

FINANCIAL INCLUSION MANDATES

A broad array of actions can contribute to increasing financial inclusion, from establishing a credit facility for indigenous farmers in rural areas to introducing broad consumer protection legislation. Some actions are more narrowly focused on regulators' traditional roles of regulation and supervision, while others are more promotional in nature. A number of government agencies are usually involved in efforts to deepen financial inclusion, each with its own mandate.

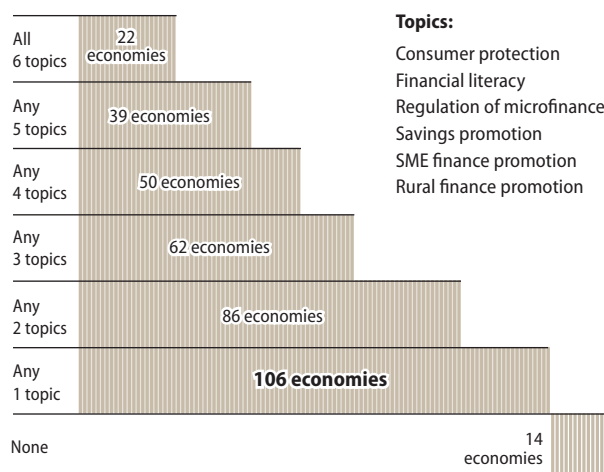
Historically, the main role of the financial regulator has been to ensure the stability of the financial system, focusing on regulation and supervision for the safety and soundness of financial institutions. With many economies embracing financial inclusion as a reform objective and putting in place programs to expand financial access, some regulators are playing a more promotional role as well. However, recent financial crises underscored the dilemma of choice between encouraging financial sector growth, especially credit, and maintaining the stability of the financial system. Several important questions arise. To what extent, if at all, should financial regulators be tasked to improve access to financial services? Are the goals of financial sector stability and financial inclusion compatible? Which government agency should be responsible for implementing financial inclusion reforms?

Answering all these questions is beyond the scope of this report. Instead, *Financial Access 2010* aims to inform the debate by presenting the results of the survey of financial regulators on their role in financial inclusion reform and the resources allocated to it.

The *Financial Access 2010* survey asked financial regulators which of the following topics relevant for a financial inclusion agenda were under the purview of their agency: consumer protection, financial capability,¹ regulation of microfinance, promotion of savings, promotion of access to finance for SMEs, and promotion of rural finance.²

FIGURE 2.1

In most economies regulators are responsible for at least one topic related to financial inclusion



Source: *Financial Access* database.

In 88 percent of economies, regulators responded that at least one element of financial inclusion comes under their responsibility, 71 percent stated that they have at least two topics covered, and about half had three topics (figure 2.1). In 18 percent of the economies, all these elements of financial inclusion are within the financial regulator's mandate.

Clearly, at least some aspects of the financial inclusion agenda are under the purview of the financial regulators in most economies. But the focus is different in high-income countries versus low- and middle-income countries. In high-income countries, where financial systems already cover most of the population, regulators tend to focus on consumer protection and financial literacy. In low- and middle-income countries, the agenda is much broader and includes promotion of financial access, in addition to consumer protection and financial literacy.

WHICH AREAS OF FINANCIAL INCLUSION FALL UNDER THE RESPONSIBILITY OF THE FINANCIAL REGULATOR?

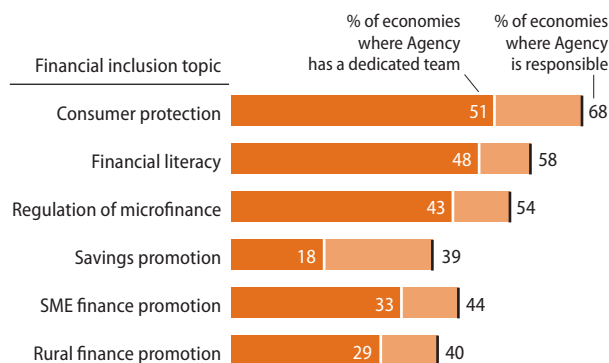
Consumer protection and financial literacy are the two areas most frequently reported to be under the financial regulator's set of responsibilities. Sixty-eight percent and 58 percent of regulators, respectively, reported that these areas are within their mandate (figure 2.2). Often consumer protection falls within the broader mandate of ensuring soundness and stability of the financial system through business regulation and supervision. Consumer protection and financial literacy are equally relevant in both developed and developing markets, as available products become more complex and affect more people.

