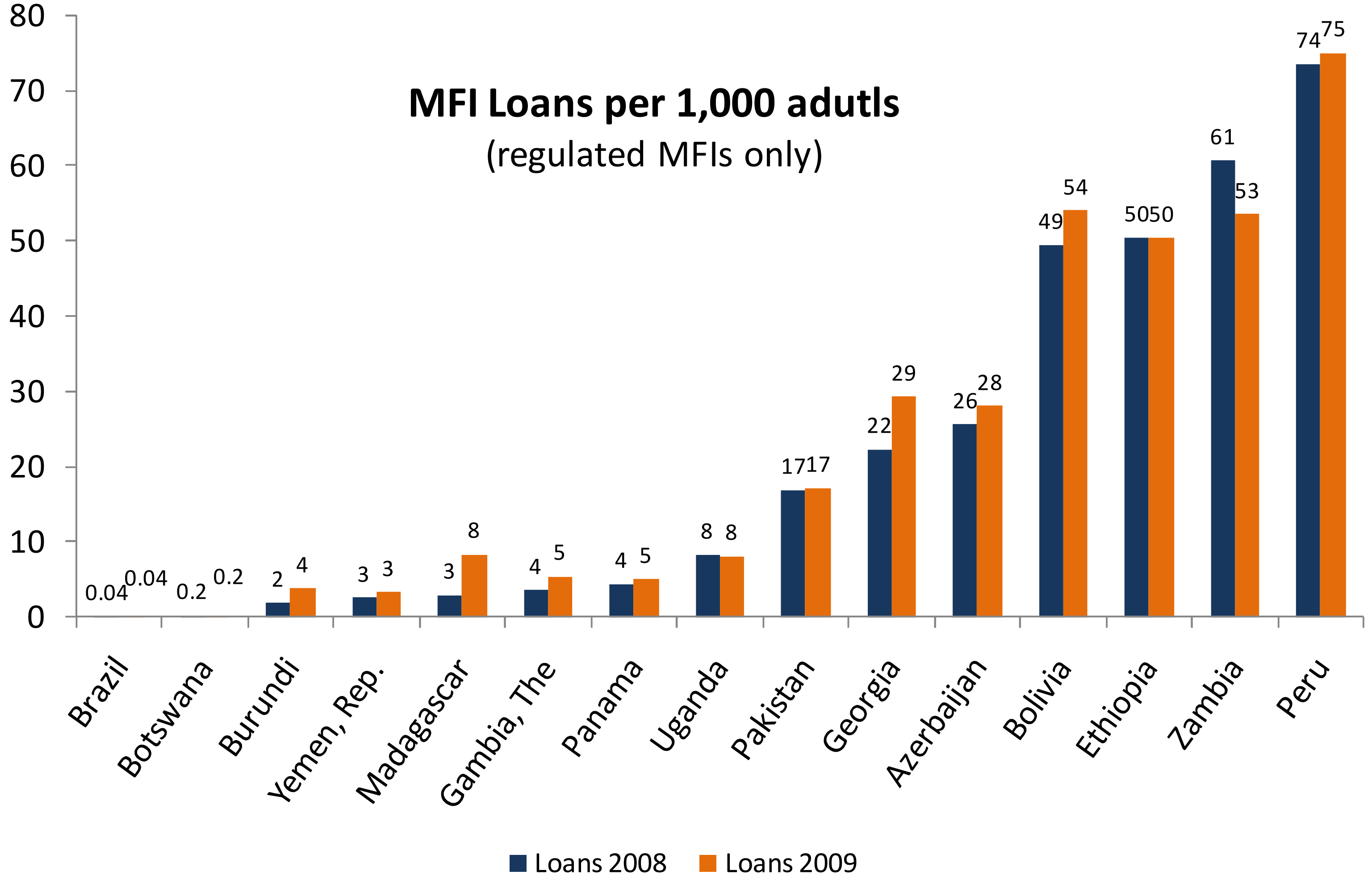
Source: *Financial Access* Database.

