Advancing Savings Services
Resource Guide for Funders

A Technical Guide

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A Guide to Unlocking Savings for the Poor

Supporting savings mobilization is fundamental to building inclusive financial systems. Many microfinance funders have long recognized the importance of savings services for poor people. However, a majority of funders still focus on scaling up access to credit, rather than savings. There are three main reasons for this.

First, historically, credit has been regarded as having the most direct link to increasing incomes. The premise was that, with a working capital loan, poor people would start or grow a microenterprise that would provide them with a livelihood to build assets that they could reinvest in their entrepreneurial activities or households. In addition, over time, making these loans to poor people would pay for itself. The very simplicity of this microcredit narrative is compelling to development leaders and heads of agencies with a poverty alleviation and economic development mission.

Second, incentives in many funding agencies are skewed toward disbursing large amounts of funding. Financing loan portfolios, whether through debt capital, grants, or equity, is by all accounts a faster way to disburse than investing in the long-term work of building institutional capacity to mobilize local deposits and engage in financial intermediation.

Third, supporting savings mobilization requires special care because the hard-earned and scarce resources of poor people are at risk if something goes wrong. Financial institutions can fail, and high inflation can erode savings. Appropriate governance for deposit-taking institutions, sound prudential regulation, and effective supervision are all important safeguards. But they are not always in place.

Despite these perceptions, however, there is renewed interest among funders in supporting savings services. First, there is an increased awareness and evidence that poor people are willing to and want to save. For example, FinScope Financial Access surveys have found that, at the time of the survey in 2009, 72 percent of Ugandans were saving, primarily at home or with an informal mechanism. In Nigeria, the 2008 FinScope survey found that 61 percent of those reported as unbanked indicated that they would like a formal bank account.[1]

[1]FinScope. Results of cross-country household surveys in Uganda (2009) and Nigeria (2008). http://www.finscope.co.za/index.asp.

Researchers of the Financial Diaries project show that poor rural households in South Africa use four different savings mechanisms on average throughout the year. Furthermore, use of informal savings mechanisms, such as roaming deposit collectors (susu in Africa) and village savings groups (rotating savings and credit associations [ROSCAs] and accumulating savings and credit associations [ASCAs]), are highly prevalent, especially across West Africa and Asia. Rural, unbanked populations continue to rely on these mechanisms despite their associated risks and frequently high cost, demonstrating that poor people are not only able to save, but are also willing to pay a price for this valuable service (Collins, Morduch, Rutherford, and Ruthven 2009).

At the same time, technology-led solutions that could enable providers to attract savings at a low cost are emerging. For example, M-PESA in Kenya has reached virtually every community through its mobile money system. Mobile money is a particularly promising means to expand access to financial services because it piggybacks off of widely deployed infrastructure—the retail shops that exist in every village and every neighborhood and the telecommunications networks that are rapidly being built in developing countries (Radcliffe 2010). Finally, concerns about over-lending and the microcredit crisis that has erupted in several markets have also turned funder attention to savings, as these markets were typically characterized by credit-led microfinance institution (MFI) models, with low deposit-to-loan ratios.

This resource guide is intended to gather in one source the issues funders need to consider when focusing on the expansion of voluntary savings mobilization.[2] This guide is meant to be a reference document for staff of donors and investors who design, implement, and monitor programs and investments to improve poor people's access to savings services. It does the following:

- Makes the case for advancing savings mobilization from the perspective of both the client and the financial institution.
- Summarizes the state of knowledge about savings services, and offers ideas for what funders can do to support savings services, including actions directly related to client demand, institutional supply, intermediation, and enabling environment.
- Provides a bibliography of resources on savings services for poor people.

[2]This guide focuses on voluntary savings services and does not analyze compulsory savings. Compulsory or mandatory savings include savings payments that are required as part of loan terms or as a requirement for membership of a savings group or cooperative, for example. Compulsory savings are often required in place of collateral. The amount, timing, and level of access to these deposits are determined by the policies of the institution rather than by the client.

1. The Case for Savings

Poor people know the value of saving, and this is reflected in their behavior. Household studies consistently show that poor people save and that unbanked households already use a variety of informal savings instruments to manage their small and unpredictable incomes. These instruments include saving at home, investing in gold or livestock, or membership in a savings club. However, some researchers have found that most informal savings options lack the privacy needed to keep others from demanding or borrowing a person's savings for their own needs, as well as the self-discipline needed to encourage saving (Collins, Morduch, Rutherford, and Ruthven 2009).

Demand for formal financial services is high when these services are tailored to the needs of customers. For example, Equity Bank in Kenya manages over US$1.2 billion in customer deposits across 5 million accounts—a 10-fold increase in both accounts and the value of savings in the past five years (Radcliffe 2010). Grameen Bank added over 2 million new savers between 2005 and 2009, and deposits currently amount to 153 percent of the outstanding portfolio. The strong and consistent deposit growth of these and other leading deposit-taking institutions points to the fact that savings services are valued by low-income clients and can make business sense for financial providers. Deposits can also be an important and stable funding source for financial institutions helping to reduce the risk of foreign exchange losses and strengthening institutional stability, especially in times of economic crisis.

Few studies have explored the role of savings services in impacting the lives of the poor. Recently, economists have been using randomized controlled trials (RCTs) to document the development benefits of formal savings services (see Box 1). The findings of these studies suggest that there are important potential benefits from access to formal savings mechanisms, such as increased business investment and private expenditures. A series of new studies examines product design to see how small changes can improve outcomes for poor clients (Thomas forthcoming).

Despite significant progress, most of the world's poor, especially across sub-Saharan Africa and in rural and remote areas, still lack access to formal savings services. Half of the world's households have no access to a bank account (CGAP and World Bank 2010). While many factors contribute to this, lack of client-level information, institution-level constraints, inadequate infrastructure, and regulatory barriers stand out as the primary challenges.

Box 1. Impact of Savings Accounts

Dupas and Robinson (2009) conducted a field experiment in rural Kenya to study the extent to which the lack of access to formal savings accounts impedes business growth. They found that access to an account had a substantial, positive impact on levels of productive investments among market women and, within six months, led to higher income levels, as proxied by expenditures. These results imply that a substantial fraction of female entrepreneurs have difficulty saving and investing as much as they would like, and have a demand for formal saving devices.

A study in Malawi involved a local MFI that facilitated savings in either ordinary accounts or commitment accounts. Commitment accounts allowed customers to restrict access to their own funds until a future date that they chose. A control group did not receive any savings treatment but was tracked alongside treatment groups. Take-up of both types of accounts in the treatment groups was high, but only the commitment treatment had statistically significant effects on subsequent outcomes. The study found that facilitating commitment savings for small-holder cash crop farmers had substantial impacts on the following: savings before the next planting season, agricultural inputs applied in the next season, access to funds during the next lean (preharvest) period, crop sales at the next harvest, and food and total expenditures after the next harvest (Brune, Gine, Goldberg, and Yang 2010).