Financial education is closely related to consumer protection in that it also aims to protect the consumer from abusive practices, but from a different angle. Financial literacy refers to the need to inform the public about the basics of financial services and ensure individuals' ability to make informed judgments and effective decisions about the use and management of their finances.

However, financial capability has different operational implications for the financial regulator than consumer protection. Consumer protection is often implemented through market conduct regulation and supervision as part of traditional regulatory and supervisory activities

FIGURE 2.2

Which areas of financial inclusion are most frequently the regulators' responsibility?

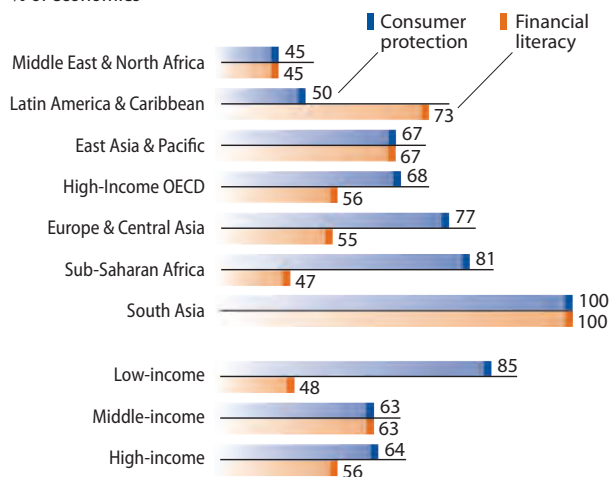


Source: *Financial Access* database.

FIGURE 2.3

Where are regulators responsible for consumer protection and financial literacy?

% of economies

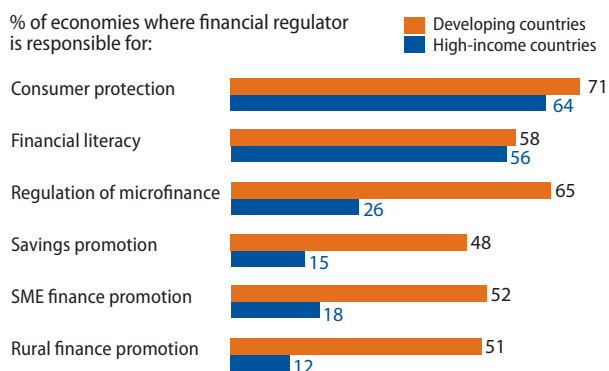


Source: *Financial Access* database.

the financial regulator undertakes on a regular basis for other topical areas. Promoting financial capability, on the other hand, requires different skill sets and operations. Consequently, although many economies report interventions in financial capability as part of the regulator's priorities, there is a great deal of diversity among the types of activities carried out. Approximately half of the economies in *Financial Access 2010* report having a team allocated to financial literacy, although in many cases, such teams are not allocated full-time to advancing this topic. In Sweden, for example, the financial education team is part of the communications team within the financial regulator. In fact, only a third of the teams are stand-alone financial literacy units. Seldom is the full design and implementation of financial literacy programs conducted entirely by the financial regulator. Peru is one of the few economies where the regulator is fully committed to financial education programs. Within the framework of Peru's financial education plan, the Division of Products and Customer Care has implemented a wide array of activities, from information campaigns to education of schoolteachers and creation of virtual classrooms on its Web site. The United Kingdom stands out as well with an entire division allocated to financial capability.

FIGURE 2.4

Developing countries are more likely to focus on a broad range of financial access issues



Source: Financial Access database.

