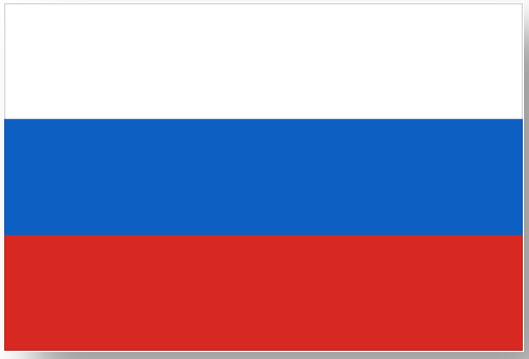
Landscaping Report:

Financial Inclusion in Russia



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January 2013, considering developments through September 2012

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List of Acronyms

AFI	Alliance for Financial Inclusion
ARB	Association of Russian Banks
CBR	Central Bank of Russia
CC	Credit cooperative
FFMS	Federal Service for Financial Markets
IMF	International Monetary Fund
KYC	Know your customer
MFI	Microfinance institution
MED	Ministry of Economic Development
MIX	Microfinance Information Exchange
MNO	Mobile network operator
MOF	Ministry of Finance
MSME	Micro, small and medium enterprises
NAFI	National Agency for Financial Studies
NAMMS	National Partnership of Microfinance Market Stakeholders
NBCO	Non-bank credit organization
NFO	Nonbank financial organization
NGO	Non-governmental organization
P2P	Person-to-person
POS	Point of sale
RMC	Russian Microfinance Center
SME Bank	Russian Bank for Support of Small and Medium-Sized Entrepreneurship
SRO	Self-regulatory organization
UEC	Universal Electronic Card

Statistical Overview:

Population	143 million	(2012)[1]
Population, urban	74%	(2012)[2]
Population aged under 15	16%	(2011)[3]
GDP/capita (based on purchasing-power-parity), USD	15,612	(2010)[4]
Accounts at a formal financial institution (% age 15+)	48%	(2011)[5]
Debit cards (% age15+)	37%	(2011)[6]
Bank branches and offices	44,467	(2012)[7]
ATMs	189,499	(2012)[8]
Bank and nonbank payment agents	12,479	(2011)[9]
Offices of the Russian Post	42,000	(2012)[10]
Customer service points of agents (bank and nonbank)	318,992	(2011)[11]
Bank accounts of natural persons (national currency)	622 million	(2012)[12]
Bank accounts with remote access	76.7 million	(2012)[13]

[1] Russian Federation Federal Service for State Statistics, http://bit.ly/rka5r3.

[2] Ibid.

[3] Ibid.

[4] IMF, World Economic Outlook Database, http://bit.ly/PFPXJW.

[5] The World Bank Global Findex Database, http://bit.ly/W7uux9.

[6] Ibid.

[7] As of 1 September 2012, CBR, http://bit.ly/SSFzDz and http://bit.ly/Viw7IU.

[8] As of 1 April 2012, CBR, http://bit.ly/QvjLIH.

[9] Center for Research of Payment Systems and Settlements and RMC (2012). The data represents the research sample size which is estimated to cover the vast majority of the market.

[10] Russian Post, http://bit.ly/b0sc9c.

[11] Center for Research of Payment Systems and Settlements and RMC (2012). The data represents the research sample size which is estimated to cover the vast majority of the market.

[12] As of 1 July 2012, CBR, http://bit.ly/StZcAl. The majority of these are dormant accounts, including accounts in Sberbank opened in Soviet times.

Mobile subscriptions	227.6 million	(2011)[14]
Mobile penetration (total)	164%	(2012)[15]
Mobile penetration (connections)	73%	(2012)[16]

[13] As of 1 July 2012, CBR, http://bit.ly/V6yCLj.

[14] Advanced Communications and Media, http://bit.ly/RcFNj7.

[15] See http://bit.ly/PFui96.

[16] Ibid.

1. Executive Situation Analysis

The Russian Federation presents a picture of rapid and accelerating change in the financial inclusion landscape for lower income Russians in the years since transition to a market economy. This reflects official government policy: as far back as 2007,[17] President Vladimir Putin identified the closing of the financial access gap as an important priority of his administration, and it has remained so since, with significant progress being made, particularly in the regulatory infrastructure for financial inclusion. Russia is one of a few countries in the region that has a comprehensive financial inclusion strategy developed by the National Association of Microfinance Market Stakeholders for 2008-2012 and 2012-2016. In 2010, the Ministry of Economic Development prepared a report to the Government on ways to increase access to financial services which set priorities for further work on advancing financial inclusion.[18]

Since 2008, when CGAP conducted its first research on the state of innovations in financial inclusion in Russia,[19] progress has been significant. In certain aspects – such as the penetration of bank branches per 100,000 adults – Russia has now moved ahead of some highly developed countries. Therefore, the issue of financial inclusion in Russia has its own specifics – more typical, perhaps, for developed countries that have all the basic prerequisites for financial inclusion. For example, for city dwellers, particularly in larger cities, access to a range of financial services has become more and more commonplace, with uniquely Russian innovations in retail payment services emerging to make usage of such services increasingly convenient for customers. Yet, for residents of smaller cities, towns and rural areas, access to safe, high quality financial services remains a far greater challenge. Here – and particularly in the most remote and sparsely populated areas, which are also generally among the poorest – innovations in retail payments have potentially a more critical role to play, not only enhancing convenience for customers transacting with financial service providers, but making it possible at all. Statistics bear out this dichotomy: on average, even though the supply of retail banking services[20] in Russia as a whole increased fivefold since 2008[21], the national average is still only about 21 percent of the Moscow level, and is as low as 5 percent of the Moscow level in the Northern Caucasus.[22]

The Russian penchant for innovation, as well as strong local traditions of mutual assistance, have shaped the market of financial service providers in distinctive ways. Particularly in areas where bank penetration is weak, a multiplicity of different forms of financial cooperatives have emerged, some growing to be

[17] President Putin's address to the State Council, November 2007.

[18] See NAMMS (2011).

[19] See CGAP (2009).

[20] The supply of retail financial services is measured as a volume of natural persons' bank loans and deposits per person. According to NAMMS (2011) it was RUB 493,000 (USD 15,944) in Moscow and RUB 102,000 (USD 3,299) on average country-wide. For all currency conversion, CBR exchange rates as of 30 September 2012 were used: USD 1=RUB 30.92, EUR 1 = RUB 39.98.

[21] In 2008, the supply of retail banking services in Russia as a whole was 4 percent of the Moscow level.

[22] See NAMMS (2011).

substantial institutions (even systemically significant, if measured by the population of the region in question and the size of other types of providers present in the local market). At the same time, the number, size, and diversity of providers of retail credit have increased dramatically, even in more rural and remote areas, and recently, many have registered as microfinance institutions (owing more to the lack of other appropriate regulatory categories than a shared vision of social development).

Notwithstanding the dynamism of privately and member-owned financial service providers, state-owned institutions remain important players in the Russian financial sector, including – even especially – that part of it most relevant to lower income Russians. The giant savings bank Sberbank, once (with limited exceptions) the only provider of retail payment services in Russia, is majority-owned by the Central Bank of Russia and remains the dominant, if not the sole, financial service provider other than the Russian Post in many more remote communities. VTB24 is another important example of a government-controlled institution. There has been a marked trend toward improving both business practices and service among state-owned providers, and in many areas and market segments (such as among the elderly) they appear to be competing very favorably with private financial service providers. This openness to state involvement, often to stimulate or subsidize private providers, is also reflected in Russian policy toward financial inclusion. For example, during the recent years, billions of Rubles were channeled into SME lending – and a lesser, but not insignificant amount specifically to microfinance institutions and credit cooperatives – through the state-owned Russian Small and Medium Entrepreneurship Support Bank (SME Bank, formerly the Russian Development Bank). It is also reflected in the orchestrating role the Ministry of Economic Development is playing in the introduction of the Universal Electronic Card – an ambitious initiative in e-government that aims, among many other goals, to establish universal access to banking services.

Beyond the emphasis on improving statistics on financial inclusion for lower income Russians, Russian policy has also focused importantly on the *quality* of formal financial services on offer, their appropriateness to the needs of customers, the market conduct of providers, and the financial literacy and capability of financial consumers. These policy priorities, so much discussed internationally in the wake of the global financial crisis, have distinct relevance in the Russian context. Many Russians, particularly older people (who are represented disproportionately among the lower income segments of the population), have only relatively recently had access to some financial products, particularly consumer credit. Rapid market development – again particularly in retail credit – has sometimes resulted in a lag between the introduction of questionable or unacceptable market practices and a regulatory response. At the same time, trust in formal financial services (and providers of those services) has been shaken by crises and devaluation. In the case of savings, prompt policy intervention helped to stabilize the situation relatively quickly during the 2008/2009 global financial crisis. After the crisis, the volume of savings increased overall, but their concentration remained significantly skewed toward trusted public service providers (for example, about half of all savings of natural persons are kept at Sberbank). In the case of insurance, trust is so low that many ordinary Russians only purchase insurance they are required by regulation to carry (such as automobile insurance).[23]

[23] Due to the low level of insurance market development in Russia, insurance providers and products were not

Several Russian initiatives related to the quality and appropriateness of financial products on offer and the financial literacy and capability of financial consumers merit specific mention. On the consumer protection and market conduct front, there are two parallel moves afoot to establish a financial consumer protection Ombudsman in Russia. One, already underway, is led by the Association of Russian Banks (ARB). Although various non-ARB members have been invited to participate, some feel this initiative lacks the breadth of provider representation and independence from ARB member banks to garner widespread public trust and to cover the full range of customer issues (including those arising with nonbank providers). The second relevant initiative would address these concerns through the adoption of a Law on the Financial Services Ombudsman, which would establish an independent body responsive to all types of issues raised by financial consumers, regardless of the type of service or provider. Regarding financial literacy and capability, in 2011 Russia embarked on an ambitious multi-year project in partnership with the World Bank. The USD 113 million Financial Education and Financial Literacy project is aimed at improving the financial literacy of Russian citizens as well as strengthening the foundations for consumer protection in financial services.

The past several years have witnessed rapid progress on legislation relevant to financial inclusion, including: a Law on Microfinance Activity and Microfinance Organizations governing nonbank microlending by both nonprofit and for-profit entities; a framework Law on Credit Cooperation aimed at providing a system for bringing the diverse array of financial cooperatives (with the notable exception of those formed as agricultural cooperatives) under delegated supervision; a Payment Agents Law governing nonbank payment agents[24] (including automated payment acceptance terminals); and a Payment System Law, which includes, among other things, provisions for regulation and supervision of e-money and for banking agents.[25] Regulations and supervisory arrangements under these laws are at various stages of development and implementation. While there are signs that such legislation will have – or is already having – a positive effect on financial inclusion, the impact of their full implementation on financial service providers – and on the low income consumers they might serve – remains to be seen.

The following Landscaping Report on the state of financial inclusion in Russia is based on CGAP's research conducted during April – September 2012.[26] The report is organized in the following way:

- Section 2 presents an overview of the demand for and usage of formal financial services in Russia with a particular emphasis on the characteristics of the most financially excluded categories and reasons for continued financial exclusion. This section also covers several

included in the research for this landscaping report and are not discussed further.

[24] The legal term used in the law is "payment agent". For the purposes of this paper, the term "nonbank payment agent" is used to avoid confusion with bank payment agents.