2. *Understanding Clients and Strengthening Their Capability*

2.1 Client Research

Knowledge on clients has many dimensions: the underlying beliefs and behavioral elements that define how or when people may save, the scale and scope of demand, and preferences that drive a client to choose one product or provider over another. While some aspects of client research are best undertaken by the retail providers serving them, many aspects serve the broader public good and may be undertaken or commissioned by donors or governments.

Behavioral economics provides much deeper insight into issues that may not seem intuitive from a rational economics perspective. It shows that, in everyday life, decisions are often not methodically contemplated, calculated, and executed, and they may have important psychological underpinnings. For example, people are often derailed from their short-term goals when they keep money aside in their homes, and small sums of money that are accessible to the household can be easily spent on temptation goods (Sendhil and Krishnan 2008). Therefore, individuals with control problems, for example, should have a preference for commitment savings products. A randomized controlled study was undertaken in the Philippines to test this assumption and to evaluate the effectiveness of a commitment savings account on financial savings. Researchers found that commitment savings products generated a strong positive impact on savings: after six months, average bank account savings increased by 47 percent in the commitment-treatment group relative to the control group (Ashraf, Karlan, and Yin 2005). Foundational research of this nature is a public good, as it has much broader usage than at the provider level alone.

Sector-wide client demand studies help to define the scale and scope of demand. They can increase awareness and knowledge on the needs of the different client segments and can contribute to attitudinal shifts of both policy makers and managers of financial institutions in support of encouraging savings. They can also support information dissemination and partnership building among regulators, financial institutions, and other actors, such as mobile phone operators. Helping local stakeholders collaborate to identify country-specific, locally appropriate ways for increasing access to savings services and linking savings with other services and interventions is ultimately what is going to help reach large numbers of poor people (see Box 2). Examples of sector studies include FinScope studies that have been undertaken primarily in southern and eastern African coun-

tries and detailed anthropological household studies, pioneered by Stuart Rutherford and published in *Portfolios of the Poor* (Collins, Morduch, Rutherford, and Ruthven 2009).

Sector studies can help define the needs of different client segments (e.g., entrepreneurs, women, youth), which may require different products and services to address their needs (see Annex 1 for more information on savings products). These studies can also help shape the broader policy agenda, as well as influence financial services providers themselves, who may not see the market potential of serving low-income market segments. Due to their broader public good nature, these studies are also best supported by funders or governments, rather than individual retail providers.

At the *provider level*, research is needed to help institutions better design and market their products to poor clients. Do clients demand deposits or long-term savings accounts? Do clients favor proximity to the financial institution or is trust in the institution the key factor for placing their funds there? Unfortunately, market research and pilot testing are often overlooked by many institutions. Practical tools, such as, MicroSave's Market Research for Microfinance toolkit, can help financial providers undertake sound market research and are widely used by various service providers.

In the long run, research to capture client preferences should be funded by financial institutions themselves. Funders' support for market research and assistance with product design, piloting, marketing, and operational planning can help financial service providers launch appropriate savings services and design cost-effective and innovative financial services and delivery mechanisms.

2.2 Consumer Awareness and Financial Capability

Consumers' ability to understand product and service features, such as fees, charges, and deposit withdrawal terms and conditions, depends on both the transparency of financial service providers and the financial capability of their clients. Programs to promote consumer awareness and strengthen financial capability seek to inform people about the benefits of managing their money and provide them the tools to do so. For savings, this can potentially impact both the take-up and use of savings products.

Empirical evidence related to the impact of financial capability interventions is mixed, and few rigorous evaluations exist for programs in developing countries. Preliminary evidence suggests that financial awareness and financial capability programs are more likely to be effective when they are directly linked with the provision of financial services and targeted at specific segments. For example, a randomized controlled study of a financial literacy training program conducted in Indonesia found no effect of the program on the likelihood of opening a bank account in the general population. However, the study

Box 2: Tapping into Opportunities: Linking Remittances and Government-to-Person Transfers to Savings Accounts

Officially recorded remittance flows to developing countries reached US$316 billion in 2009, according to the World Bank (2010). Unfortunately, a relatively small portion of these funds remains in the formal financial system. A number of recent studies have found a positive correlation between remittances and savings mobilization. For instance, a 2009 World Bank study of the Mexican remittance market found that clients who receive remittances through a formal financial institution are more likely to open a bank account (Demirgüç-Kunt, Cordova, Peria, and Woodruff 2009). Offering affordable remittance services can thus introduce the unbanked population to savings accounts. Financial institutions can also benefit from mobilizing longer term savings from migrants, tapping into a new market segment, cross-selling products, and earning extra revenue on wire fees. For instance, a 2009 analysis of MIX data found that financial institutions that offered remittance services were able to mobilize a higher level of voluntary savings than MFIs that did not (Sukadi Mata 2009).

Linking government-to-person (G2P) transfers to savings accounts has also successfully brought poor people into the formal financial system. CGAP estimates that close to 170 million people are recipients of transfers from their government, and less than 25 percent receive these payments into a bank account. Institutions that participate in electronic G2P programs can thus benefit from guaranteed deposits as well as a new client base. Mexico's Oportunidades program introduced optional savings accounts with the Mexican Bank of National Savings and Financial Services. By 2004, over 1 million of 5 million beneficiaries of G2P programs had savings accounts linked to the program. Preliminary evidence from pilot programs also implies a positive link between G2P programs and willingness to save. A study of Paraguay's Tekoporã program found that beneficiary households saved 20 percent more on average than they had prior to the introduction of the program, with the highest savings rate changes occurring among the extreme poor (Zimmerman and Maury 2009).

found that the training had a significant impact on unschooled and financially illiterate households, increasing the likelihood of opening a bank account by 12 percent and 5 percent, respectively (Cole, Sampson, and Zia 2009).

Funders can support innovative approaches for delivering financial capability programs and building consumer awareness. They can also play a useful role in helping to develop a knowledge base on what constitutes cost-effective interventions in this area.

3. Extending the Reach of Sound Providers

3.1 Institutional Prerequisites for Savings Mobilization

Mobilizing savings should be done only by institutions that are subject to government prudential regulation, except in the case of informal credit and savings groups and, in some cases, small savings and credit cooperatives. To mobilize savings, institutions must have a sound governance structure and the capacity to comply with all central bank requirements, ranging from staff with specific management profiles to reserves maintained at the central bank.

Institutions considering mobilizing savings should do so only if management is clearly up to this task. While a credit-only provider can manage growth by the number of borrowers approved, voluntary savers cannot be turned away without long-term negative effects on the institution. Institutions must have strong internal risk management systems that allow them to manage inflation or currency devaluation, which can sharply erode the real value of deposits. For example, an acute liquidity problem may arise when inflation or currency devaluation make customers withdraw their money or change it into hard currency. The latter can also leave a financial institution with an unwanted currency mismatch.