Financial literacy programs are more commonly cross-cutting initiatives, spanning several departments within the financial regulator, as in Brazil, or several government agencies, including ministries of finance, superintendents, or deposit insurance agencies, as in El Salvador. The role of the regulator can therefore be one of coordination, consultation with private partners and financial institutions, or, less frequently, implementation. Regulators in low-income countries, where the need is probably the greatest, are generally less likely to include financial literacy as one of their areas of responsibility (figure 2.3).

PROMOTION ACTIVITIES AND REGULATION OF MICROFINANCE ARE THE PRIORITY FOR REGULATORS IN DEVELOPING COUNTRIES

Regulators in low- and middle-income countries, where financial access remains limited, are more likely than high-income countries to have the responsibility for promotional activities linked to financial inclusion, such as creating incentives for savings or outreach to rural areas. These activities are in addition to roles found among high-income countries of putting in place measures for consumer protection and financial capability (figure 2.4).

Regulation of microfinance, promotion of savings, and improvement of access to finance for SMEs and in rural areas are topics that are closely linked to developing countries' policy objectives. Of these, regulation of microfinance is the next most frequent item after consumer protection on a financial regulator's list. As the microfinance industry has matured, professionalized, and experienced sustained growth, it is increasingly becoming an important part of the financial sector in many economies. In 65 percent of developing countries, the main financial regulator reported regulation of microfinance to be within its mandate.

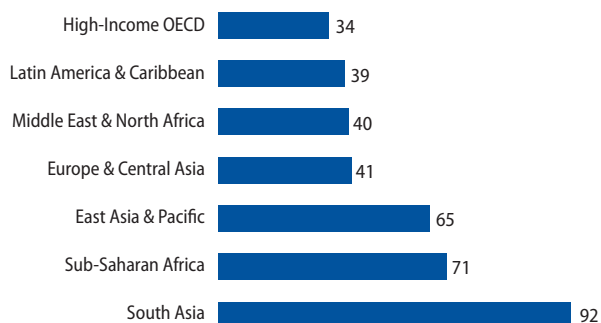
Promotion of savings, SME finance, and rural finance are more frequently reported as areas of responsibility of the financial regulator in developing countries than in high-income countries. About half of regulators in developing countries say that these issues are part of their agenda, compared with less than 20 percent in high-income countries.

East Asia and the Pacific, South Asia, and Sub-Saharan Africa place the most financial inclusion topics under the responsibility of the financial regulator (figure 2.5). This is also true for savings, rural finance, and SME finance promotion. In East and South Asia, the role of financial regulators is more focused on promotion of economic growth. In some economies such as

FIGURE 2.5

South Asian economies give regulators a greater mandate over financial inclusion topics

Average share of topics under the mandate of financial regulators (%)



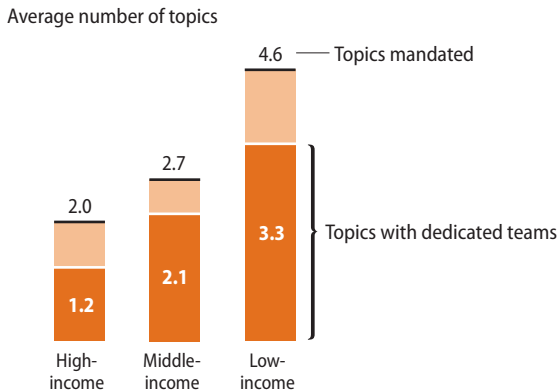
Source: Financial Access database.

the Philippines, entire units are allocated to financial inclusion, and financial inclusion is at the core of their agenda. Other central banks take financial inclusion one step further and formally recognize it in their charters. Bank Negara Malaysia’s role in promoting inclusive financial systems is explicitly articulated in the legislation as one of the primary functions of the central bank.

WHAT RESOURCES ARE ALLOCATED TO IMPLEMENTING THE FINANCIAL INCLUSION AGENDA?

More often than not, financial regulators are mandated by their governments to tackle one or more aspects of financial inclusion. To implement this broad agenda, the regulator requires staff and resources. *Financial Access 2010* surveyed regulators on whether they had specific teams, units, or departments allocated to each of the financial inclusion topics they had under their purview. Figure 2.6 summarizes this information. It appears that the commitment to reform is not always matched by allocated staff. For example, for savings promotion and rural finance promotion, for which 49 and 52 economies, respectively, reported these areas as being under their responsibility, only 47 and 71 percent, respectively, had teams assigned for those areas. Low-income countries have more resources allocated to the work on financial inclusion, but given the breadth of their agenda, they also have a larger resource gap.