[25] The full titles and details of the laws can be found in the list of references.

[26] We would like to acknowledge the contributions by Michael Tarazi (CGAP), who joined the first mission in April 2012 and commented on an earlier draft of the report; Mikhail Mamuta (NAMMS), who provided overall support to the research and valuable contributions; Oleg Ivanov, who provided advice on the interpretation of various laws, regulations, and bills mentioned; and Victor Dostov (Russian Electronic Money Association), who provided valuable comments as well.

important initiatives vis-à-vis the demand side – on financial literacy and education and financial consumer protection, including the current and planned Financial Ombudsman institution.

- Section 3 presents today's picture of the supply of financial services in the country and covers a range of providers – the traditional banking sector, the sector of microfinance organizations and credit cooperatives (which has existed for about two decades but only recently was brought under a regulatory and supervisory framework), and the newly formed and rapidly growing sector of payment services providers which are at the forefront of technology innovation in terms of the delivery channels. The section explores the role and potential of each provider type in advancing financial inclusion, as well as key constraints they face.
- Section 4 covers issues related to the infrastructure and other initiatives with relevance for financial inclusion – the Universal Electronic Card project of the Russian Government, the infrastructure for credit reporting, the Russian Financial Inclusion Strategy and Russia's collaboration with the Alliance for Financial Inclusion.
- At the end of each subsection, the authors share observations on the key challenges and opportunities with respect to the topics covered and suggest recommendations for follow-up activities.
- The report concludes with a summary of the key opportunities and challenges outlined for each subsection (Section 5).

2. Demand for and Usage of Formal Financial Services

There is only limited data available about the demand for formal financial services among lower income Russians; rather various research conducted has traditionally covered the usage of such services. The data on usage paint a picture of the financial exclusion in Russia – disproportionately affecting remote and rural areas, and older and lower-income people. One of the initiatives to address financial inclusion gaps is a newly launched large World Bank-supported government project aimed at improving financial education and financial literacy of the Russian people; with over a third of the population with low financial literacy levels, these factors are recognized as serious impediments to financial inclusion. At the same time, there is realization in Russia that financial inclusion cannot be pursued without strengthening financial consumer protection mechanisms, such as a Financial Ombudsman, and there is still much work to be done in this area.

2.1 Financially Excluded and Underserved Communities

Nature and Scope of Financial Exclusion

The outreach of financial services among the Russian population has been growing in recent years, but still leaves the majority of the population without a bank account. In 2008, about 48 percent of the adult population did not use any banking services, while at the end of 2011 this number was reduced to 22 percent.[27] However, with 48 percent the share of the adult population (age 15 years and above) having

[27] Unless noted otherwise, the source of data for this section is NAFI (2012). In their research NAFI uses a

an account at a formal financial institution is much lower, as many people use banks for payment services without opening a bank account.[28] The share of the population is even lower when only looking at the bottom 40 percent of the population in terms of income (40 percent) and for people with primary education or less (24 percent).[29] The most used formal financial products are plastics cards (46 percent). Among users of plastic cards, the vast majority (89 percent) received the cards from their employers to be paid their salaries; and 84 percent of all cardholders use their cards only to receive cash from ATMs. After plastic cards, the second most used formal financial service is bill payment (28 percent). The next most used type of formal financial services is credit products – used by 24 percent of the population, but 89 percent of these are consumer loans. Only approximately one-fifth of the population use any form of formal deposit account, and of these, there are 42 percent who use term deposits while others have demand deposits or other current accounts. It should be noted, as well, that these latter figures cover the adult population as a whole, and do not reveal the levels of usage specifically among lower income Russians. Overall, Russians do not show much interest in using formal financial services: for example, when asked what financial services they plan to use in the next 12 months, 61 percent did not plan to use any and another 21 percent were not sure.

Table 1: Use of Banking Services by the Adult Russian Population as of October 2011*

Types of services	Percent	Breakdown of users	Percent
Plastic cards	46%	To receive salary	89%
		Debit card	12%
		Credit card	8%
Regular payments	28%		
Credit services	24%	Consumer credit	89%
		Car loan	11%
		Mortgage loan	11%
Deposit services	18%	Current account/Demand deposit	67%
		Term deposit	42%
Remittances	8%		
Internet banking	1%		
Deposit box	0%		
None of the above	22%		

Source: NAFI (2012). ** The totals exceed 100 percent as multiple responses were allowed.*

Some of the reasons for the low or passive use of formal financial services include:

- Distrust in financial institutions. The whole region of Eastern Europe and Central Asia is characterized by the lowest level of trust in formal financial institutions worldwide – 31 percent cited distrust of banks as a key reason for not using financial services.[30] Russia is no exception –

statistically representative sample of 1,600 adults.

[28] 2011 data from the World Bank Global Findex Database, http://bit.ly/W7uux9. The results are based on a representative sample of 2,000 people with a margin of error of 2.8 percent. See http://bit.ly/O6XkNi.

[29] Ibid. Russia has the lowest access figures for people with low education among the BRICS countries (Brazil, Russia, India, China, and South Africa) and among developing countries in Europe and Central Asia.

[30] See Klapper (2012).

with its recent history of multiple economic and political shocks and resulting loss of life savings prior to the 2008/2009 crises. It was rated last in a 2012 Edelman Trust Barometer survey of 25 countries with respect to trust in financial institutions and services (with only 34 percent of people reporting that they trust financial services).[31] According to the National Agency for Financial Studies (NAFI), only 4 percent of people believe that saving with a commercial bank is safe (though the trust to state-owned banks is 7 times higher).

- Low levels of financial literacy. According to results of a survey in 2011, more than one-third of the adult population has low levels of financial literacy. To address this issue, Russia embarked on a multi-year Financial Education and Financial Literacy Project together with the World Bank (see Sec. 2.2).

- Low income levels. In the first quarter of 2012, there were 19.1 million people (13.5 percent of the population) living below the poverty line in Russia.[32] About 68 percent of people cited their low income level as a reason for not using deposit services. For the same reason, 83 percent said they cannot afford mortgage loans. According to NAFI, the desire to use or continue to use deposit services is directly correlated with people's income levels.

- Supply side constraints. According to the World Bank, 53 percent of adult urban residents in Russia have an account at a formal financial institution, while in rural areas this indicator is 45.5 percent.[33] The level of the supply of retail banking services in the country has been uneven: on average, it is just above one-fifth when measured in comparison to the level of Moscow (and 13 percent when the two largest cities – Moscow and St. Petersburg – are excluded from the calculation).[34] With respect to newer channels for financial service provision, 27 percent of people living in rural areas said they do not use payment terminals (automated cash-in devices allowing for the payment of various types of bills and services) because there are none near their home or work. The lack of infrastructure for card acceptance is the most often cited reason (34 percent) for not using cards to pay for goods in retail stores. Another 16 percent mentioned that those stores that accept cards tend to be more expensive.

In general, the most financially excluded Russians tend to be those living outside of large cities, who are less educated and older, have lower income and are less technologically savvy. Thus, in Moscow and St. Petersburg, there are 1.5 times more users of plastic cards and about 3 times more people who requested debit and credit cards themselves (versus receiving them automatically from an employer); the number of deposit account owners is higher by 10 percent compared to the rest of Russia.

[31] Edelman Trust Barometer 2012, quoted from http://bit.ly/Q2VSKq.

[32] Federal Service for State Statistics, http://bit.ly/Q2VYI9.

[33] See World Bank (2012).

[34] See NAMMS (2011).

Changing Picture of Retail Demand

The majority of the Russian population use traditional channels for financial services – e.g. 68 percent of people prefer making regular payments through bank branches and 33 percent through the Russian Post. Very few people currently use mobile banking, e-money or internet banking to make payments (2, 1 and 1 percent respectively, though most leading retail banks offer this possibility).[35] At the same time, in the last few years there has been a shift in preferences towards the use of payment terminals – not just in terms of the number of people (about 51 percent currently use payment terminals[36] – a significant number given that the industry emerged less than a decade ago), but also in terms of the types of services used. For example, in just one year, between 2011 and 2012, the composition of payments through payment terminals and POS-terminals changed – payments for communication services reduced in volume from 95 to 86 percent, and other types of payments started becoming more popular – such as loan repayments, bank account replenishment, payments for utility services and purchases of prepaid cards (see Section 3.3).[37]

Despite the fast penetration of innovative solutions such as payment terminals, it seems that in the coming years the majority of people currently financially underserved will continue using traditional channels to meet their basic needs for financial services.

2.2 Financial Education, Literacy, and Capability

According to results of a national survey of the Higher School of Economics in 2011,[38] 36 percent of people admitted to having low levels of financial literacy. Only 23 percent of respondents were able to identify characteristics of a financial pyramid, and 80 percent of people have never heard the word "financial ombudsman" and another 5 percent were not sure. Sixty percent could not say what types of investments are protected by the deposit insurance system, and another 9 percent were wrong in their understanding.

Less educated, older, and lower-income people manifest the lowest financial literacy levels (financial literacy indices of 0.8, 1.3 and 1.1 respectively, compared to 1.6 on average).[39] Younger people tend to use innovative solutions for financial services – such as payment terminals – much more often than people of the retirement age. For example, among 18-24 year old customers, 47 percent use payment terminals, while among people of 55 and older, only 15 percent are payment terminal users.

To address the issue of financial literacy, Russia has started the implementation of a five-year, USD 113 million, Financial Education and Financial Literacy Project together with the World Bank. The project

[35] The World Bank Global Findex Database provides more data on mobile phone usage: In 2011, 1.7 percent of adults above 15 years used a mobile phone to pay bills, 1.8 percent to receive money, and 1.5 percent to send money. See http://bit.ly/W7uux9.

[36] See http://bit.ly/PKGIqQ.

[37] See Center for Research of Payment Systems and Settlements and RMC (2012).

[38] See Kuzina (2012).

[39] See Kuzina (2012).

aims to improve the financial literacy of Russian citizens as well as strengthen the foundations for consumer protection in financial services. As of mid-2012, the project started in two pilot regions, Volgograd and Kaliningrad, which adopted a medium-term regional financial literacy programs for 2011-2015/16, identified activities to be financed from the federal budget, and allocated the needed funds in the regional budgets.[40]

2.3 Financial Consumer Protection and Financial Ombudsman

There is currently no specialized public financial consumer protection authority in Russia, but consumers can apply to a number of organizations with their complaints depending on the nature of the complaint, service and provider: to financial institutions themselves, to supervisory authorities,[41] to the Federal Service for Supervision in the Area of the Protection of Consumer Rights and Human Wellbeing (Rospotrebnadzor), as well as to other organizations (for example, to the Administration of the President or the Prosecutor General's Office). Among one of the recommendations of the World Bank 2009 diagnostic review[42] was the establishment of a dedicated financial ombudsman to whom financial consumers could submit their complaints.

A Financial Ombudsman's Office in Russia, founded in October 2010 by the Association of Russian Banks (ARB),[43] did not replace other authorities as had been recommended by the World Bank. Rather, it became yet another organization involved in handling certain financial consumer complaints. The Financial Ombudsman activities are currently governed by provisions adopted by ARB, though there are plans to adopt a special law creating a government appointed financial ombudsman in 2012.[44] The law should provide for the centralization of financial consumer protection and dispute resolution mechanisms, as recommended by the World Bank in 2009, and ensure that the Financial Ombudsman has the independence, authority and capacity necessary to handle financial consumer complaints.