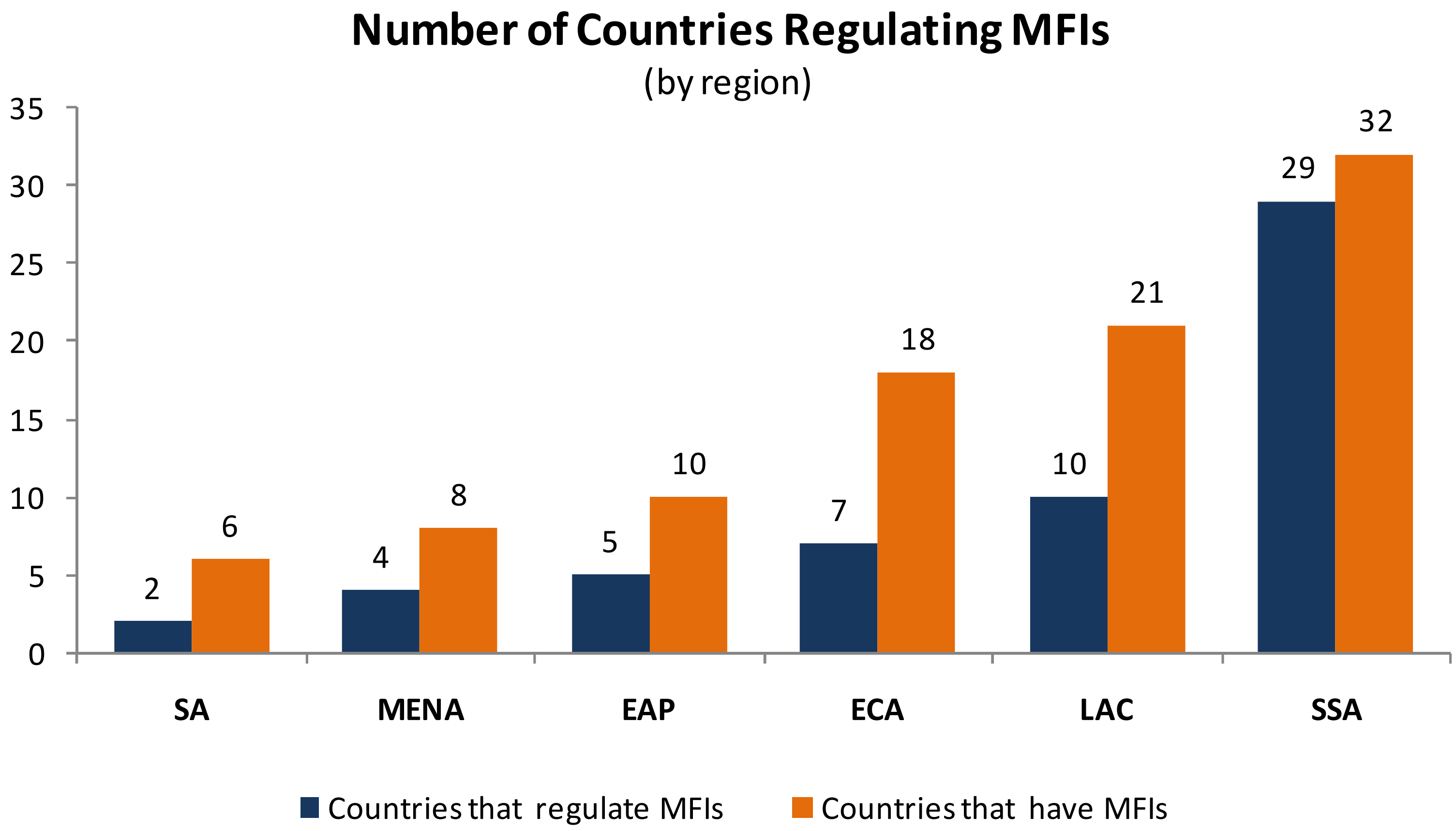
Numbers of regulated MFI loans per 1,000 adults have either increased or remained unchanged in most of the countries.