A sound asset and liability management (ALM) process is therefore especially important for deposit-taking institutions since the variety of liabilities available to them is by definition more complex than those available to nondeposit takers. ALM focuses on measuring and managing risks arising from factors beyond any organization's control, such as foreign exchange rate volatility, interest rate volatility, and availability of funding (liquidity), all of which are a function of the supply and demand for money in the global economy. Good ALM systems enable organizations to minimize the risks inherent in their balance sheets by matching the currencies and terms of assets and liabilities as closely as possible with their organization's risk appetite (for more information, see Brom 2009).[3]

Providing poor people with a safe place to save may be a challenge for many financial institutions as poor clients tend to keep small balances, prefer to make many transac-

[3]For financial and risk management definitions and terms see Glossary in Annex 1.

tions, and live and work far from traditional banking outlets. The biggest challenge is often achieving cost-efficiency and finding innovations in service delivery that make it feasible to mobilize very small deposits. Economies of scale and technology-based innovations can play an important role in bringing down costs. A recent CGAP study of the business case for small-balance savings (Westley and Palomas 2010) shows that high operating costs linked with small-balance savings mobilization can be offset by the profits generated through cross-sales of loans and other products to the small savers and by the fee income derived from their savings accounts. For example, cross-selling of loans and money transfer products to small savers was significant for both ADOPEM (Dominican Republic) and Centenary Bank (Uganda). In ADOPEM there was a high rate of cross-selling of loans to small savers, with about three quarters of ADOPEM's small savers also borrowing at any given time, while Centenary Bank generated most of its profits through the fees charged on small savings accounts and by offering a range of money transfer products. Centenary also makes substantial use of automated teller machines to attract and retain clients, boost savings levels, and cut costs (Westley and Palomas 2010).

However, it is difficult for financial institutions to cover their costs with savings alone. To be sustainable, deposit-taking institutions need to move to full financial intermediation, which includes a sound credit business. A sound credit business is key as it enables a financial institution to profitably invest the savings captured and reduce credit risk.

Funders can support different types of institutions, formal and informal, depending on the country context. Funders interested in supporting formal financial institutions to scale up savings should carefully assess the health of the institution (see Box 3). These preconditions help to guard against the most important risk—loss of client savings. In all cases, it is important for donors to specify a time horizon for their support for each institution. The time required to achieve financial sustainability depends on the country context, local market conditions, the capital structure of the retail financial service provider, and the market segment served.

3.2 Different Institutional Types: Challenges to Scaling up Savings and Support Needs

There are diverse types of financial service providers with the potential to scale up savings services. They range from informal groups to formal institutions, such as commercial banks. Also, new delivery methods, such as branchless banking and the use of mobile technology, offer considerable scope for expanding access. A variety of service providers and links and partnerships among different providers will be required to meet clients' diverse demands. The main operational challenges of these providers to becoming secure and viable financial intermediaries vary significantly across different business models.

Box 3. How to Select a Partner: Summary Checklist of Due Diligence/Assessment Considerations

- **Legality.** Is it legal to accept deposits? If this is unclear, are the authorities willing to waive or adjust legal or regulatory requirements? If the institution is not supervised, as is often the case with member-owned institutions, is it prepared to implement high financial monitoring standards and full disclosure on an ongoing basis?
- **Current profitability.** Has the institution reached sustainability? An institution should offer voluntary saving services only if it is at or very close to profitability. Otherwise, the risks to the depositors are unjustifiable.
- **Credit management.** Does the institution have a history of stringent credit management and results to match, including sustained high levels of portfolio quality?
- **Liquidity and asset and liability management.** Does the institution have the skills, policies, and systems needed for proper liquidity and asset and liability management? Appropriate capital adequacy?
- **Internal controls.** Are internal controls sufficient or adequate? Are they reinforced by the institution's culture, policies, procedures, information systems, and training and supervision of staff? Are cash and data security prioritized as an integral part of operations?
- **Human resources.** Does the institution have (or can it add) adequate management and staff to design and successfully launch a savings operation? Does management have the skills to reorient existing staff or recruit and train new staff to interact with clients in a way that inspires trust and confidence to make deposits?
- **Distribution channels.** If relying on branch offices, will the physical facilities afford adequate protection, accommodate clients, and inspire their trust? If a branchless banking model is being used, has a full operational and financial analysis been done of the business model and due diligence carried out on proposed partners?
- **Information systems and financial reporting.** Can the information system handle the expected number and type of transactions associated with the new service? Does the information system provide information that is sufficient, accurate, timely, and transparent? Is the institution capable of providing the reports required by the banking supervision body, if required?
- **Governance and clear ownership.** Does the institution have an effective board, clear ownership, or other governance body that exercises reasonable oversight, ensures sufficient discipline, and serves as a check on management?

- **Demand.** Is there demand for the proposed product? Will the proposed product strike the right balance of product features, convenience, security, and price?
- **Future profitability.** Is there a business plan that demonstrates ongoing profitability across the business? Does it include sufficient reserves, capital, and operating funds to cover initial operating losses and losses due to major portfolio shocks without relying on client deposits? Does it have a profitable place to invest excess savings?

Note: These due diligence criteria are adapted from a list of prerequisites for intermediating deposits developed by McKee (2005).

Hence, each type of provider will require different types and levels of support from donors and investors.

The overview that follows does not include all types of financial services providers. Of those described, their prevalence varies greatly by country or region. For example, in some countries (e.g., the Philippines) rural banks are important providers of savings services in remote areas, while financial cooperatives dominate in West and Central Africa.

Informal member-owned savings and credit groups have proven effective in providing the most basic financial services to poor people, especially in rural areas of Africa and Asia. For example, rotating savings and credit associations (ROSCAs) are indigenous savings institutions that are found in virtually every country under a local name, such as tontine in West Africa, dhikuti in Nepal, and arisan in Indonesia. These groups are usually low cost to operate and simple to manage; they are often a first step to creating a savings culture. Participation in a savings group can help empower members and build up social capital within communities, particularly among women who represent the majority of membership. Even in countries with a large number of specialized MFIs, such as Bangladesh, the groups play an important role in the poorest villages lacking formal financial institutions.

Savings and credit groups provide basic savings services, but they also have many shortcomings. They often have limited product offerings, members are frequently unable to access savings when they want them, and many suffer from poor management due to limited member capacity. Furthermore, the risk of theft and fraud can be high.

Donors' support to savings and credit groups should focus on improving risk management and operational capacities to address these challenges. In areas where there is little alternative financial service provision, donors can also facilitate the creation of new groups and linkages with formal financial institutions. International and local non-

governmental organizations (NGOs) often provide direct support to informal savings groups. The role of an NGO or other support provider typically involves introducing the concept to a community, facilitating group formation, and delivering a structured training program to help members define the group's purpose, elect members to serve as officials, establish terms for savings and loans, and set up and even manage systems for record keeping. Donor funding is required for such support.