The ARB-housed office of Financial Ombudsman deals with natural persons with complaint values of less than RUB 300,000 (USD 9,700) and only after they have first sought redress from the bank in question. As of January 2012, there were only 10 banks, 5 microfinance institutions (MFIs) and 1 collection agency that signed the ARB provisions on the Financial Ombudsman; but in total, 92 organizations cooperate with the Financial Ombudsman, though most of them informally. In two years, the Ombudsman reviewed over 3,600 complaints.[45] This is a small figure if compared to the number of complaints about

[40] See http://bit.ly/Q2W78g.

[41] This would be the Central Bank in the case of banks, NBCOs, and money transfer operators, and the Federal Financial Markets Service in the case of microfinance institutions and credit cooperatives. It should be noted that neither agency has a specific system for receiving such complaints, and customers with complaints against other types of providers – e.g. mobile network operators or e-money issuers – may be uncertain where to take their complaints.

[42] World Bank (2009).

[43] Until February 2012 the Ombudsman position was held by Pavel Medvedev, State Duma deputy, who then went to serve as advisor to the Central Bank Governor (currently the head of the ARB serves as acting Ombudsman).

[44] A draft law on financial ombudsman is expected to be developed by November 2012. See http://bit.ly/Q2W8ZV.

[45] See http://www.biztass.ru/news/one/7757.

retail financial services received by Rospotrebnadzor only – close to 41,000 during 2011-2012.[46] It should be noted that Rospotrebnadzor reports a tenfold increase in the number of such complaints since 2008 due to the rapid growth of the consumer credit market.

Box 1: Demand and Usage – Key Challenges and Opportunities

To date, there has been no specific research on the demand for financial services in Russia – and there is no comprehensive picture of the demand, as a result. Rather, research has focused on the current use of financial services and thus could not fully capture the gaps in supply.

Despite impressive progress in outreach and a fivefold increase in the per capita supply of retail banking services since 2008, significant regional disparities remain, with remote and sparsely populated areas (which are generally among the poorest) having just a small percentage of the retail banking services supply level enjoyed by residents of Moscow.

Though some innovations in financial service delivery (in particular, payment terminals) are becoming increasingly popular and ubiquitous, helping meet the demand for one of the most used services – bill payment, they are not well aligned to close financial access gaps for the financially underserved categories (older, lower-income, living outside of large cities, less educated).

As the increased availability of financial services (see Sec. 2.1) does not automatically increase uptake, further study of the financially underserved categories could provide insights into the reasons for their continued financial exclusion.

To build trust in financial services, there is an ongoing need for a centralized, specialized financial consumer protection and dispute resolution agency covering all types of financial service providers that has sufficient independence, authority and capacity to handle and resolve complaints.

3. The Service Provider Landscape

The landscape of providers serving lower income Russians can be broadly divided into banks and other credit organizations, nonbank financial organizations (NFOs), and payment service providers. Banks and nonbank credit organizations (NBCOs), which are both licensed under the Banking Law and supervised by the CBR, play a role both as partner institutions of payment service providers and as providers of microfinance services themselves. NFOs such as lending-only microfinance institutions (MFIs) and credit cooperatives (CCs) mostly target the lower end of the market. Finally, payment service providers are a diverse group of institutions such as money transfer operators, electronic money operators, mobile network operators (MNOs), and bank and nonbank payment agents. They have recently been the most innovative in providing new payment channels, virtual accounts and mobile wallets, which may have potential to reach previously underserved clients. The recent introduction of a Payment System Law is leading to substantial changes of the regulatory framework applicable to this diverse group of providers.

[46] See Prusakov (2012).

Table 2: Typology of Service Providers

Type of financial service provider	Main players/ Key characteristics	Main law regulating their activities	Regulatory and supervisory bodies	Role in financial inclusion
Credit organizations				
Banks	915 banks, with top 50 banks having over 80 percent of all banking assets, including Sberbank with over 25 percent	Banking Law	Central Bank	Banks remain the main traditional channel for financial service provision to the vast majority of people.
Non-bank credit organizations	60 operating as various types of NBCOs providing a limited range of banking services (some types are allowed mobilizing deposits from legal entities). Include payment service providers with NBCO license	Banking Law	Central Bank	Most money transfer operators and electronic money operators (see entries below) in operation to date are likely to choose this legal form.
Payment service providers				
Money transfer operators	All banks and NBCOs conducting domestic and international money transfers	Payment System Law and Banking Law	Central Bank	Providing more convenient and accessible payment services. Money remittance operators provide important lessons on cost-saving innovations in international remittances.
Electronic money operators	Providers of virtual accounts (e.g. WebMoney and Yandex), to be registered either as banks or NBCOs by November 2012	Payment System Law and Banking Law	Central Bank	Providing easily accessible virtual accounts to the wider public, but so far mostly targeting the young, internet-savvy, well-educated population.
Mobile network operators	3 largest include Beeline, MegaFon, and MTS	Communications Law and Art. 13, Payment System Law	Not currently regulated and supervised as financial service providers unless operating though a subsidiary or partner	Allowing for the use of prepaid airtime for various types of payments. Recently other services such as person-to-person transfers and utility payments growing in popularity.

Bank and nonbank payment agents	Many thousands of small enterprises	Payment System Law and Payment Agents Law, respectively	Regulated by the Central Bank, but not supervised	Increasing accessibility of bank and payment services in areas without bank branches.
Nonbank financial organizations				
Microfinance institutions	Over 2,100 small, lending-only institutions registered in various legal forms, both for profit and non-profit	Law on Microfinance Activity and Microfinance Organizations	Regulator: Ministry of Finance Supervisor: Federal Financial Markets Service	Providing microloans to individuals and micro and small businesses, in particular those having difficulties in accessing bank loans. Many MFIs operate as consumer lenders.
Credit cooperatives	Over 1,400 small, membership-based organizations	Law on Credit Cooperation	Regulator: Ministry of Finance Supervisor: Federal Financial Markets Service	Providing access to lending (both for business and consumption) and savings services to their members, in particular those living in areas not served or under-served by banks.
Agricultural credit cooperatives[47]	Over 1,700 small, membership-based organizations	Law on Agricultural Cooperation	Not currently supervised as financial service providers; the Ministry of Agriculture is in charge	Providing access to lending and savings services to their members – farmers and peasants' households in rural areas.

Source: Analysis by the authors.

3.1 Banks and NBCOs

Sector Overview

The banking sector in Russia is comprised of all credit organizations regulated and supervised by the Central Bank of the Russian Federation (CBR), including both banks and a variety of nonbank credit organizations (NBCOs). As of April 1, 2012 there were 975 functioning credit organizations, most of them banks,[48] working through 43,652 branches.[49] During 2011, the number of branches grew by 8.4 percent. According to the IMF Financial Access Survey, in 2011 there were 37.09 bank branches for every 100,000 adults. This is close to or even higher than in some highly developed countries (e.g. Germany – 15.70,

[47] Agricultural credit cooperatives are covered in this report only in connection with the discussion about regulation and supervision of financial cooperatives as data on their activities is limited.

[48] Of the total, there are 915 banks and 60 NBCOs.

[49] Unless otherwise noted, the source of all statistics on the banking sector is the CBR. See http://ww.cbr.ru.

Great Britain – 24.87, France – 41.58, USA – 35.43).[50] The distribution of bank branches generally follows the distribution of the population (see Table 3).

Table 3: Distribution of Banks, Branches and Population

Federal Districts of the Russian Federation	Percentage Distribution		
	Banks	Branches	Population
Central	59%	28%	27%
incl. Moscow and the Moscow Region	*52*	*15%*	*13%*
Northwester	7%	9%	10%
Southern	5%	10%	10%
North Caucasian	6%	3%	7%
Volga	11%	24%	21%
Urals	5%	9%	8%
Siberian	5%	13%	13%
Far Eastern	3%	4%	4%

Source: Based on CBR data, 2012.

The solid average figures of bank branches and relatively equal distribution across regions may be masking a significant intra-regional variation as most branches are located in oblast and regional centers, with very few operating in smaller towns and rural areas. Furthermore, in a large country such as Russia it is important not only to look at number of branches per population, but also per geographic area. A comparison of the number of bank branches per 1,000 km^2 in Table 4 shows the specifics of the financial inclusion challenge for a country of such size as Russia – with a relatively low population density and various infrastructure gaps which significantly increase banks' operational costs. For example, FORUS Bank, the only specialized microfinance bank in the country, reported, among other difficulties, facing unreliable internet connections when working through their mobile van offices in areas outside of oblast centers.[51]

Table 4: Commercial Bank Branches and ATMs per 1,000 km in Select Countries, 2011

	Russia	France	Germany	Great Britain	USA
Commercial bank branches per 1,000 km^2	2.73	40.22	31.86	52.87	9.58
ATMs per 1,000 km^2	11.75	106.22	248.2	260.94	n/a

Source: IMF Financial Access Survey, 2011. Data for Germany and Great Britain are for 2010.

The growth in the number of bank and NBCO branches in recent years has not been even: the number of full service branches actually contracted by about 14 percent from about 3,300 to 2,800, and the number of "light" branches (which include additional offices, operational cash offices outside cash units, credit cash offices and operational offices) grew by 16 percent in the last five years – from approximately 34,000 to over 40,000.[52] This disparity has to do with the fact that in 2004 and 2007,[53] the

[50] IMF Financial Access Survey, 2011, http://fas.imf.org/. Data for Germany and Great Britain are for 2010.

[51] Interview with Stacie Schrader, FORUS Bank, 25 September 2012.

[52] For the purposes of this paper, the term "branches" is used to refer to full service and "light" branches.

[53] CBR Instruction No. 109-I of January 14, 2004, "On the Order of the Bank of Russia Decision on the State Registration of Credit Organizations and Issuance of Licenses for Performing Banking Operations" and CBR

Central Bank allowed the establishment of special types of bank branches performing a limited number of operations (and therefore less costly for banks to set up); in addition, some of these "light" branches could be opened in regions other than the location of their parent bank headquarters. Overall, while allowing the growth of bank branch infrastructure, the CBR has been pursuing banking sector consolidation: in 2012, the minimum capital requirement of banks was increased two-fold to RUB 180 million (USD 5.8 million), and by 2015 banks must have RUB 300 million (USD 9.7 million) in capital.[54] The result of this strategy has been the gradual reduction in the number of banks – by almost one-fifth since 2007 (from 1,143 to 915). Increasing banks' capital is viewed by the CBR as key to increasing the stability of the banking sector.[55] Experts believe that if the current trend remains, there will be about 600 banks and NBCOs by 2020.[56]

Banking sector assets are highly concentrated in a few large banks – the top 5 banks account for over 50 percent of the total, and the top 50 banks (or 20 percent of the total number of all banks) – for over 81 percent of the total. Four hundred sixty-six regional banks[57] at the beginning of 2012 held about 12 percent of the total assets. As for the deposits of natural persons, their distribution is very similar to that of the total assets among the largest banks - with 58.8 percent of all such deposits held in state-controlled banks, while regional medium-sized and small banks hold only 3.7 percent.