Note: Comparison is possible only for countries that provided data for both years.

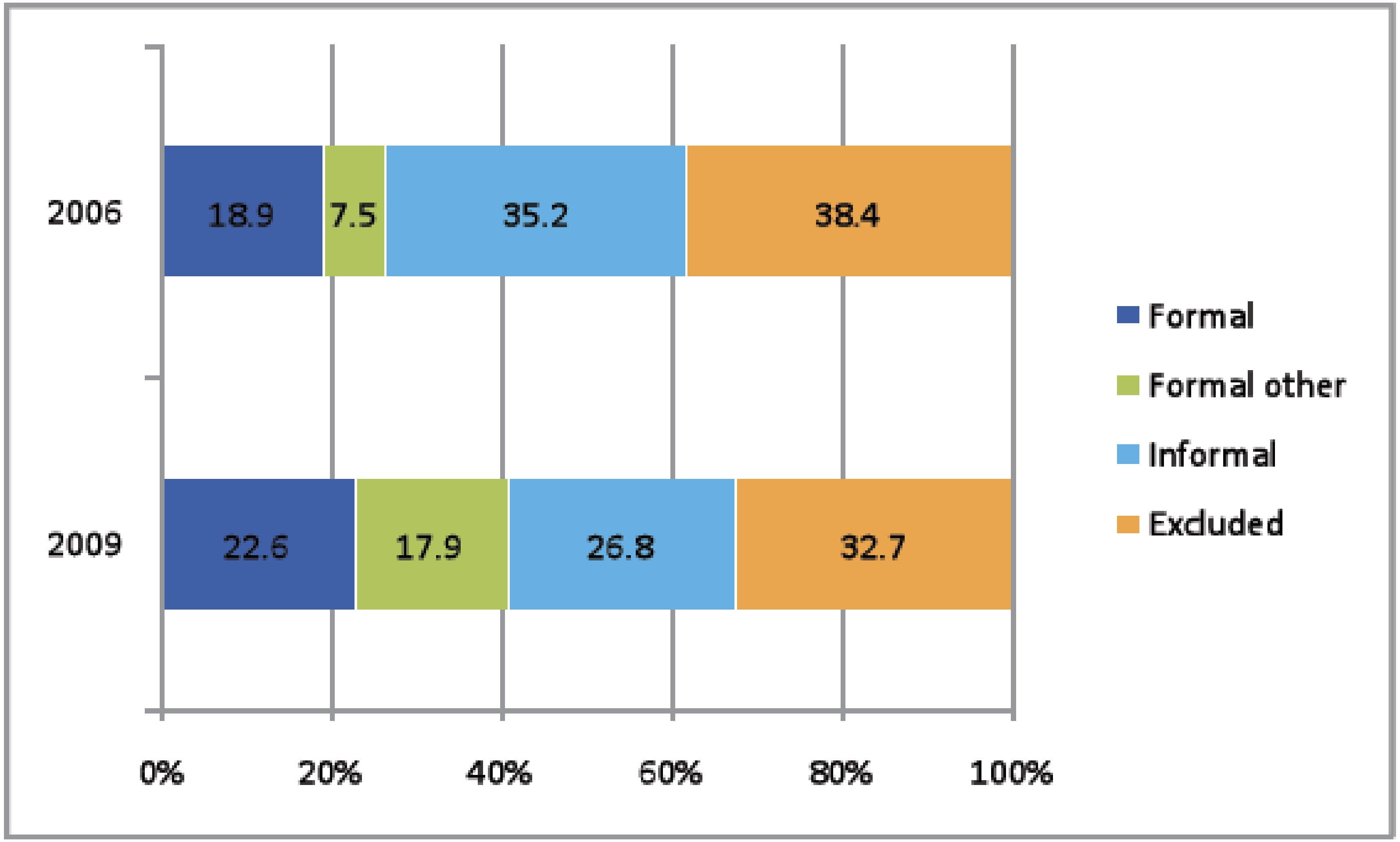
Source: *Financial Access* Database.