When supporting member-based savings groups, donors must be careful with how they structure their assistance. Typically, support for capital should be minimal. Studies show that an external injection of capital funding, especially in the early stages of institutional development, reduces groups' incentives to build up their own savings pool and undermines sustainability.[4]

Financial cooperatives and credit unions around the world already mobilize large numbers of small voluntary savings. They are inherently savings-led organizations. Proximity to their clients allows many cooperatives to serve poor, hard-to-reach depositors. Their size and depth of outreach varies across institutions and countries; in Kenya, Senegal, and Cote d'Ivoire, average savings balances of cooperatives are quite low—less than 7 percent of GDP per capita (WOCCU 2008). In East and West Africa cooperatives serve primarily middle-income households (Hirschland et al. 2008). The challenges to scaling up savings services are typically related to lack of management and staff capacity, inadequate management information systems (MIS), poor governance, and lack of oversight and supervision. Some financial cooperatives and credit unions also face an inability to safely lend funds received as deposits due to lack of credit capacity and systems.

Donors can best support member-based financial providers by building institutional capacity to increase and manage deposits (and loans). This includes developing governance standards, using business planning tools, instituting monitoring systems through formal MIS, and developing new savings products and delivery channels to reach poorer customers. Growth also requires investing in information systems and negotiating equal access to payment systems. Often, a first step in supporting financial cooperatives is to ensure the safety of deposits by making sure the organization meets accepted financial management standards. The World Council of Credit Unions (WOCCU) uses the PEARLS financial performance monitoring system in its technical support to credit unions. This system is explicitly structured around indicators that ensure the institution is a safe place to save, incorporating measures such as proper loan loss provisioning. It also ensures that assets, financed by savings deposits, generate sufficient income to pay market rates on savings, cover operating costs, and maintain capital adequacy. This is an example of

[4]See e.g., Murray and Rosenberg (2006).

good practice that could be replicated by other associations and credit unions while being adapted to their specificities.

Funders should concentrate resources on cooperatives and/or federations that are willing to implement sound policies, standards, and regulations. Small institutions may also need support for federating and linking into larger distribution networks and the commercial banking system to allow greater financial intermediation. As with informal member-owned savings groups, funds for lending should be approached with great caution as access to external credit can weaken governance and undermine incentives for savings mobilization without proper oversight and training.

Credit-only MFIs that plan to introduce savings services can have the advantages of already serving a poorer client base and, in some cases, having a social mission and management commitment to expanding financial access to the poor. Lack of regulatory authority, limited institutional capacity and qualified staff, high cost of institutional transformation and preparation for the rigors of prudential regulation and supervision, and governance issues are often the main constraints to such organizations introducing savings services.

Introducing savings services is a major undertaking, representing a process of complete institutional transformation. Institutions need to apply for a license to become regulated and supervised, and they must comply with all regulatory requirements. A typical challenge from the regulatory side is meeting the minimum capital (equity) and liquidity requirement as many nondeposit-taking MFIs operate with low capitalization.

The biggest operational challenges are often developing institutional capacity as a financial intermediary, changing the institutional culture from a focus on credit to financial intermediation, and building clients' trust in the institution as a place to deposit their money.

Credit-only MFIs select borrowers whom they trust. However, when collecting savings, it is the clients who must trust the MFI. There are three key shifts as an MFI goes from credit-only to introducing savings among its services. These relate to the importance of marketing and branding, branch distribution (given clients' lower willingness to travel), and ALM (greater uncertainty over cash flows). Savings mobilization requires moving toward efficient management and accountability systems, expanding both the product range and the client base, building a more qualified and professionally trained staff, and understanding and fulfilling banking regulations. These challenges can be met only if senior management and the board are fully committed and have given serious consideration as to whether transformation is the right move.

There are many cases of transformed microcredit institutions that struggle to mobilize deposits successfully. For example, regulators may put limits on the percentage of the portfolio that can be uncollateralized. This can have negative implications for MFIs that

have been using unsecured lending methodologies to reach low-income clients. However, there are some notable successes. Probably the most well-known example is Grameen Bank. Grameen II, the bank's fundamental overhaul of its products that began in 2001, has moved the bank from simple microcredit to a more sophisticated system offering a range of financial services, including savings.[5]

In some cases, credit-only MFIs may decide that they do not have the capacity or do not wish to invest in the infrastructure needed to carry out full financial intermediation. In such cases, funders might support these MFIs in offering agency banking services by mobilizing savings for another regulated institution. In this case, prudential regulation and supervision is required for the principal but not for the agent. The principal is responsible for supervision of the agent. In an agency relationship, the institutional capacity-building requirements for an MFI are far less onerous. However, staff will still need to be trained on savings products, cash management, and customer service.

Funders can play an important role in the transformation of credit-only MFIs to deposit-taking organizations. Such support is particularly necessary in the initial two to three years to carry out the detailed business planning and financial modeling for the transformation (including costs of deposits and impact on overall profitability, etc.), technical assistance to help MFIs meet central bank requirements, and the introduction of new internal controls and risk management procedures, such as treasury and asset–liability functions. Investors should also consider helping MFIs meet local capital adequacy requirements through an equity investment. Additionally, funding and support for market research, product development, marketing, and staff training are also needed. Furthermore, many MFIs also need major infrastructure investments to upgrade or expand their premises and information systems. Finally, funders should note that supporting MFI transformation may be a long-term commitment, as this process can take several years.

Savings banks and postal institutions include a broad range of institutions from universal banks, which provide the full range of financial services (money orders, savings, current accounts, credit etc.), to postal institutions, which focus mainly on savings services. These organizations, many of which are state-owned, already provide mass-market access to savings accounts and loans for people, including low-income customers in rural areas.

For the most part, *savings banks* maintain a strong focus on serving low-income segments of the population and often operate under the same conditions as retail banking institutions. They have the capacity and technical expertise to mobilize savings, but product design and marketing, as well as internal procedures and processes, often need

[5]For more information see *MicroSave*'s Briefing Notes on Grameen II, www.microsave.org.

improvement. This may require investment in information technology (IT) systems and new delivery channels.

Over 70 percent of countries in the world use *postal institutions* to deliver financial services (CGAP 2009). Building on their pre-existing infrastructure, postal institutions have a potential to reach large numbers of unbanked clients, and recently, a number of countries have taken steps to reform and revive postal networks. For example, Banco Postal in Brazil opened almost 10 million savings accounts in eight years, providing access to financial services to 20 percent of the country's 50 million financially excluded people (Universal Postal Union 2010).

Postal savings institutions have traditionally been weak on customer service. They often have poorly qualified staff and have limited use of technology and equipment (e.g., connectivity of branches). Furthermore, their procedures are frequently bureaucratic. These issues are the main challenges that limit their ability to offer attractive savings services to unbanked clients. Nonetheless, the potential of postal networks for financial service delivery is increasingly recognized by many of the organizations themselves and donors.

Funders working with postal savings institutions must respond to demand from these institutions rather than taking a supply-driven approach. Given the sheer size, and (typically) state ownership of these institutions, institutional reform and other technical assistance projects are generally complex and large in scope. Thus, funders should carefully target assistance to institutions that demonstrate a vision to reach low-income savers and have commitment to sound governance. Institutions should also demonstrate a willingness and flexibility to potentially adopt new operational structures, such as public–private partnerships.