Despite their small size, regional banks, united in the Association of Regional Russian Banks, believe that they have important advantages over larger banks as they tend to be closer to their customers, are better suited to regional specifics, and work in the locations where large banks are not present. In their proposed alternative strategy for the banking sector development until 2020, the Association, while acknowledging the need for a moderate increase of banks' minimum capital, advocates for the preservation of regional banks (most of which will be forced to close down or consolidate in line with the envisaged new minimum capital requirements) and the introduction of differentiated regulation and supervision depending on banks' systemic significance.[58]

In addition to the above analysis of some quantitative financial inclusion indicators, further research is needed to fully understand the complexity of factors preventing universal financial services coverage. What is the profile of the main clientele of regional banks and how is it different from that of large banks? What will be the ramifications of the upcoming consolidation of regional banks, and will large banks be able to ensure the same regional relevance and outreach? How many bank branches and in which locations are necessary for Russia given its territory and population dispersion? And to which extent do factors beyond physical presence of bank branches influence financial exclusion? These

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Direction No. 1794-U of February 21, 2007, "On Introducing Changes to the Bank of Russia Instruction Dated 14 January 2004.

[54] Article 11.2 of the Banking Law.

[55] See Government of the Russian Federation and the Central Bank of the Russian Federation (2011).

[56] See http://bit.ly/Q2WdfU.

[57] Defined by the CBR as those registered outside of the Moscow region.

[58] See Association of Regional Russian Banks (2009).

questions need to be answered to determine which policy measures will be most effective in addressing the financial inclusion challenge in the country.

Branchless banking solutions used by banks

Though much cheaper than traditional bank branches, "light" branches are still expensive. Thus, while many smaller banks have been growing their "light" branch infrastructure, Sberbank, the largest retail bank owning about 45 percent of all branches (and with a disproportionate share of lower income customers),[59] has been reducing the number of its branches – in six months of 2011, the reduction was by 239 down to 19,110,[60] and by August 2012 the number further dropped by 508 to 18,608.[61] Instead, Sberbank has been growing the network of ATMs and payment terminals, as well as developing other branchless solutions. Sberbank's network of ATMs during 2011-2012 grew by 23 percent and exceeded 34,000; its network of payment terminals as of January 2012 was the largest among banks – over 21,000 (Moscow Credit Bank, by comparison, was second with just over 3,200 terminals).[62] At the same time, it remains to be seen whether the branchless solutions of Sberbank will be an adequate replacement of its branches. For example, in one of the regions in Siberia, in response to multiple requests of local residents, local authorities had to interfere and urged Sberbank not to close down its branches in four rural settlements which served, in total, clients in ten such settlements (six of them had no bank branches and their residents would otherwise had to travel over 60 km to the nearest regional center with a bank branch).[63]

According to the CBR, the number of bank devices for the provision of "distance services" (defined by CBR as "e-terminals and imprinters, ATMs, payment terminals and e-terminals for remote access") grew by over 20 percent in one year and reached about 757,400 at the end of 2011.[64] This is important from the financial inclusion perspective as banks try to move closer to customers and reduce costs of their services.

Many retail banks offer remote account access solutions to their customers. In 2011, the number of bank accounts that can be accessed through the internet grew 1.8 times, and those that can be accessed through a mobile phone 2.2 times, for a total of 616.2 million transactions with the total volume of RUB 158 trillion (USD 5.1 trillion).[65]

Amendments to the Banking Law in 2009 introduced the notion of bank payment agents which opened up a possibility for banks to use services of non-CBR-licensed companies and individual entrepreneurs

[59] According to the Agency for Deposit Insurance, in 2011 Sberbank held 47.9 percent of all individuals' deposits, of which 76.5 percent were small and medium-sized deposits (defined as deposits below RUB 700,000 – USD 22,639); the average ratio of small and medium sized deposits for all banks was 58.2 percent. See http://bit.ly/Q2WkIs.

[60] See http://bit.ly/UupUvI.

[61] See http://bit.ly/Uuq0Ue. The two periods were chosen due to data availability.

[62] See http://bit.ly/Uuq4Du.

[63] See http://bit.ly/Uuqeea.

[64] See CBR (2012), p 12.

[65] Ibid., p. 13. These are likely to include transactions by legal entities.

for cash in and cash out functions (with further clarification of bank and payment agent functions in the Payment System Law adopted in 2011). It should be noted that the banking sector was not the one driving these innovations – rather, the legislation came to formalize and bring under the supervision the fast growing (nonbank) payment sector. Unlike bank and NBCO headquarters, agents (97 percent of them registered as individual entrepreneurs and limited liability companies)[66] are distributed more evenly across the country – their distribution corresponds to the distribution of the population by regions. This has a good potential for forming a basis for increased accessibility to financial services – however, the range of services that bank payment agents can perform is limited. Under current legislative definitions banking agents are primarily used by customers to make payments and top up their existing accounts, as agents are not allowed to identify customers for new bank account opening (see *Regulation and Supervision* below).

Some banks are experimenting with totally branchless models. Examples include Tinkoff Credit Systems Bank (see Section 3.3) and Ocean Bank where most transactions are internet-based or performed through ATMs and payment terminals. Another example of innovation includes Promtorgbank which joined forces with Svyaznoy ("Messenger"), a large network of electronics retail shops, to found Svyaznoy Bank and use the existing retail shops as its agents. These models often require creative approaches to implementing relevant legislation. For example, since account opening by agents is not allowed, some banks hire agents' staff part-time to perform these operations (see *Regulation and Supervision* below). It will be important from a financial inclusion perspective to monitor whether these new models hold a financial inclusion promise for broader customer groups – beyond the younger and more technology-savvy internet users or electronics shops customers, as well as whether other banks will consider these models worthy of replication.

An important factor in determining the success of many financial inclusion innovations is the significant reliance on cash in the provision of financial services – in particular, to lower-income customers. With an insufficient card acceptance infrastructure (see Sec. 2.1) and limited functionality of agents in terms of cash out functions which will be discussed below, there is a risk that some innovative models will not realize their financial inclusion potential. Yet CBR figures suggest that the usage of cash is still very high – 81 percent in the total volume of payments in 2011 (though reduced by 5 percent since 2010).[67] Unless there are convincing incentives in place both for customers and retailers to use cards, and a sufficient cash out network, it is difficult to imagine how "cashless" solutions such as internet-based and mobile phone-based financial service provision models can compete with traditional brick and mortar banking.

Bank Lending to Micro, Small and Medium-Sized Enterprises (MSMEs)

As of April 1, 2012, the total banking sector portfolio of loans disbursed to MSMEs was RUB 4,008 billion (USD 129.6 billion); 11 percent of this portfolio was provided to individual entrepreneurs. It is hard to say to what extent this meets the existing demand as there are no reliable demand data with respect to MSME finance. In CBR statistics, there is no disaggregation by micro, small and medium-sized

[66] Center for Research of Payment Systems and Settlements and RMC. (2011).

[67] See http://bit.ly/UuqrOp.

enterprises; all MSMEs are referred to as "subjects of small and medium entrepreneurship" – which can include MFIs and CCs. It is possible therefore that this portfolio includes wholesale loans to MFIs of CCs – though it is unlikely that their share is significant (see Sec. 3.2). The top 30 banks accounted for over 61 percent of all loans to SMEs, including about 72 percent to individual entrepreneurs.

The total portfolio to MSMEs grew by over 60 percent since 2009,[68] and in 2010-2012, per industry experts, the MSME lending sector has been among those with the highest growth rates.[69] Among the largest MSME lending programs are those of SME Bank (122 partner banks as of August 2012)[70] and European Bank for Reconstruction and Development (EBRD) (14 partner banks – participants of the downscaling program). In comparison to MFIs and CCs, it is clear that banks serve a different category of enterprises. For example, EBRD partner banks' average loan size disbursed to clients is about EUR 11,470 (approx. USD 14,900),[71] or about ten times higher than that of MFIs and CCs.[72] In case of SME Bank partners, the loans to end MSME clients are even higher – about RUB 5 million (USD 162,000) disbursed by partner banks and about RUB 1 million (USD 32,000) disbursed by other partner organizations (defined as "small and medium-sized entrepreneurship infrastructure support institutions" that include leasing companies, business incubators, several MFIs and CCs, as well as other organizations falling under this definition per the Russian law).[73]

Despite the high growth rates of the MSME lending programs, access to finance is still cited by MSMEs as among the top three barriers for business development.[74] According to a survey of OPORA, a national organization of associations of entrepreneurs,[75] over 42 percent of companies and individual entrepreneurs said it was difficult if not impossible for them to get a loan for a term of one year, and almost 50 percent said the same about 3-year loans.[76] This is confirmed by industry experts who believe that among access gaps for MSME are longer-term and investment loans as well as loans for start-ups – especially micro and small enterprises with less than 6 month of experience.[77] The SME Bank operates a program that is an attempt to address the issue of longer-term finance as its partners can only fund MSME activities other than trade and at a set interest rate. Depending on a product, the rate to the end borrowers cannot exceed 1.5 – 2 times the SME Bank interest rate on its wholesale loans, resulting in the weighted average of 12.32 percent[78] – while the market average, according to a survey of 17 banks,

[68] See http://bit.ly/PKIgB5.

[69] Interviews with Mikhail Mamuta, NAMMS, September 2012.

[70] See SME Bank, http://bit.ly/Uuru0B.

[71] See Russia Small Business Fund (2012).

[72] See MIX and CGAP (2010).

[73] See SME Bank 2012, http://www.mspbank.ru.

[74] See OPORA (2012).

[75] As of August 2012, OPORA had 141 associations of entrepreneurs as its members and works through 81 of its regional offices covering the whole country.

[76] See OPORA (2012).

[77] Interviews with Mikhail Mamuta, NAMMS, September 2012.

[78] See http://bit.ly/QV39KI.

was 19.75 percent.[79] The result of this strategy has been a much higher share of investment loans in the SME Bank program portfolio – 45 percent compared to the market average of 19 percent.[80] While currently the share of the SME Bank-funded enterprises is less than 1 percent of the total bank MSME lending portfolio, the high growth rate of the SME Bank portfolio (over 120 percent in 2011 when the market grew just by 19 percent)[81] could potentially create an un-level playing field for other MSME loan products offered by banks.

Since the adoption of the Law on Microfinance Activity and Microfinance Organizations (see Sec. 3.2), some banks have pioneered a different model. VTB24, for example, a state-owned institution and one of the largest retail banks in Russia, co-founded a microfinance organization called "Mikrofinans" that issues loans with the average amount of RUB 375,000 (USD 12,100).[82] At some point Sberbank considered the establishment of its own MFI as well, but later declared that it would rather fund existing MFIs.[83] It is yet to be seen which model turns out more promising and cost-efficient for banks – the former where the microlending activity is transferred to a separate institution free from the burden of the Central Bank supervision, or the latter – where it is left to specialized providers such as MFIs or CCs and a bank acts as a wholesale lender.

A model successful in other countries – a specialized microfinance bank – has not become popular in Russia. There is currently only one specialized microfinance bank, FORUS, established in 2005 as a result of a transformation from an NGO MFI. In the same year, another NGO MFI – Russian Women's Microfinance Network transformed into a nonbank deposit and credit organization (a type of NBCO), but in 2011 gave up the CBR license and re-registered as an MFI in the form of a limited liability company. Earlier, between 1999 and 2005, EBRD-established KMB Bank[84] had been operating in 16 regions of Russia as a bank dedicated to small business lending.[85] But in 2005 the bank joined the Intesa Sanpaolo international banking group and under a new name of Bank Intesa turned into a universal bank, though lending to MSME remained an important part of the bank's business (for example, in 2011, it was rated 14th among the top 20 banks lending to MSME[86]).[87] Why has the specialized microfinance bank model not worked in Russia as it has in other countries? One of the reasons may be higher delivery costs as banks try to reach down market in areas outside of bigger towns[88] - the same reason that makes Sberbank close down its branches, but the issue highlights the need for additional research.