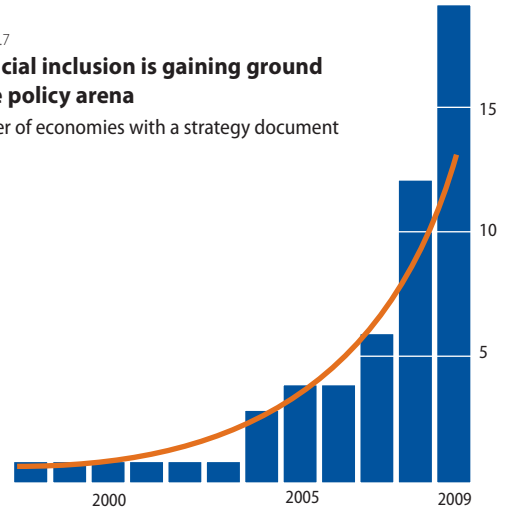
FIGURE 2.6
Resource gap is greater in low-income countries



Source: *Financial Access* database.

FIGURE 2.7
Financial inclusion is gaining ground in the policy arena

Number of economies with a strategy document

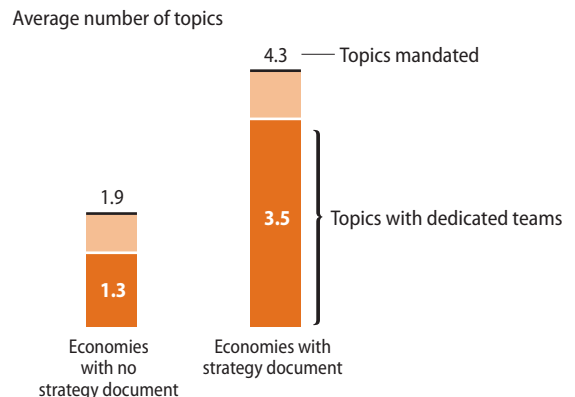


Source: *Financial Access* database.

STRATEGY DOCUMENT FOR FINANCIAL INCLUSION

One approach to the implementation of financial access reforms is through a comprehensive financial inclusion strategy. Forty-five percent of economies in *Financial Access 2010* report having a strategy document for the promotion of financial inclusion, with 91 percent of them dating from 2004 or later (figure 2.7). Not surprisingly, regulators with a financial inclusion strategy are more likely to have more financial inclusion topics under their purview and more resources and staff allocated to working on these matters. They also have a relatively lower resource gap (figure 2.8).

FIGURE 2.8
Strategic approach translates into a broader agenda and more resources



Source: *Financial Access* database.

FINANCIAL INCLUSION REFORMS

What were the main areas of reform in financial inclusion in 2009? Reported reforms vary greatly, from setting up task forces and working groups to drafting strategies or legal text, to enacting them into legislation and to final implementation and enforcement. Despite this great variance in the nature of reforms, reforms reported were weighted equally for the purposes of analysis and comparison in *Financial Access 2010*.