Specialized microfinance banks include transformed NGOs and nonbank financial institutions, as well as **greenfield banks**, set up as deposit-taking institutions that target poor clients and small and medium enterprises (SMEs). ProCredit Holding, which has set up 21 greenfield banks, has been supported and funded by a range of public and private investors. Several ProCredit banks have been very successful at mobilizing deposits, including from lower income customers. Public subsidies for these institutions should be limited to the initial years of operation to help cover the costs of technical assistance and training of local staff. In addition, a package of debt and equity can be used to provide the working capital and cover the investment needs of the bank until it breaks even.

Mainstream **commercial banks** generally do not serve low-income savers in developing countries, though a number of banks have taken steps to facilitate access by investing in technological innovations, simplifying account opening procedures, and partnering with existing providers, such as ICICI in India. For commercial banks, the first obstacle to servicing small-balance depositors and expanding into rural areas is often manage-

ment's view that a move down market is not a priority as it cannot be cost-effective and profitable. Other deterrents include inappropriate systems to manage low-cost delivery channels, lack of competitive pressure to search for new market segments, and a corporate culture that is not oriented toward serving poor clients.

Funders' support to commercial bank downscaling projects has historically focused on encouraging mainstream banks to reach out to low-income clients and SMEs through a support package that combines technical assistance and wholesale loans for on-lending. Funders of downscaling initiatives have typically not invested in working with commercial banks to research how they could extend their savings services to low-income customers. However, as commercial banks move into microfinance, they are naturally beginning to look at how they can cross-sell products, including savings services. Funders' roles in supporting these banks should focus on providing incentives and technical support for innovation, product design, customer service, and promotion to low-income customers. In some cases, funders can work with policy makers to reduce the onerous regulatory requirements that could provide additional incentives to banks to provide small-balance accounts. Additionally, funders can work with commercial banks to support their compliance of know-your-client norms, which small depositors often find difficult to meet.

See Table 1 for a brief summary of the pros and cons of different saving providers.

3.3 The Role of Technology in Scaling Up Savings

New delivery methods, such as branchless banking and the use of mobile technology, are likely to evolve rapidly and play an important role in achieving financial access for poor people alongside or in partnership with the institutions discussed in the preceding sections. Leveraging existing networks of nonbank retail outlets, such as retail stores or post office outlets, as cash transaction points and agents of licensed financial institutions has already proven to be a successful business model in countries such as Brazil. Two models of branchless banking through retail agents are emerging: one led by banks, the other by nonbank commercial actors. For example, customers of Caixa Econômica Federal, a Brazilian state-owned bank, can open and deposit money in a current account, make person-to-person transfers, and get loans—all using simple bankcards and card readers at over 12,000 lottery outlets, supermarkets, and even butcher shops. Customers of Globe Telecom, the second largest mobile network operator in the Philippines, can use prepaid airtime dealers to deposit cash into virtual "e-money" accounts tied to their mobile phones (Lyman, Ivatury, and Staschen 2006).

Technology innovation is also crucial in reducing the high cost of operations in mobilizing poor people's savings. For example, Urwego Opportunity Bank in Rwanda was the

Table 1: Summary of the Advantages and Challenges of Different Saving Providers

Financial Service Provider	Advantages	Challenges
Informal Community-Managed Savings Groups (SHGs, ROSCAs, ASCAs, VSLAs)	• serve poor clients, primarily women • operate in remote, rural regions • low-cost operations • easily replicable and/or self-replicating • build social capital and self-esteem	• limited product offering • limited managerial capacity • savings methods limit asset building • risk of exclusion of poorer individuals • risk of theft of savings
Credit Unions and Other Financial Cooperatives	• inherently savings led • simple products • often located in remote regions accessible by the poor • low transaction and financial costs	• governance challenges • finding the right balance between borrowers' and savers' interests • risk of capture by net borrowers/elite • lack effective prudential regulation and oversight by financial authorities in some countries
Transforming (formerly Credit-Only) MFIs	• knowledge of poor clients • social mission often oriented to serve poor and marginalized communities • increasingly more interested in using deposits to diversify funding sources	• inadequate institutional capacity for savings, e.g., ALM • high costs of institutional transformation • credit-led culture; staff pose resistance to transformation
Specialized Microfinance Banks and Greenfields	• adequate skills and expertise • set up as deposit-taking institutions, no transformation required • broad range of products	• may require significant subsidies initially • knowledge gained not shared beyond network/holding for proprietary reasons • often not reaching clients in remote areas • limited branch network
Savings Banks	• capacity and technical expertise to mobilize savings • usually perceived to be safe and secure	• product design and marketing often need improvement • limited distributional channels
Postal Savings Institutions	• extensive branch networks that often penetrate rural markets • pre-existing infrastructure can allow for low transaction costs	• governance and management challenges • bureaucratic culture • often require significant institutional reform • limited product range • poor customer service
Mainstream Commercial Banks	• broad range of products and services; recognized brand name • large network of branches and other outlets • experience in retail banking and established systems • linkages to payment systems • ability to cross-sell products	• corporate culture not oriented toward serving low-income markets • limited incentives to target poor and remote clients • existing products often do not meet the needs of the poor • lack of low-cost delivery channels • operate mostly in urban areas

Note: SHGs = self-help groups; ASCAs = accumulating savings and credit associations; VSLAs = village savings and loans associations

first bank in Rwanda to introduce biometrics, which allowed for fast and paperless banking. This new technology not only reduced cost of operations but it also made banking easy for poor people, reducing transaction time significantly from as long as five minutes to less than one minute per transaction per customer.

Thus far branchless banking has mainly facilitated money payments and transfers, and the current linkage to savings mobilization is not as yet formed. However, the role of mobile phone technology in savings mobilization is likely to increase rapidly as more telecommunication companies become savings agents by partnering with financial institutions and collecting savings on their behalf. Poor people are already starting to use mobile banking for something that looks like savings despite what the providers designed the products to be.

For instance, M-PESA, operated by Safaricom in Kenya, is not a licensed deposit-taking institution. However, M-PESA clients are storing money in their "virtual wallets." Safaricom customers can register for M-PESA by visiting a merchant who acts as an "agent" for account opening and handling of deposits and withdrawals into the customer's virtual wallet. Agents also serve as customer support. Customers can then use an application on their mobile phone to check their balance, send money to other people, pay bills, and purchase mobile phone airtime. One study found that in Kibera, a poor slum area in Nairobi, a fifth of unbanked interviewees stored money with M-PESA because it is safer than storing it at home (Morawczynski and Pickens 2009). Studies have also shown that saving in a branchless banking account is cheaper than most basic no-frills accounts. Banks and MFIs are now using the M-PESA infrastructure to offer deposit accounts, paving the way for more formal use of mobile platforms for savings mobilization. For example, Equity Bank has already partnered with mobile operators to launch M-KESHO (with Safaricom) ORANGE MONEY with Telkom Kenya as well as YUCASH with Essar (Equity Bank 2010).