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[79] See http://bit.ly/PhzjEP.

[80] See SME Bank (2012).

[81] Ibid.

[82] See http://www.micfin.ru/about.html.

[83] See http://bit.ly/Q5wp2X.

[84] Established in 1992 by EBRD as the Russian Bank for Project Financing and renamed into KMB Bank in 1998; in 2009, renamed into Bank Intesa.

[85] In Russian, the abbreviation KMB stands for "small business lending".

[86] See http://bit.ly/OLsmMg.

[87] See http://bit.ly/ULv4xY.

[88] Interview with Stacie Schrader, FORUS Bank, 25 September 2012.

Regulation and Supervision

Banks and NBCOs, as previously stated, fall under the regulatory and supervisory jurisdiction of the CBR and are governed by a broad Banking Law. This law together with the Central Bank Law gives the CBR broad latitude to adjust the regulatory and supervisory treatment of credit organizations to be proportionate to their specific risk profile.

Few examples exist of MFIs having successfully transformed to banks. While no detailed research has been conducted yet about the challenges of transformation, a few possible reasons can be identified. One is high minimum capital requirements for banks, which only allow very large players to apply for a bank license. As discussed above, the minimum capital requirement for banks will rise to RUB 300 million (USD 9.7 million) by 2015. Russian Finance Minister Anton Siluanov even described a future requirement of RUB 1 billion (USD 32.3 million) as "possible and normal", which would be very hard for banks predominantly providing microfinance to comply with.[89]

Some banks have criticized CBR for being heavy-handed in supervising banks, thus driving up the costs of compliance and leading to a situation where the costs of being regulated (not only cost of compliance with regulations, but also the time spent on serving information requests by the supervisor) are higher than its benefits (first and foremost access to alternative sources of funding such as deposits). This can raise the question of whether the legal form of a bank is the best fit for conducting microfinance.

On the positive side, most of the other prudential regulations do not create serious issues for banks offering microfinance services, though some banks and NBCOs targeting the low income market find them to be time consuming and expensive to comply with. Also on the positive side, CBR has not imposed any caps on lending rates that might be an obstacle to providing microloans (given the inherently higher costs involved in large numbers of small transactions).

An important legal innovation for banks is the introduction of provisions on the use bank payment agents.[90] An amendment to the Banking Law in 2009[91] permitted banks to use bank payment agents to accept cash from individuals as payment for goods or services, as well as taxes and other government fees and dues. Art. 14 of the Payment System Law has now superseded these rules (see Sec. 3.3). It includes detailed rules for banks and NBCOs[92] utilizing bank payment agents (Art. 14), which are wider than the previous rules under Art. 13.1 of the Banking Law. In particular, with the lifting of restrictions on the types of payments that can be conducted through bank payment agents, they can now provide all kinds of card transactions, and have been authorized to conduct cash-out services as well. Bank payment agents can also identify clients in case of funds transfers that do not involve the opening of bank accounts (including e-money operations described in Sec. 3.3.

[89] See http://buswk.co/Qrkpa4.

[90] See CGAP (2010).

[91] Federal Law No. 121-FZ of 3 June 2009.

[92] The Payment System Law defines these as money transfer operators (see Sec. 3.3).

Bank payment agents are different from the nonbank payment agents described below (see Sec. 3.3), as they can offer a broader range of services since the payee can be a bank or other credit organization. Typical transactions only permitted for bank payment agents are deposits into bank accounts, inter-account money transfers, and loan repayments. Unlike nonbank payment agents, they are also allowed to use more than one level of sub-agents (nonbank payment agents can only use one), and to accept payments via ATMs.

Permission for banks to use bank payment agents as their main customer interface is limited by customer identification requirements in the AML/CFT Law.[93] In particular, the law requires for account opening that bank clients be identified through government-issued identity documents and that their residential address is established. This seems to be easy to comply with for most Russian citizens, as all of them are issued with a national passport (national ID), which also states their registered address. However, one issue is that the account opening cannot be delegated to an agent and requires the physical presence of the client. At the same time, the law does not specify that the account opening must be undertaken at a bank branch so one option is for banks to place a person authorized by the bank to conduct client identification (this does not necessarily need to be a bank employee) at an agent's location for conducting the know your customer (KYC) procedures.[94] There are no restrictions on agents conducting "transactional" KYC, i.e. for all transactions (payments and transfers) that do not involve the opening of a bank account (this applies to both payment and bank payment agents). However, if bank payment agents provide cash-out services, the recipient must in most cases be identified regardless of the amount.[95]

[93] See also CGAP (2010).

[94] An example for this is the retailer Svyaznoy (see *Sector Overview* above), which bought a bank and is now able to post bank staff at its retail locations for account opening purposes.

[95] One exception is if the bank payment agent offers cash-out services at ATMs and the client uses a plastic card to withdraw cash at an ATM, authorization via PIN rather than identification is sufficient. See Ministry of Economic Development and Alliance for Financial Inclusion (2011).

Box 2: Banks and NBCOs – Key Challenges and Opportunities

Despite a period of consolidation in the banking industry triggered by higher capital requirements, banks have overall been successful in expanding their physical footprint. The higher number of access points is mostly due to the opening of more "light" branches and the introduction of bank payment agents, yet it is still mostly branch-based and thus relatively expensive to maintain. The recent permission for bank payment agents to conduct cash-out transactions might help to change this.

There is a risk that more regional banks will be forced to close down or merge with larger banks, which might have a negative impact on accessing banking services in less populated areas.

Banks face difficulties and have no strong incentives to move down-market and to offer innovative financial services for customers at the base of the economic pyramid. At the same time, increasingly high capital requirements for banks constitute a high barrier for MFIs that might consider transforming into banks. Inflexible regulations on issues such as non-face-to-face account opening and high costs of compliance can lead to an unfavorable cost-benefit ratio for providing microfinance services under the legal structure of a bank.

Disaggregated data, both in terms of geographic distribution (urban versus rural) and in terms of client profile (e.g., by age and gender) is needed to understand why banks and NBCOs are not realizing their financial inclusion potential. For example, the MSME sector has been experiencing strong growth, but it is not clear how much of this reaches microfinance clients rather than providing relatively larger loans to SMEs.

Without clear initiatives to adapt to the needs of the most excluded segments – particularly the elderly and poorer Russians - it is difficult to say whether innovative delivery channels hold a financial inclusion promise for broader customer groups – beyond those already reached by financial services.

3.2 Microfinance Institutions, Credit Cooperatives and Other Nonbank Financial Organizations

Sector Overview

In addition to banks and NBCOs, there are financial institutions in Russia that are not subject to the Central Bank regulation and supervision as they are not allowed to mobilize deposits and disburse credit. Instead, these are *lending* institutions taking advantage of the general power granted to all legal entities under the Russian Civil Code to make loans.[96] Among these nonbank financial organizations (NFOs), microlending microfinance institutions (MFIs) and credit cooperatives (CCs) are of particular importance to financial inclusion.

As of September 2012, there were 2,137 registered MFIs[97] and 1,433 registered CCs (representing approximately 983,000 individual CC members),[98] the latter organized into 10 Self-Regulatory

[96] It should be noted that there is an important legal difference between "credit activity" allowed only to Central Bank-licensed institutions and "lending activity" allowed to other institutions. While economic relationships between the parties of credit and loan agreements are similar, only "credits" may be financed from deposits, and only CBR-licensed entities are permitted to mobilize deposits.

[97] FFMS, http://bit.ly/QHhkEx.

Organizations (SROs).[99] Previously unregulated and unsupervised, all MFIs and CCs came under the regulatory jurisdiction of the Ministry of Finance (MOF) with the adoption of the Law on Credit Cooperation in 2009 and the Law on Microfinance Activity and Microfinance Organizations in 2010. (No change was made to the Russian Civil Code provisions on lending, so there remain NFOs that still lack any regulation beyond these minimal definitions and requirements.) In late 2011, once the legal framework for CCs and MFIs was finalized, the Federal Service for Financial Markets (FFMS)[100] was appointed as their supervisor. Responsibilities of FFMS include registration of MFIs and CCs as well as the monitoring of their activities.

As of the date of this report, there was no information available on the total of MFIs and CCs as the collection of statistics by FFMS started only in the first quarter of 2012. According to the Microfinance Information eXchange (MIX),[101] the average loan balance of Russian MFIs and CCs is about USD 1,600.[102] An average CC or MFI is small, serving less than 1,000 borrowers. (For example, according to the data provided by a leading SRO, the average number of individual members of its member CCs is 741.)[103] According to industry experts,[104] there are about 70 NFOs with loan portfolios exceeding USD 10 million. However, there is data available only on 6 such CCs and MFIs (see Table 5). NFOs serve many more microenterprise clients than downscaling banks[105] (see Sec. 3.1) and reach to remote and less populated areas. The latter is especially true for CCs. For example, among the largest NFOs are the First Far Eastern Credit Cooperative and EKPA Credit Cooperative working in the Far East and Urals, respectively. It is not uncommon for CCs in small towns and settlements to unite a significant share of local residents as their members. The case of EKPA is especially noteworthy as this CC's membership represents one-fourth of the population of 43,500 in the town of Uray where it operates.

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[98] Data from Mikhail Mamuta, NAMMS, based on data published by SROs.

[99] FFMS, http://bit.ly/UEXNo3.

[100] FFMS is the federal agency in charge of the supervision of most financial institutions in the country other than Central Bank-supervised banks and NBCOs. These include, in addition to CCs and MFIs, participants of the securities market, investment companies, pension funds, commodity stock exchanges, credit bureaus, insurance companies, as well as any self-regulated organizations of these financial institutions.

[101] MIX is the leading global provider of business information and data service for the microfinance industry. The MIX has self-reported data on 98 MFIs and CCs from Russia covering the largest institutions.

[102] This is approximately ten times lower than loan balances of Russian banks partnering with the EBRD to lend to micro and small enterprises.

[103] Interview with Alexander Solomkin, SRO "Cooperative Finances", 18 April 2012.

[104] Interviews with Mikhail Mamuta, NAMMS, September 2012.

[105] The total number of active end clients of the largest Russian MSME finance program of the SME Bank was about 26,000 as of August 2012. See http://bit.ly/LSEJ7L.

Table 5: Largest NFOs in Russia by Loan Portfolio (USD)

	Name	Date	Type	Gross Loan Portfolio	Number of Active
1	CMFinance	2011	MFI	58,921,813	55,567
2	EKPA	2010	CC	40,691,139	11,034
3	FINCA - Russia	2011	MFI	33,569,563	11,281
4	First Far Eastern Credit Cooperative (FFECC)	2011	CC	11,550,163	5,226
5	Udmurtia State Fund for Small Business Support (USFSBS)	2011	MFI	11,535,938	377
6	Doveriye (Amursk)	2010	CC	10,579,357	3,440
7	Gorodskoy	2011	CC	9,176,656	3,882
8	Women's Microfinance Network (WMN)	2010	MFI	7,981,756	3,258
9	Kassa Vzaimopomoshi	2011	CC	6,586,844	5,880
10	SBS (Union of Bank Workers)	2011	CC	4,762,875	1,582

Source: http://www.mixmarket.org.