In 59 out of 142 countries, central banks (or other financial regulators) regulate MFIs



Source: *Financial Access* Database.

For example Kenya: Deposit accounts with nonbanks substantially increased financial access



Source: FinAccess Survey 2009

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A wide range of legal entities can provide microfinance services

- NGOs (various forms)
- Commercial finance (and leasing) companies
- Financial cooperatives
- Deposit-taking MFIs
- Commercial banks
- A variety of government-run financial service entities: state-owned commercial banks, agricultural banks, other development banks, postal savings banks
- New players on the scene
  - Nonbank retail agents
  - Mobile network operators and other nonbanks offering financial services

Three broad regulatory approaches in microfinance can be distinguished

No specific MF law	Special legal window for MFIs	Microfinance-specific statutory regulations under general “financial institutions” law
• Existing legal window(s) might allow for microfinance services provision	• In many cases, separate law for deposit-taking MFIs • In ECA region/civil law countries: Only covering MCIs or several categories of credit-only **and** deposit-taking MFIs	• Adjusting **regulations** to allow for microfinance services provision • Defining microfinance as one activity

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Standard banking regulations may not fit the risk profile of deposit-taking microfinance institutions (DMFIs)

Standard Banking Regulations	When Applied to Microfinance
Standard provisioning and write-off rules	Have to be adjusted considering the short maturity of microloans
Limits on unsecured lending	Impractical for character-based lending
Registration of collateral	Too expensive for tiny loans
Requirements for branches: Security standards, working hours, daily clearing of accounts, limitations on location, use of non-bank agents	May interfere with innovations that reduce costs and bring more convenient service to clients
Standard loan documentation requirements	May be too expensive and time consuming

The nonbank-based model of branchless banking involves the issuance of e-money by not prudentially regulated financial instituitons

Standard definition of e-money:

- Monetary value as represented by a claim on an issuers
- Electronically stored (on a server or on a card)
- Can be used (redeemed as cash, transferred between customers, used for payments) at multiple sites other than the issuer

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E-money is neither a full fledged deposit nor a pure payment

	Payment	Electronic money	Deposit
Definition	Transfer between two parties; Time restricted (e.g. within T+3)	Special type of repayable funds with transaction focus	“Repayable funds”
Who can accept?	Payment Service Providers	E-Money Institutions; Banks	Only Banks (and other prudentially regulated FIs)
Prudential requirements	Low	Medium	High
Deposit insurance	NA	No	Yes
Reserve requirement	NA	No	Yes

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Three main options how to regard e-money that stretches the boundaries of payment and banking legislation

Option 1	Regard e-money as exclusive domain of prudentially regulated financial institutions (South Africa, India, Pakistan)
Option 2	E-money as a service to be offered by banks and nonbanks (Philippines, Nigeria, Afghanistan, EU)
Option 3	E-money as a payment service (Kenya, but soon to change)

Fund safeguarding and fund isolation are two key regulatory provisions for nonbank e-money issuers

Fund safeguarding	Fund isolation
Maintain liquid assets equivalent to e-float	Ownership of funds
Restrictions on use of funds	Issuer failure: hierarchy of claims
Diversification of e-float fund holdings	Trust account/escrow account

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Transaction limits are also overall risk mitigation measure

Maximum transaction values

- Maximum value of individual transaction
- Maximum monthly/periodic load
- Maximum holdings

'Putting the banking in branchless banking'*: Reaping the full potential of mobile banking

Paying interest

- Typically not permitted in order to differentiate from banking
- Could be "pass through" of interest on pooled account

Being subject to deposit insurance

- Coverage limits to low or e-money excluded from coverage
- Pooled accounts in insured institutions can provide coverage for each customer

*see: Ehrbeck/Tarazi (2011): Mobile Financial Services Development Report

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Ministry of Foreign Affairs of the Netherlands

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