The likely future role of technology is further exemplified by the recent acquisition of a majority share of Tameer Bank in Pakistan by Telenor, a mobile network operator (MNO). The bank and MNO are now planning to offer multiple financial products, including savings services. Such joint ventures are likely to become more common globally.

When working with mobile phone companies, funders need to take an entrepreneurial and commercial approach. The technology business is not suited to traditional donor funding. Experience working with telecommunication companies has shown that these private companies already have access to considerable resources and are not seeking external funding from donors with significant strings attached. In fact, the funding needed for telecommunication companies is relatively small. Instead, these players are looking

for flexible partnerships to allow those with a strong understanding of the technology to serve the poor. Thus funders need to be strategic, using their leverage and influencing role, rather than their financial resources, to persuade telecommunication companies to reach the unbanked.[6]

[6]For more information see Martinez and McKay (2011).

4. Strengthening the Enabling Environment

4.1 Effective Market Infrastructure

Market infrastructure refers to the full gamut of services and institutions that support retail institutions, including payment systems and money markets, technical assistance providers, training, and other support organizations and services. This section focuses on those services that are most relevant for savings mobilization and not the full spectrum of services that make up market infrastructure.

Training Support and Capacity Building

Financial institutions rely on a host of technical service providers that offer specialized training, information, and consulting services in areas such as strategic planning, financial and risk management, new product development, etc. When they are available locally, these services can be supplied by government entities, private-sector providers (consulting firms, training institutes), NGOs, and professional associations. A large number of specialized international, regional, and national networks provide services directly or facilitate members' access to services (Helms 2006). However, the in-country training needed to develop delivery channels, train staff on customer service, or design products for the low-income *depositors* market is not easily accessible by financial institutions serving poor clients. This is because most microfinance markets have been credit-driven, and few local trainers and experts have emerged with savings-related expertise. In fact, most NGO transformations and support for savings mobilization have happened with the backing of international, not local, technical service providers funded by donor subsidies.

Donor support for building human and institutional capacity remains crucial for extending access to deposit services, and international NGOs, networks, and support organizations can play a very important role in this process. It is essential to ensure that an adequate local supply of technical service providers exists. Funders can help strengthen this capacity by investing in existing providers, sharing knowledge, and creating linkages between financial institutions and existing local support institutions. Funders can also support training of trainers and individual experts as a way to strengthen the overall supply of trainers and experts available to local service providers.

Payment Systems and Money Markets

Payment systems allow the transfer of money among participating financial institutions. Access to the payment system affects an institution's ability to intermediate deposits as linkages to payment systems allow financial institutions to make clients' savings available in multiple locations and perform electronic transfers. Traditionally, access to payment systems has been restricted to large, regulated financial institutions.

Lack of access to money markets can undermine institutions' incentives to mobilize savings. In many markets, regulated financial institutions already have more than sufficient funds relative to lending or investment opportunities, especially in the short term. Demand for short-term client deposits can thus be weak. For instance, in many developing countries, liquidity management mechanisms of commercial banks are limited by the lack of treasury notes, interbank markets, or repurchase agreements. In developed countries these imbalances are usually corrected by liquidity management mechanisms (i.e., money markets). However, many developing country markets lack such liquidity management mechanisms, and as a result, many commercial banks do not target additional deposits, especially short-term deposits.

Supporting the development and reforms of payment systems is complex and is not exclusively a financial inclusion issue. The World Bank and regional banks have active programs that address payment systems development within their financial infrastructure practices. To ensure that these systems do not exclude providers reaching the poorest market segments, funders should encourage the development of effective communication among relevant stakeholders in the payment system, including the central bank and existing financial institutions using the system. Funders could help organizations serving low-income market segments negotiate terms on which they can afford to link into the payment system.

Deposit Insurance

A deposit insurance system is a public or private scheme aimed at protecting depositors from losing their savings when banks fail. It is meant to stabilize the banking system by preventing bank runs.

Every country has some type of *implicit* deposit insurance, even if no *explicit* deposit insurance system is in place. This means that whenever a large or widespread banking insolvency occurs, even if no explicit deposit insurance system is in place, pressure for governmental relief of at least some depositors and other bank stakeholders can become

politically too intense to resist. The International Association of Deposit Insurers (IADI) lists about 120 countries with explicit schemes in operation, planned, or under serious study. As of 2010, 106 countries had explicit deposit insurance systems in place, compared to 85 in 2006 and 47 in 1995; of these more than half are in developing and emerging economies.[7]

Public confidence in providers of deposit services to the poor (whether banks, MFIs, or financial cooperatives) can be reinforced if those providers have deposit insurance. Deposit insurance also protects clients who may not have the information to assess a financial service provider against failure due to fraud or mismanagement. An explicit scheme typically requires licensed depositories to become members of the scheme paying regular premiums. Deposit-taking institutions that are not regulated and supervised by the central supervisory body, such as small financial cooperatives, are not typically covered by deposit insurance.

Funders supporting deposit insurance should keep in mind that deposit insurance and government guarantees should never completely replace market discipline. When supporting deposit insurance schemes, funders should consult the established good practice design features (see, for example, the IADI Core Principles[8]). Examples of funders' support to deposit insurance include (co)financing of the initial capital allowance of a deposit protection fund or technical assistance in creating the legal and regulatory framework. Funders have already successfully supported deposit insurance in many countries.

4.2 Supporting Sound Policy Environments[9]

Supportive policy environments that balance increased access, financial stability, and protection of savings are crucial for successful deposit mobilization. Each country has its own regulatory and supervisory framework, and there is no "one size fits all" solution on the policy and regulatory side. Generally, if a financial institution takes deposits from the public, prudential regulation is called for. Prudential regulation aims to ensure the financial health of the regulated institution to protect depositors from the loss of their savings and the financial system from the so-called contagion effect stemming from the failure of one depository institution. Prudential supervision is an external oversight and engagement aimed at determining and enforcing compliance with prudential regulation.

[7]http://www.iadi.org/di.aspx
[8]http://www.iadi.org/core.html
[9]For more information, see CGAP (forthcoming).

Effective supervision is essential to ensure the security of deposits. Effective supervision is intensive and expensive—for both the supervisor and the supervised institutions.

Funders that focus on the policy level must be careful to balance the need for increased access by the poor with that of the security of deposits and the stability of the financial system as a whole. Macro-level support by funders must take into account the existing legal, regulatory, and supervisory capacity in the country and build on the existing framework, rather than importing models that are used elsewhere. Some regulatory and supervisory entities may also be reluctant to accept external advice—particularly from parties other than fellow supervisors. To address this problem, peer-to-peer learning and "south–south" dialogue can be very effective. For instance, the Alliance for Financial Inclusion (AFI), a global network of policy makers funded by the Bill & Melinda Gates Foundation, currently has such a project in place.