At the same time, many MFIs and CCs do not pursue any enterprise or social development goals and engage primarily in consumer lending. In fact, the adoption of a new Law on Microfinance Activity and Microfinance Organizations (see below) providing for relatively low market entry barriers prompted many NFOs to apply for an MFI status simply to lend legal certainty to their lending activities (formerly carried out based only on general provisions of the Russian Civil Code). The divide between development-oriented NFOs that have existed since the mid-1990s and newly registered, purely profit-maximizing consumer lending "MFIs" became especially evident in early 2012 when a payday lender[106] registered as an MFI commenced a partnership with the Russian Post and began advertising "mini-loans" at over 2,700 percent per annum. This caused massive public criticism of both the concept of microfinance and the Russian Post as a public institution, and led to regulatory discussions and proposed regulatory changes described below.

Unlike banks, CCs and MFIs have not been making much use of the innovative solutions that have emerged in the market in recent years. (For example, there is only one CC that acts as a bank payment agent.) From the financial inclusion perspective, CCs' and MFIs' typical closeness to clients and focus on lower-income consumer segments are strong advantages, and linking with these new financial service delivery models could represent an important opportunity to expand outreach.

Regulation and Supervision

MFIs

Until 2010, there was no legal definition in Russia for microfinance or microloans; however lending has been allowed to any legal entity since the adoption of the Russian Civil Code, while deposit taking was and remains only allowed to Central Bank-licensed credit organizations.

[106] In other countries, a term "payday loan" is usually used to describe a small, short-term unsecured loan that is intended to cover a borrower's expenses until his or her next payday. In Russia, the repayment of the loan is not necessarily linked to a borrower's payday. There is no legal definition for a payday loan or a payday lender in Russia.

In 2010, a federal law on Microfinance Activity and Microfinance Organizations was adopted (effective from January 2011) with the purpose of providing legal definitions, standardizing and streamlining the activities of microlending MFIs (both nonprofit and for-profit). Though registering as an MFI is not mandatory and a lending institution can still operate under the Civil Code, receiving MFI status gives a number of important benefits (such eligibility for government financial support offered through the SME Bank, calculating tax-deductible loan loss provisions etc.).

The law introduced a formal definition of a "microloan" as not exceeding RUB 1 million (USD 32,342). MFIs can still disburse larger loans but these will not be considered microloans. The microloan definition was introduced not to limit lending, but rather to get a better picture of the size of the sector and demand for such type of loans, as reflected in MFIs' statistics. At the same time, it is not clear whether institutions disbursing only a small percentage of microloans or engaged primarily in activities other than lending or microlending can rightfully be registered as MFIs.

MFIs can be funded with loans (i.e., from lenders not licensed by the CBR) and credits (i.e., from banks and NBCOs licensed by the CBR), voluntary contributions, donations, and other (unspecified) types of funding. The law limits borrowing from natural persons to prevent unlicensed financial intermediation: MFIs cannot receive loans smaller than RUB 1.5 million (USD 48,500) unless this money comes from the MFI's founders (participants, shareholders or members). For MFIs taking loans from natural persons and legal entities, there are two prudential standards established by MOF regulations:[107] capital adequacy and liquidity.[108] While the law does not impose significant limitations on funding sources for MFIs, in reality it is difficult for them to get access to funding. For many banks, MFIs are not eligible borrowers as most of them can offer only their loan portfolios as collateral – which many banks consider risky. The SME bank mentioned above serves primarily banks; there are fewer than 30 MFIs in its portfolio but currently this is the largest wholesale MFI lender in Russia. Other large banks have recently started or announced similar programs (e.g. VTB24 and Sberbank, respectively) which is expected to send signals to even more banks to start lending to MFIs. There are few foreign microfinance investors working in Russia and only one small specialized microfinance wholesale lender – Centurion Capital (which had 3 MFIs and 6 CCs in its portfolio as of August 2012[109]).[110]

In the area of consumer protection, in response to the Russian Post interest rate scandal, a draft law requiring standardized interest rate disclosure was developed (initiated by the National Partnership of

[107] Ministry of Finance Decree No. 42n of March 30, 2012, "On Approving the Numerical Values and the Order of Calculation of the Economic Standards on Capital Adequacy and Liquidity of Microfinance Organizations Attracting Monetary Funds of Natural Persons and Legal Entities in the Form of Loans".

[108] The capital adequacy ratio, defined as MFI's capital in relation to its assets (excluding cash and cash equivalents), cannot be below 5 percent for all types of MFIs except those registered as non-profit partnerships; for the latter, being membership-based organizations, it must be at least 50 percent. The liquidity ratio, calculated as liquid assets (excluding inventory and value-added tax on purchased assets) in relation to short-term liabilities (excluding deferred income and estimated liabilities), must be at least 70 percent for all types of MFIs.

[109] Information from Irina Fedyaeva, Centurion Capital, September 2012. The total loan portfolio of Centurion Capital as of August 2012 was RUB 148 million (USD 4.8 million), and the loans to MFIs and CCs were 45 percent of the total (the rest was to 5 leasing companies and 25 MSMEs).

[110] Centurion Capital is a joint-stock company owned by the Russian Microfinance Center and the Association of Russian Banks.

Microfinance Market Stakeholders (NAMMS) – see Sec. 4.3), and amendments to the Law on Microfinance Activity and Microfinance Organizations and regulations were proposed requiring all MFIs to report to credit bureaus (see Sec. 4.2) and report to FFMS, the supervisor, on their short-term (less than 60 days) loan portfolio of microloans below RUB 45,000 (USD 1,455). As it is difficult at this rather early stage of the microfinance market development in Russia to clearly define the term payday loan, the characteristics of the term and microloan size will be used as proxies which should help assess the magnitude of this market. In addition, according to industry experts,[111] discussions are currently underway about mandatory MFI membership in MFI SROs and on the need to collect and publish information on average interest rates for various lenders and credit products. It is not clear which entity will be responsible for this. There are also proposed legal amendments which provide for a definition of "an indicative usury ceiling" calculated on the basis of an average market interest rate for different types of loans/credits.[112] If adopted, these will apply to all financial institutions – both banks and credit organizations and NFOs.

Credit Cooperatives

Before 2009 financial cooperatives existed in at least four different legal forms and were governed by a number of legal acts. The adoption of the Law on Credit Cooperation in July 2009 was important for the harmonization of the CC sector, bringing all but one type of financial cooperative – agricultural CCs (important, in terms of market share)[113] – under the same legislation and regulation.

The law established a number of prudential requirements for CCs, such as limitations on borrowing, lending and member savings. CCs can operate only if they join one of the self-regulated organizations (SROs) for CCs – NGOs required by the law to perform monitoring functions for the supervisor, FFMS. CC SROs must maintain a register of their member CCs, and are responsible for monitoring their members' compliance with legal and reporting requirements. CC SROs are also required to maintain a compensation fund of 0.2 to 5 percent of aggregate member assets aimed at helping member CCs meet financial obligations before their shareholders (within the limits and following the rules set forth in the legislation); however, it is not clear whether the fund can be used (or will be sufficient) to cover lost savings of members in the event of CC failure. It should be noted that legally member savings are not considered deposits (though CCs are obliged to repay members' share capital upon their withdrawal from CC membership and members can earn a return on their shares). They are therefore not covered with the deposit insurance scheme which applies to all deposits held in Central Bank-licensed banks and NBCOs.

As with MFIs, funding of CCs presents an issue as there are very few funding options available. Besides member savings (in the form of mandatory and voluntary share capital), the law provides for the establishment of the so called second-tier CCs (credit cooperatives of credit cooperatives) to provide

[111] Interviews with Mikhail Mamuta, NAMMS, June 2012.

[112] Information from Oleg Ivanov, Association of Regional Russian Banks, August 2012.

[113] Agricultural CCs are numerous in Russia – as of January 2011 there were 1,772 agricultural CCs; in 2010 they lent over RUB 3 billion (USD 97 million) in rural areas (according to data from the Ministry of Agriculture, cited from materials of a conference of the Union of Agricultural Cooperatives held on 4-5 April 2011).

funding to their member CCs. According to industry experts,[114] there are currently only 5 registered second-tier CCs with approximately 150 member CCs. Though the law does not encourage extensive borrowing by CCs as they hold member savings,[115] the vast majority of CCs has no options for external borrowing at all.

With the newly appointed supervisor with no prior experience supervising CCs and CC SROs that have just been established (some of them under pressure to reach membership thresholds by the legally set deadline), the adequacy of these supervisory arrangements remains to be seen.

[114] Interviews with Mikhail Mamuta, NAMMS, June – September 2012.

[115] Per the law, the total volume of external funding in CC cannot exceed 50 percent of the total volume of funds attracted from CC members.

Box 3: MFIs, CCs, and Other NFOs – Key Challenges and Opportunities

While bringing most types of financial cooperatives under the common legal, regulatory and supervisory framework was a significant step in terms of the harmonization of the Russian financial service market for lower-income customers, there still remains a huge market of agricultural CCs that are regulated separately and are subject to the oversight of the Ministry of Agriculture rather than any financial market-related authority.

As some larger CCs may be of systemic importance – at least in terms of the share of the population they serve in their regions – the involvement of the Central Bank as the supervisory authority with the greatest experience and capacity related to preserving systemic stability may be justified.

Individual member savings and shares placed with CCs in the economic sense are very similar to deposits with Central Bank-licensed credit organizations, yet they are not protected by either the deposit insurance scheme or its equivalent.

The Law on Microfinance Activity and Microfinance Organizations has set the stage for the harmonization and increased transparency of the microfinance sector and set basic rules for its regulation and supervision. But the absence of significant entry barriers and a very general definition of 'microfinance institution' has resulted in a situation where virtually any company can obtain registered MFI status, (even if lending or microlending is not its core activity), and has spawned the rapid proliferation of extremely heterogeneous registered 'MFIs'. This in turn creates various risks - particularly reputational risk for the industry due to irresponsible activities of some market players, and increased burden for FFMS supervising market conduct of registered MFIs. One approach to mitigating the problem would be the introduction of additional classes of registered NFOs, allowing for differentiation between development-oriented MFIs on the one hand and various types of consumer and payday lenders on the other.

There is still risk of unregulated financial intermediation since on-lending of loans from the public is not restricted for those NFOs that do not have registered MFI status (and borrow and lend instead under the Civil Code). It is also currently impossible to assess the size of the unregistered NFO market – and there are industry experts[116] who believe it may be even larger that the market of registered MFIs. Policy makers in Russia therefore face a challenging task of offering the right incentives for microlending institutions to obtain registered MFI status (and remain registered) and while providing an adequate level of market conduct supervision for registered MFIs, as well as appropriate levels of and types of prudential supervision in the case of those that borrow from natural persons. The effectiveness of the delegated supervision model is yet to be evaluated – both FFMS and SROs currently have no prior experience and very limited capacity and resources to ensure compliance with the prudential norms set forth in the law and reporting requirements for CCs. Experience shows that the chosen model of the delegated supervision has worked in some countries where the government financial supervisor closely monitored the quality of the delegated supervisor's work, although it is not clear that this model reduces total supervision costs.[117]

Neither MFIs nor CCs are integrated well with the financial sector – there are very few options for refinancing. While this is less of an issue for CCs that have strict limitations for external borrowing established by the law, limited access to finance for MFIs significantly restrains their growth.

CCs and MFIs, though many of them located close to their lower-income customers, are yet to make use of the new delivery channels – such as payment terminals and agents. This may be an important opportunity for them to further expand outreach to the under-served segments.