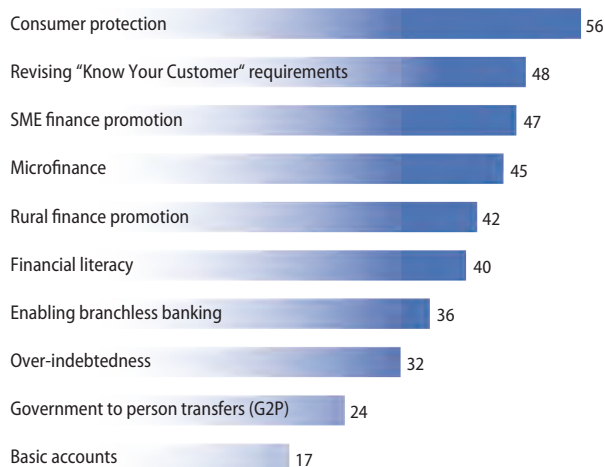
Consumer protection is the most prevalent area of reform across all regions (figure 2.9). Sixty-five economies reported reforms in this area. It is also the only reform area in which high-income countries lead, highlighting the importance of consumer protection beyond the specific issue of access, especially in the past year when financial supervisors were implementing reforms to deal with the effects of the global financial crisis and to ensure the soundness and stability of the financial sector. The most common reform within consumer protection is disclosure requirements, cited by 10 economies. Next are reforms linked to putting in place recourse mechanisms, complaint handling, and dispute resolution systems, reported by nine economies. Three countries—Austria, New Zealand, and Australia—list the extension of deposit insurance as a reform under consumer protection; another three countries—the Czech Republic, Finland, and Algeria—focus their reform energies on fraud protection. Many economies are in the early stages of preparing strategy documents on consumer protection reform.

For consumer protection to be effective, clients need to understand the basic characteristics and functions of the products offered to them. Yet according to the *Financial Access 2010* survey, financial literacy is a much less common area of reform. Only 40 percent of economies enacted reforms in this area last year. Reforms range from creating or updating financial education school programs, as in Argentina and New Zealand, to establishing financial literacy weeks and launching financial learning centers. Some economies are just start-

FIGURE 2.9

What do economies reform?

% of economies that reformed by area of reform



Source: *Financial Access* database.

ing to tackle this issue by drafting strategy and national programs to be implemented at a later stage. Some regulators post a variety of learning materials on their Web sites. In Peru and Lesotho, regulators chose to do broad advertising campaigns informing the population at large of the benefits and risks of financial products.

Thirty-eight economies report specific reforms related to consumer overindebtedness in 2009. Overindebtedness is the result of both demand and supply forces. Reducing the number of consumers who borrow beyond their means can partly be addressed by enhanced disclosure requirements and consumer education. On the supply side, regulators may choose to require stricter risk management and to improve transparency in credit markets. Survey respondents indicate that the most frequent measure taken to combat excessive lending and overindebtedness is related to credit bureaus and credit registries. More than 15 economies report modernizing or establishing credit bureaus as a way to monitor and prevent excessive lending. Some economies, such as Portugal, have passed legislation to make credit bureau consultation mandatory; other economies, such as Rwanda, now require financial institutions to report information to the credit bureau.

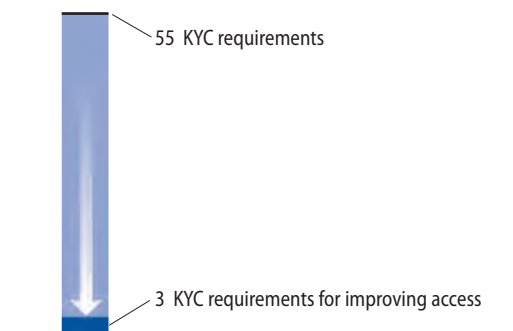
Panama, Syria, and Liberia report establishing quantitative restrictions limiting loan sizes with respect to a borrower's income. The practice of quantitative restrictions on consumer credit was reviewed in *Financial Access 2009*. To date, there is no robust assessment of the effectiveness of this measure, although experience with other quantitative caps indicates that these policies are hard to enforce and are rarely effective.

In recent years many economies have put in place strict “know your customer” (KYC) requirements. These rules are designed to ensure that the financial system is not used for illicit purposes, such as money laundering and terrorist financing. These rules often have the unintended consequence of limiting access to financial services for the poor, who may not have the required documentation available to open an account.³ In the *Financial Access 2010* survey, 48 percent of economies report revising their KYC requirements. However, few economies actually did so with a financial inclusion focus. In most cases, countries' efforts have been geared toward updating, improving, or amending their anti-money-laundering/combating the financing of terrorism legislations and procedures. But three economies reformed in this area with financial access concerns in mind, to achieve higher participation rates: Afghanistan reformed with regard to branchless banking KYC requirements; Colombia