In the past decade there has been a tendency to support regulatory reform aimed at promoting the licensing of new depository institutions targeting the poor, but not the supervisory capacity needed to ensure that the new institutions can be effectively supervised. Yet in practice, it is the supervisory body that often lacks the capacity to effectively monitor institutions' performance and intervene if their financial health comes into question. Funders should formulate realistic plans to build the capacity of regulatory and supervisory bodies to manage supervision of any new deposit-taking entities. Bearing in mind that supervision of microloan portfolios requires expertise that a typical bank examiner does not have (BIS 2010), this is a considerable, long-term commitment. Furthermore, regulators and supervisors need exposure and training on essentials of microfinance to fine-tune their systems to the specifics of the sector. Funders should not support the development of deposit services unless prudential regulation and supervision in a country has the potential to be reasonably effective (except in the case of informal credit and savings groups and, in some cases, small savings and credit cooperatives; for more information on regulation and supervision of cooperatives see Box 4).

Investors may have an inherent conflict of interest when working on the policy level and must recognize that what may be good for their partner institutions may not necessarily be the best regulatory advice for the industry as a whole. In particular, they need to realize that any new regulatory provisions designed to promote licensing of depository MFIs carry the risk of regulatory arbitrage. This means that the applicants for the new license may include institutions that choose this option because it is an easier license to obtain than a banking license, rather than out of a genuine interest in serving the poor.

Box 4: Regulation and Supervision of Financial Cooperatives

While cooperatives in many developing countries provide savings and other financial services to large numbers of low- and middle-income clients, they typically have not been subject to the same kind of regulatory scrutiny and oversight as banks—or at least not until they grow to a significant size. Cooperatives tend to hold a far smaller fraction of system-wide assets, and they are often considered more "cooperative" (i.e., nonfinancial member-based) than financial institutions and, hence, are not considered a risk to the financial system as a whole. However, given their importance in providing savings services to large numbers of low-income clients, improving their regulation and supervision—and governance—is a topic of great concern.

Although, in some countries, larger cooperatives may be regulated and supervised as banks, in practice a vast majority of financial cooperatives are not effectively regulated, and many are in practice entirely unsupervised. The arguments for regulation and supervision of cooperatives are related to those for the regulation and supervision of the banking sector as a whole. Even when cooperatives account for a fraction of total deposit amounts in a given country, depositors are still worthy of protection, and in many cases large cooperatives function more like banks than member-based organization. As such, they have the potential to impact the stability of the financial system. Moreover, an argument can be made for protecting their (typically poorer and more vulnerable) depositors and suppliers of redeemable share capital even where they are unlikely to have a systemic influence. The challenge, therefore, is how to set up a supervisory system that minimizes those costs while still providing credible protection.

The arguments against regulation and supervision of cooperatives are typically associated with the costs of supervising large numbers of relatively small institutions. For small cooperatives, at least where the concept of membership and mutuality is strong, costly external regulation and supervision may not be justified. Instead, good governance and well-functioning internal control mechanisms may be sufficient to ensure protection of the deposits of members and to prevent management and boards of directors from exposing depositors' funds to unwarranted risks.

Funders that wish to work on policy issues related to cooperatives need to have a deep understanding of the performance of the sector in the country and its particular features (in many countries, financial cooperatives do not present a homogeneous picture). Also, more research aimed at understanding and identifying the conditions under which alternative regulation and supervision models may be more effective than others (including cost effectiveness) is needed—and might be a worthwhile investment for interested funders.

5. Choosing the Right Roles

As with any other intervention, donors and investors need to reflect internally to determine if they have the capacity (e.g., clear strategy, staff, accountability systems, etc.) to support savings mobilization before working in this area. From a funders' perspective, promoting savings mobilization is primarily about capacity building at the micro, meso, and macro levels of the financial system, but it can also be about strategically placed equity and debt into financial service providers able to deliver savings services to poor people. Overall, different types of funders have different instruments that can contribute to strengthening financial intermediation.

Grants can be effectively used to support a broad range of institutional needs and models. In the case of supporting the scale-up of retail provision, grants can be used to support investments in technical assistance and training, physical infrastructure (e.g., upgrading premises, MIS, study visits, etc.), as well as market research and experimentation with new products. Grants can also be used to support technical assistance and capacity-building to develop market infrastructure and a sound policy environment for savings mobilization. Grant support should be time-limited, performance-based,[10] and disbursed against the grantee institution's attainment of clearly established performance targets.

Debt financing is one of the most prevalent ways that funders support microfinance, representing more than half of all cross-border funding for microfinance. To advance savings mobilization, debt financing should be structured in such a way that it does not negatively affect financial institutions' incentives to mobilize deposits. Debt providers can also use their influence to promote savings mobilization with retail service providers. For example, increasing savings could be a condition or performance target for a loan and could function as a positive incentive. Finally, debt is fundamentally important for helping financial service providers diversify their funding mix, allowing them to better manage liquidity and address maturity mismatches.

Equity can be an important instrument in supporting savings mobilization. Development finance institutions (DFIs) have used equity investment to help meet the start-up capital needs of greenfield microfinance banks or to help credit-only institutions meet the capital adequacy standards of banking regulators when transforming to a regulated deposit-taking institution. Equity can potentially provide a more patient source of growth

[10]For more information on performance-based agreements see El-Zoghbi, Glisovic-Mezieres, and Latortue (2010).

capital than debt and is thus suited to institutions looking to start up or scale up savings services. Furthermore, it involves risk-sharing by the investor, which can make it a more attractive source of funding. However, to appropriately use equity as a tool for advancing savings mobilization, equity investors must have at least a medium-term investment time frame. Investors can also use their position on the board to maintain oversight of the governance and management of the institution to ensure that it has the necessary capability to mobilize savings and that sound financial management standards are being met.

Supporting savings mobilization is an integral component of funders' overarching goals, such as poverty alleviation, access to finance, and building of an inclusive financial system, and each funder has a different role in supporting savings services. Some funders, such as bilateral agencies providing mostly grant funding, can support a broad range of institutional needs, including market research, technical assistance, and training. Multilateral agencies and regional banks can play an important role particularly on the market infrastructure and policy level as they have close relations with governments and yield significant influence on broader financial sector development issues. Investors can bring in needed equity and debt to help financial service providers to meet minimum capital requirements. Investors can also prioritize savings-led institutions as investees, given their resilience to financial market fluctuations and their ability to better serve the needs of customers.

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Annex 1: Savings Glossary: Types of Savings Services, Financial and Risk Management

1. Types of Savings Services

Compulsory/Mandatory Savings

Savings payments that are required as part of loan terms or as a requirement for membership, usually in a credit union, cooperative, MFI, village bank, or savings group. Compulsory savings are often required in place of collateral. The amount, timing, and level of access to these deposits are determined by the policies of the institution rather than by the client. Compulsory savings policies vary: deposits may be required weekly or monthly, before the loan is disbursed, when the loan is disbursed, and/or each time a loan installment is paid. Clients may be allowed to withdraw at the end of the loan term; after a set number of weeks, months, or years; or when they terminate their memberships.

Contractual/Programmed Savings

Savings in which the client commits to regularly depositing a fixed amount for a specified period to reach a predetermined goal. After the maturity date, the client can withdraw the entire amount plus the interest earned. Early withdrawal is prohibited or penalized. Contractual products help depositors accumulate funds to meet specific expected needs, such as expenses associated with school, a festival, a new business, an equipment purchase, or a new house. They also help financial institutions better predict the volume and timing of deposits and withdrawals.