[116] Interviews with Mikhail Mamuta, NAMMS, June – September 2012.

[117] See CGAP (2012).

3.3 Payment Service Providers

Innovations in retail payments have been among the main drivers in improving access to finance in Russia. As recently as 2007, three main provider types of innovative retail payments could easily be distinguished: providers of automated payment terminals (only providing cash-in services), web-based e-money issuers, and mobile network operators, with only the former two showing any scale.[118] Most of the providers have since diversified their product channels and expanded the range and accessibility of their offerings, bringing them into direct competition with each other. Thus, companies mostly known as leaders in the payment terminals market (such as QIWI) now also offer virtual accounts (e.g., QIWI Wallet); e-money issuers have linked their virtual accounts to payment cards (e.g., Yandex Money); and mobile network operators have launched virtual and plastic cards under joint branding with Visa or MasterCard and in cooperation with banks (e.g., MegaFon Online Card and MTS Dengi) and are slowly moving into the remittance market (Beeline in cooperation with Mobi.Dengi). As a result of this, the world of innovative retail payments has become much more complex, but the potential for synergies between different models has also increased. These different types of payment service providers have since founded the Russian Electronic Money Association as a platform to bring different players together and to discuss issues of common interest in particular pertaining to the issuance of electronic money.[119]

Innovations in retail payments make use of the impressive market penetration rate of mobile phone connections (1.7 connections per Russian citizen; see *Statistical Overview*) and the wide card base in the country (see Sec. 2). They have had a profound impact on improving the accessibility and increasing the convenience of conducting basic retail payments not only in urban, but also in more remote and sparsely populated areas, where a higher percentage of the population lacks access to accounts in the formal financial sector (see Sec. 2.1). However, it is not equally clear that these innovations have been successful in providing previously underserved communities with essential services to manage their financial lives.

A parallel development to the innovations introduced by payment service providers has been the emergence of nonbank payment agents that can accept payments on behalf of a payee. While the core activity of both types of agents is the same – the acceptance of payments from individual persons to be paid to various types of business entities (see Sec. 3.1) - nonbank payment agents are not permitted to make transfers from one bank account to another and to offer cash-out services.

While many of the innovations in the payments arena initially happened without a clear legal framework, legal changes with regard to payment service providers, KYC rules, and payment agents have been gradually introduced. With the recent adoption of the Payment System Law in 2011, regulatory change has taken center stage. This law is gradually coming into force over a period of 18 months and will be fully in effect by the end of December 2012. More than 50 implementing regulations are supposed to be issued by then, of which about half had been issued by August 2012. Respective changes in the supervision of payment service providers are still ongoing. Even though this means that

[118] See CGAP (2008).

[119] See the Association's website at http://www.npaed.ru.

the legal framework for payment service providers still is very much in flux, what can already be said to date is that the Payment System Law has brought clarity with regard to a number of issues affecting the operations of payment service providers, which are described in detail in the Sec. *Regulation and Supervision* below.

The fast-moving nature of the sector and of its regulation and supervision, as well as the diversity of players and different models that are in operation to date make it difficult to provide a fully up-to-date picture of the sector and the legal framework applying to it. The following provides a snapshot of the main players and the applicable legal provisions as of September 2012. Table 2 lists the main types of payment service providers.

Sector Overview

A wide range of payment service providers can be distinguished that are currently operating under various institutional set-ups and different legal regimes. The Payment System Law has introduced a new categorization, which will also be broadly followed here: money transfer operators, e-money operators, and mobile network operators.[120]

Money transfer operators: Sberbank and the Russian Post have long had a near-monopoly in the provision of retail payment services in Russia. Two major innovations have changed this over recent years. The first innovation is the emergence of payment terminals. The second innovation is web-based e-money issuers (see *Electronic Money Operators* below). Companies such as OSMP (offering terminals under the QIWI brand) and Cyberplat – the two biggest providers – have set up their own payment processing platforms and provide clearing and settlement services for a network of self-service payment terminals.[121] These terminals are essentially cash-in devices allowing for various types of payments (for mobile communication services, for internet service and commercial TV, loan repayments, top up of electronic wallets, tax payments, etc.). Some of the terminals are owned by the payment service provider, others are run by banks or (bank or nonbank) payment agents. The total number of payment terminals in Russia is not exactly known, but is estimated to be between 220,000 and 300,000,[122] which means that there are between five and seven times as many terminals as bank and NBCO branches and still more terminals than ATMs.[123] While these numbers are impressive, the majority of payments processed through terminals have traditionally been for mobile top-ups. Only recently this has started to

[120] The latter are referred to as communications service providers under the law. The law also provides for payment system operators, which develop the rules of payment systems and own them, and payment infrastructure service providers, which provide the back-end infrastructure. As both do not directly interact with individual customers, they are not covered in the report.

[121] OSMP (Unified Instant Payment System) and Cyberplat do not hold licenses as a bank or NBCO and are therefore not money transfer operators as defined in the Payment System Law.

[122] According to Center of Payment Systems and Settlements and RMC (2012), the share of terminals among customer service points is 70 percent. According to Boris Kim, QIWI, the total number is approx. 300,000 (interview on 16 April 2012).

[123] Center for Research of Payment Systems and Settlements and RMC (2012).

change with repayment of bank loans and the top up of virtual accounts (see *Electronic Money Operators* below) becoming more popular than before.[124]

Payment service providers make use of payment agents for cash-in or bank payment agents for cash-in, cash-out, and customer identification purposes (see *Payment Agents* below). Most agents operate a number of customer service points. In the majority, these are unmanned terminals, but they also operate through manned agents that use a cashier and are equipped with technology such as point-of-sale (POS) terminals or computers linked to the internet (using either a web-interface or special software provided by the operator). This allows clients to choose the technology they feel most comfortable with, as some might prefer the "human touch" of interacting with agent staff rather than operating through a self-service terminal.

Growing numbers of terminals are owned by banks (which can also operate as money transfer operators under the Payment System Law), which increasingly make use of a combination of terminals for cash-in and ATMs for cash-out as a substitute for traditional brick-and-mortar branches (see Sec. 3.1). While terminals and ATMs are lower cost delivery channels, it remains to be seen whether the elderly, those who are less financially educated, and customers in more remote regions will feel equally comfortable with using them as compared with traditional bank branches.

Another group of money transfer operators are *money remittance operators* that are providing domestic and international money remittance services.[125] From a financial inclusion perspective of great importance is the Russian Post, which is the dominant player in the domestic remittances market (with 185 million Postal remittances per year) and delivers pensions to people without a bank account (over 23 million pensioners or almost 60 percent of all pensioners in Russia).[126] The Russian Post is regulated under its own law (and thus not a money transfer operator as defined in the Payment Systems Law) and can take advantage of its vast network of 42,000 post offices, many of them located in remote rural areas where no other financial service providers are present. Since the launch of its electronic money order system in 2003, the Post has been in a better position to compete with banks and money remittance operators in the money transfer business both domestically and internationally. It has signed agreements with 13 countries (8 CIS countries plus the Baltic States, China, and France), which allow for electronic transmission of remittance transaction data (rather than using the previous system of physically sending postal orders).

The international remittances market between Russia and CIS countries is huge and still growing. According to CBR data, (resident and nonresident) individuals sent USD 43.8 billion from Russia across the border in 2011, of which about 40 percent was sent via money remittance operators (a year-on-year

[124] No data are available for the whole sector, but QIWI reports that the share of the payments volume for mobile top-ups paid through terminals has dropped from 93 percent in 2008 to 54 percent in the first half of 2012, while now 16 percent of payments are for repaying bank debt. See http://bit.ly/SED1cC).

[125] Confusingly, the use of the term money transfer operator has previously been used by the Central Bank to refer narrowly to money remittance operators, while it now also includes companies mostly offering payment services.

[126] All data from the website of the Russian Post (without date): http://www.russianpost.ru.

growth of 37 percent).[127] For the first time again the remittance flows were higher than before the financial crisis in 2008.[128] Nineteen international money remittance operators are currently registered with the Central Bank, including Western Union and MoneyGram,[129] as well as leading Russian companies with a wide regional presence (particularly in CIS countries) such as CONTACT, Golden Crown, Leader, and Unistream, and the Russian Post. The main service offered by them is processing payments without the opening of bank accounts. In most cases, it is cash on both ends, although in some cases the money can also be transferred to a bank account or even to a mobile wallet.[130] This is also reflected in the low share of people in Russia who use bank accounts to send or receive remittances (2.1 percent and 2.4 percent of people 15 years and above, respectively), which is below the regional average and even lower when compared to other upper-middle-income countries.[131] To send money, customers either have to go to the branch of a partner bank, to a retail store that operates as an agent for the money remittance operator, or to use a payment terminal. Russia is one of the lowest-cost remittance markets globally with a total average cost for sending USD 200 of 2.68 percent and very low spreads between minimum and maximum amounts charged (indicating a highly competitive market).[132] It therefore provides important lessons on how to implement cost-saving innovations that benefit mostly unbanked migrants. At the same time, there seems to be a large untapped potential to link remittance flows to other financial products such as savings or loans.

Golden Crown, as one of the fastest growing operators, allows for money to be sent from almost 17,000 bank branches or about 11,000 retail shops operating as agents.[133] It has also been a pioneer among the money remittance operators in offering "sender cards" which can store basic information about the sender and recipient, thereby speeding up the process of sending money (and reducing the costs). Some operators have also signed agreements with mobile operators that allow customers to send money directly from mobile wallets (see *Mobile Network Operators* below) to one of their outlets.

Most money remittance operators also offer retail payment services. For example, the Russian Post is a major player in accepting payments for various services (the same type of services also being paid through the terminals). In 2009, it accepted 642 million payments for 8,000 different services with an overall volume of almost USD 10 billion.[134] At least one money remittance operator, Leader, has launched its own digital wallet that can be replenished at one of its partner locations (banks, MNOs, agents, terminals, etc.) and be used for payments.[135]

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[127] The CBR does not report how the remaining remittances were transferred.

[128] Data from CBR's External Sector Statistics, http://bit.ly/RnbCXO.

[129] MoneyGram is registered as a money transfer operator, but not as a payment system operator.

[130] For example, in April this year the CONTACT system launched direct transfers into M-PESA accounts in Kenya. See http://bit.ly/KkIZ81.

[131] See World Bank (2012).

[132] Data for third quarter 2011. See World Bank (2011).