FIGURE 2.10

Many reformed KYC regulations but few reforms improved financial access

Number of economies that reformed

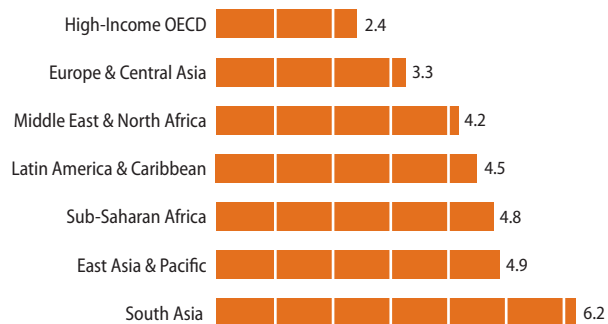


Source: *Financial Access* database.

FIGURE 2.11

Where are economies reforming the most?

Average number of reforms, 2008–09



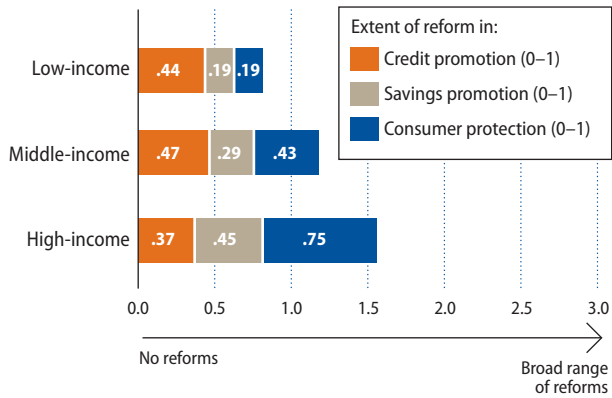
Source: *Financial Access* database.

relaxed its KYC requirements for opening electronic savings accounts; and Ghana reduced its requirements for low-value transactions (figure 2.10).

In times of economic slowdown, governments tend to focus on policies that can help create jobs. Reforms aimed at improving access to finance for SMEs constitute the third most popular area of reform after consumer protection and KYC requirements. Forty-seven percent of economies indicate that they implemented reforms in this area in 2009. Fifteen of those economies focused on the set-up or expansion of credit guarantee schemes. Other countries, such as Oman and Zimbabwe, have taken softer approaches, including encouraging banks to increase their lending to the SME sector. Some regulators, such as those in Sri Lanka, require banks to direct a designated minimum amount of their portfolios to SMEs.

Across regions, South Asia and East Asia and the Pacific introduced the most reforms, followed by Sub-Saharan Africa. Europe and Central Asia and high-income countries had fewer reforms in financial access (figure 2.11). Not surprisingly, regions that include financial access in their strategies and mandate their financial regulators to carry out such agendas are also the regions that reformed the most. Pakistan and India lead the way for South Asia with six and seven different areas of reform, respectively. The three economies

FIGURE 2.12

Reform priorities differ by income group

Source: *Financial Access* database.

reporting the highest number of reforms, with 10 different areas of reform each, are the Philippines, Malaysia, and Nigeria. Once again, all their central banks have special access to finance units.

Overall, low-income countries, where needs are the greatest, reformed more actively and focused more on promoting deposit and credit services than high-income countries (figure 2.12). High-income countries, where access to basic financial services is nearly universal, focused more on enhancing consumer protection.

NOTES

1. Throughout the report, financial literacy, financial education, and financial capability are used interchangeably to maintain a broader focus and facilitate cross-country comparison of reforms.
2. These broad categories of topics relevant for the financial inclusion agenda were identified for the purposes of the *Financial Access 2010* survey to enable cross-country comparison. This list does not include the full universe of issues covered by the concept of financial inclusion. The focus on these topics by a financial regulator does not necessarily imply an explicit financial inclusion mandate but may reflect the importance of these issues for implementing financial stability and macroeconomic policy mandates. For example, improvements in financial literacy and consumer protection are expected to improve loan performance, and SME dependence on bank financing can be an important transmission channel for monetary policy.
3. See Genesis Analytics (2008) and Isern and Porteous (2005).