Current Accounts

Demand deposit accounts that allow the account holder to transact using checks. Account holders can also transact face to face at the branch and may be able to use ATMs or point-of-service devices.

Demand/Sight Deposit

Fully liquid accounts in which the saver may deposit and withdraw any amount at any time with no advance commitment. Often, the saver must maintain a minimum required balance. Demand deposit transactions (deposits, withdrawals, transfers/payments) may be made using passbooks, checks, debit cards, ATMs, and/or point-of-service devices. If clients overdraw their demand deposit accounts, financial institutions generally charge penalties and/or high rates of interest or the payment may be rejected outright. Sometimes the number of withdrawals per month is limited by internal policies.

Informal Savings

Savings held outside of a formal financial institution. Informal savings mechanisms include saving at home (in cash or kind), savings groups, rotating savings and credit associations (ROSCAs), accumulating credit and savings associations (ASCAs), reciprocal savings and lending with neighbors or relatives, money guards (friends or relatives willing to hold a saver's money for a period), and informal sector deposit collectors (people who charge a fee to hold a saver's money for a determined period). Informal savings devices are often highly convenient but may be unreliable, insecure, and/or illiquid. A financial institution should have a solid understanding of the local informal savings market before it attempts to develop savings services for poor people.

Passbook Accounts

Demand deposit accounts that use passbooks rather than checks, ATMs, or point-of-service devices for transactions.

Savings/Regular Savings Accounts

Demand deposit accounts that use passbooks, magnetic stripe or smart cards, ATMs, point-of-service devices, or some combination of these for transactions. They do not allow account holders to use checks and may limit number of withdrawals.

Time/Certificate/Fixed Deposit

A savings product in which a client makes a single deposit that cannot be withdrawn for a specified period. At the appointed time, the client withdraws the entire amount with interest. The financial institution offers a range of possible terms and usually pays a higher

interest rate than on its demand deposit or contractual products. Because they tend to be larger than other types of deposits, have contracted withdrawal times, and involve fewer transactions, time deposits can provide a significant source of relatively low-cost funds that facilitate asset and liability management. This is particularly true if an MFI can attract large institutional depositors.

2. Financial and Risk Management

Asset and Liability Management (ALM)

The process of planning, monitoring, and controlling asset and liability volumes, maturities, rates, currencies, and yields. A primary goal of ALM is to minimize interest rate risk while still earning sufficient profits. ALM is more important and complex for institutions engaged in financial intermediation because interest rate risk tends to be higher for these institutions than for institutions engaged solely in credit or savings. Financial institutions manage interest rate risk by carefully maintaining a balance between different types and volumes of assets (in particular, loans) and liabilities (in particular, savings).

Financial Intermediation

The process of mobilizing deposits and disbursing them as loans to clients or investing them in other types of financial instruments. Managing financial intermediation is significantly more demanding than managing credit alone. In particular, maintaining the quality of assets to protect the value of deposits and managing liquidity, internal controls, and assets in relation to liabilities are more challenging.

Interest Rate Risk

The risk associated with changes in market interest rates that can harm a financial institution's profitability. A financial institution exposes itself to interest rate risk when it mobilizes deposits at one interest rate and lends them out at another.

Interest Rate Spread

The difference between the rate the financial institution pays for deposits and the rate it charges for loans. In a financially sustainable institution, this spread is large enough to cover operating costs, the opportunity cost of holding liquid reserves that earn no or low

interest, losses in the value of the institution's assets due to inflation, the cost of provisions for loan and investment losses, and capitalization.

Internal Controls

Policies and procedures designed to minimize and monitor operational risks, in particular, the risks of fraud and mismanagement. Because the unpredictable size and timing of cash deposits make financial institutions particularly vulnerable to fraud and errors, institutions that mobilize deposits must implement rigorous internal control policies and procedures. Essential controls include board approval and monitoring of information; rotation and segregation of duties; dual control of safes and vaults; established limits on cash holdings and expenditures; signature requirements; cash management procedures; daily balancing of cash drawers with the general ledger; receipts for all transactions; restricted access to offices and assets; periodic physical inventory of assets and cash counts; internal operational reports that are timely, easy to understand, and concise; accounting that complies with local accounting law and is consistent from one period to the next; sequential numbering of documents; an adequate audit trail; a secure management information system; and periodic reconciliation of the general ledger totals with bank statements or other subsidiary ledgers.

Liquidity Management

The process of effectively balancing between two requirements: (1) satisfying all cash outflow requests and reserve requirements without having to sell assets at a loss or borrow at a high cost and (2) holding enough assets in forms that earn sufficient interest to ensure operations are viable.

Financial institutions use tools, such as cash flow forecasting and ratio analysis, to project future liquidity needs and monitor current liquidity levels. They also arrange reliable options for obtaining liquid funds quickly when needed (a line of credit, for example) and for safely investing excess liquid funds at reasonable rates of return.

Liquidity Reserve Requirements

Government regulations mandating the percentage of deposits that a financial institution must set aside as liquid reserves to be able to meet withdrawal demands. The reserve rate affects the viability of the institution in two ways. First, by improving the likelihood that depositors will be able to withdraw their funds when they want to, reserves protect the

institution from the risk of a liquidity crisis and insolvency. Second, reserves often earn no or little interest, so if the reserve rate is high, the financial institution must compensate by obtaining a higher return when it invests the rest of its deposits. In some countries, nonbank deposit-taking institutions are required to deposit their liquidity reserves in local banks or in a central finance facility. In these cases, the returns are determined by the reinvestment market and are still likely to be lower than the returns on lending or long-term investments.

Liquidity Risk

The risk that a financial institution will not have enough liquid assets to meet the demand for cash outflows, including saving withdrawals, loan disbursements, and payment of operating expenses. A lack of liquidity can put a quick and final end to a financial institution's efforts to mobilize deposits—and, in the worst case, can cause it to collapse or close. Deposit mobilization requires clients to trust that they will always be able to access their savings when they want or need them. A financial institution invests significant time and resources instilling this trust in clients, but a liquidity crisis can destroy it instantly.

Risk Management

A systematic approach to identifying, measuring, monitoring, and managing business risks in an institution. Effective risk management includes the following steps: (1) identify, assess, and prioritize risks; (2) develop strategies to measure risk; (3) design policies and procedures to mitigate risks based on cost–benefit analyses of different measures; (4) implement and assign responsibility for policies and procedures; (5) test their effectiveness and evaluate the results; and (6) revise policies and procedures as needed. The operational risks that financial institutions must manage include credit risk, liquidity risk, interest rate risk, reputation risk, transaction risk (the risk of financial loss due to negligence, mismanagement, or errors), and fraud risk. (Anita Campion, "Improving Internal Control: A Practical Guide for Microfinance Institutions," MicroFinance Network with GTZ, 2000, pp. 2, 5, 8–10.)

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