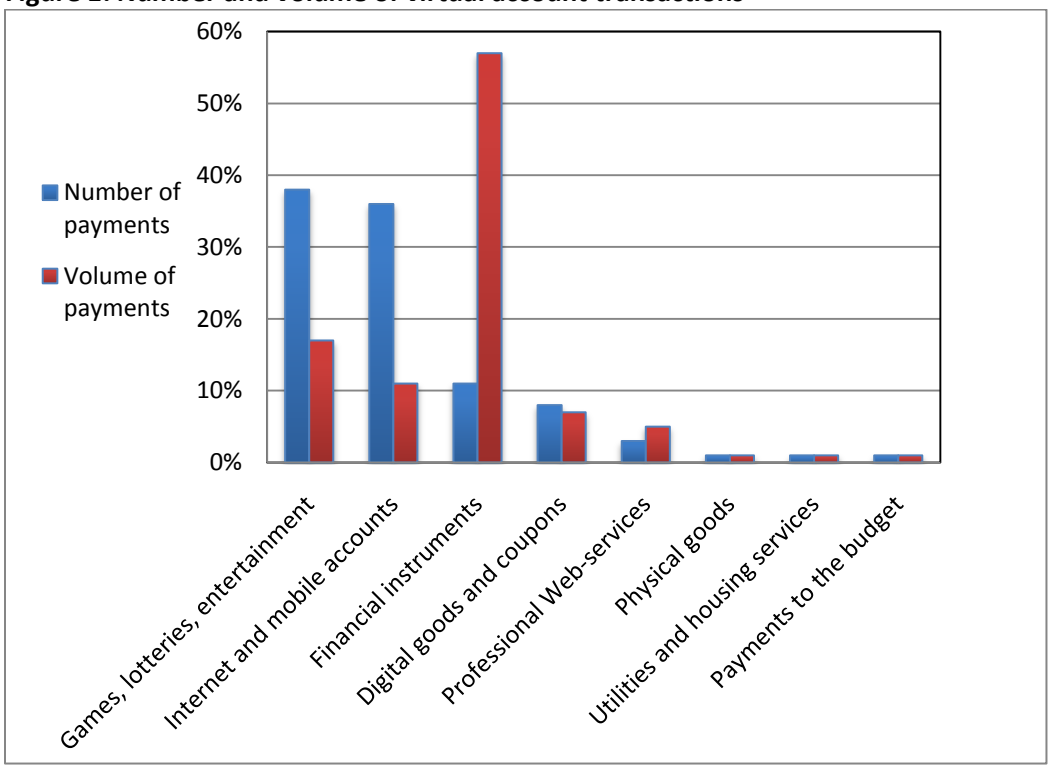
[133] Interview with Maria Mikhailova, Golden Crown, 18 April 2012.

[134] See Ministry for Economic Development and Alliance for Financial Inclusion (2011).

[135] See http://bit.ly/SFp0JV.

Electronic money operators: The second innovation changing the retail payment landscape has been (mostly web-based) *e-money issuers* that are classified as e-money operators under the Payment System Law. They allow customers to open electronic wallets (further referred to as "virtual accounts") either on the internet or through terminals or other agent locations.[136] These virtual accounts can be replenished at agent locations, through payment terminals, scratch cards, bank transfers, or by payment in cash at a bank teller.

Figure 1: Number and volume of virtual account transactions



Source: Dostov (2012). Financial instruments includes virtual prepaid cards, P2P transfers to other virtual accounts, loan repayments, and other transfers that do not involve the purchase of goods or services.

According to the CBR, 12 providers offering e-money over the internet are currently operating in Russia.[137] The most widely used virtual accounts are Yandex.Money, QIWI Wallet (offered by QIWI Bank, which belongs to the same group as OSMP), and WebMoney.[138] PayPal entered the Russian market in 2006, but has not made much headway yet.[139] Looking at some data on the market, it can be seen that virtual accounts have become increasingly popular, but that their use is still very much focused on

[136] Depending on the type of transaction, customers might be required to send a scanned copy of their passport or show their passport at one of the agent locations and/or a notary.

[137] Interview with CBR, 20 April 2012.

[138] This is according to a public opinion survey among 18-45 year-olds living in Russian cities with a population exceeding 800,000, which was commissioned by Yandex.Money and conducted by TNS in February/March 2012 (TNS 2012).

[139] A planned cooperation with the Russian Post might change this. See http://bit.ly/JMZ7lv.

paying for services without much relevance for financial inclusion.[140] The volume held in virtual accounts has increased from RUB 40 billion (USD 1.29 billion) in 2009 to RUB 70 billion (USD 2.26 billion) and RUB 125 billion (USD 4.04 billion) in 2010 and 2011, respectively, and is expected to double in 2012. The number of active mobile wallets has grown from 30 million (2010) to 34 million (2011). However, almost ¾ of all payments from virtual accounts are for online games, entertainment, social networks, lotteries, airtime, and internet (see Figure 1). Virtual accounts are hardly used for paying for physical goods, utilities and housing, and payments to the government budget (e.g. taxes), all of which would be of interest to the financially excluded. One reason for this is that users would want to receive a paper receipt or electronic confirmation by the payee that they have paid, a functionality that has not been launched yet. All this said, financial instruments are the number one payment in terms of volumes, as payment amounts are much higher than for the other categories. To get cash, customers have to transfer the e-money balance to a Visa or MasterCard (which could also be a prepaid card as described below in the Section *Regulation and Supervision* and can then be accessed through the usual channels such as ATMs), to a bank account, they can use a money remittance operator for cashing out, or they can directly cash-out at agents if they have been previously identified.[141] In all cases that involve the opening of a bank account, full identification of the customer is required before the money can be taken out as cash. Cashing out through money remittance operators without opening a bank account is also possible without client identification if the amount is below RUB 15,000 (USD 485). According to a public opinion survey among 3,500 18 to 45 year-olds living in Russian cities with a population exceeding 800,000 (1,800 of the respondents live in Moscow), the typical e-money user in Russia tends to be young (35 and younger), male, an advanced internet user, and either a student or professional.[142] This is clearly not the typical profile of someone who lacks access to financial services. It still has to be shown that e-money operators will be a compelling value proposition to someone living in more remote areas, who does not have access to traditional bank accounts and might not be familiar with using the internet.

An interesting recent innovation is the tie-up between e-money operators and card issuers. In November 2011, QIWI started offering a physical Visa prepaid card to its QIWI Wallet users. Five months later, Yandex.Money followed suit and launched a joint product with Tinkoff Credit Systems Bank (a purely virtual bank without any bank branches and with a focus on credit cards), which allows all Yandex.Money customers to receive a free MasterCard debit card. This card is linked to the Yandex.Money account and transforms an e-money account that can only be used in the world of online payments and transfers into a physical card that is accepted at about 28 million merchants and more than 1 million ATMs worldwide.[143] Innovations like these might eventually lead to a unified payment tool that would combine all the advantages of different access channels (virtual and physical cards, e-money,

[140] The data in this paragraph is from Dostov (2012) and correspondence with Victor Dostov, October 2012.

[141] Yandex.Money, for example, charges 3 percent commission on transferring the e-money balance to a money remittance operator, which might charge an additional 1 to 1.5 percent commission for cashing it out. Interview with Evgeniya Zavalishina, Yandex.Money, 16 April 2012. As some of the virtual accounts are also linked to a virtual credit card (e.g., QIWI wallets come with a prepaid Visa virtual card), they can even be used to order at online stores that otherwise do not accept payments from e-money accounts (e.g. at foreign stores).

[142] See TNS (2012).

[143] See http://on.mktw.net/LfbECC.

mobile wallets, etc.) and lead to a wider network of access points and greater usability. The impact on financial inclusion is difficult to estimate at this point, but can potentially be substantial.

Mobile Network Operators: Unlike in some other countries, the mobile network operators (MNOs) in Russia have not been at the forefront of innovation in the retail payments arena, not least because of the lack of legal certainty before the Payment System Law was introduced. The need to top up prepaid airtime accounts has driven many of the payments innovations in Russia, but the relevant payment channels were mostly operated by other providers (money transfer operators and e-money issuers).[144] However, recently the MNOs have increased their efforts to tap into the market for retail payments as a way to earn additional fee income outside their traditional voice market.[145]

During recent years, MNOs have launched several initiatives either alone or in cooperation with other financial sector players, which are mostly targeted at allowing mobile customers to use their prepaid airtime balance for various payments and to link it with other channels such as cards or those offered by money remittance operators.[146] The three largest MNOs - MTS, MegaFon, and Beeline - have all entered into more or less close partnerships with banks that allow them to expand their mobile financial services offerings.[147]

The biggest question is how many of these services are likely to reach new customers that have previously been financially excluded rather than just providing a more convenient payment channel for existing bank customers. The fact that Sberbank has not entered into a special partnership with any of the MNOs, even though it might have the highest potential of reaching out to the financially excluded, is not a good sign for this. Moreover, while most of the current services allow for person-to-person transfers (P2P), they are – quite similar to the e-money operators – rather restrictive with regard to cashing out (i.e., mostly through the banking channel or by transferring money from the electronic wallet to a card account), which implies that they cannot be easily used as a basic substitute for a bank account. Further research would be required on the impact of MNOs' innovations in retail payments on financial access.

On the positive side, one peculiarity of Russian mobile money services is that most make use of the existing prepaid airtime account rather than requiring clients to open a separate wallet for payment transactions. It can be hoped that this will facilitate adoption by the financially excluded, as clients do

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[144] According to one blogger, around 75 to 85 percent of terminal providers' revenues come from mobile top-ups and about 80 percent of MNOs' revenues come from voice traffic. See http://bit.ly/Pi77Sc.

[145] For example, MegaFon has recently launched MegaLabs, which focuses, among others things, on developing a strategy for MegaFon in providing financial services.

[146] The following blog by Daniel Gusev covers many of the innovations by MNOs: http://blog.danielgusev.com. Interestingly, the three largest MNOs have signed an agreement of interoperability at merchants, which allows a customer of one operator to make a payment for a supplier of goods and services, which is only connected to one of the other operators. See http://bit.ly/SFSkBR (in Russian).

[147] MTS and MTS Bank (recently rebranded from Moscow Bank for Reconstruction and Development) are part of the same investment company; Beeline works with Alfa-Bank, which are both part of the Alfa Group Consortium (even though Beeline previously cooperated closely with Tavrichesky Bank); and MegaFon works with five smaller banks that have an interest in playing a stronger role in the retail payments market.

not have to fund a separate wallet before they can start transacting, but can simply use their existing airtime balance. However, as the average balances on prepaid accounts are relatively low (estimated to be below USD 7),[148] customers generally still have to top up their account before they can initiate larger payments. There is no separate data available about the current usage of mobile money accounts for payments and transfers.

Payment agents: Bank payment agents and nonbank payment agents are also important players in providing retail payment services on behalf of banks and a wide range of payees. It was not only the amendment of the Banking Law in 2009 which allowed bank payment agents to accept cash on behalf of a bank (see Sec. 3.1), but also the adoption of a new Payment Agents Law at the same time that permitted nonbank payments agents to accept cash funds from individuals (but not from legal entities) as payment for goods and services. One and the same entity can be both a bank agent and nonbank payment agent at the same time, as these terms do not define the type of market participant, but the type of financial transaction they are authorized to provide. QIWI, for example, which has a bank license, uses both types of agents opportunistically to minimize the costs of regulatory compliance.[149]

According to a 2012 study on agents, 70 percent of bank and nonbank payment agents are providing services via unmanned payment terminals, with the remainder serving their customers using a cashier.[150] The number of both categories of agents has been increasing rapidly – from 7,800 in 2010 to 12,400 the year after, working through over 319,000 customer service points (including both unmanned terminals and outlets with cashiers).[151] The latter model is mostly offered by retail enterprises for which payment services do not constitute their core business, as it would otherwise not be economically feasible.

By far the largest use of agents is for mobile top ups and payments for other communication services such as internet fees (86 percent of the number of transactions in 2012, down from 95 percent during the previous year). However, other payments (deposits into a personal bank account, purchases of prepaid cards, loan repayments, replenishment of payment cards, and person-to-person transfers) have recently been experiencing strong growth so that this picture might change in the near future. Figure 2 shows how the composition of payments has changed between 2011 and 2012. (As a comparison, 89.9 percent of payments by natural persons through banks were for utilities and to public authorities).[152]

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[148] See http://bit.ly/SFSkBR.

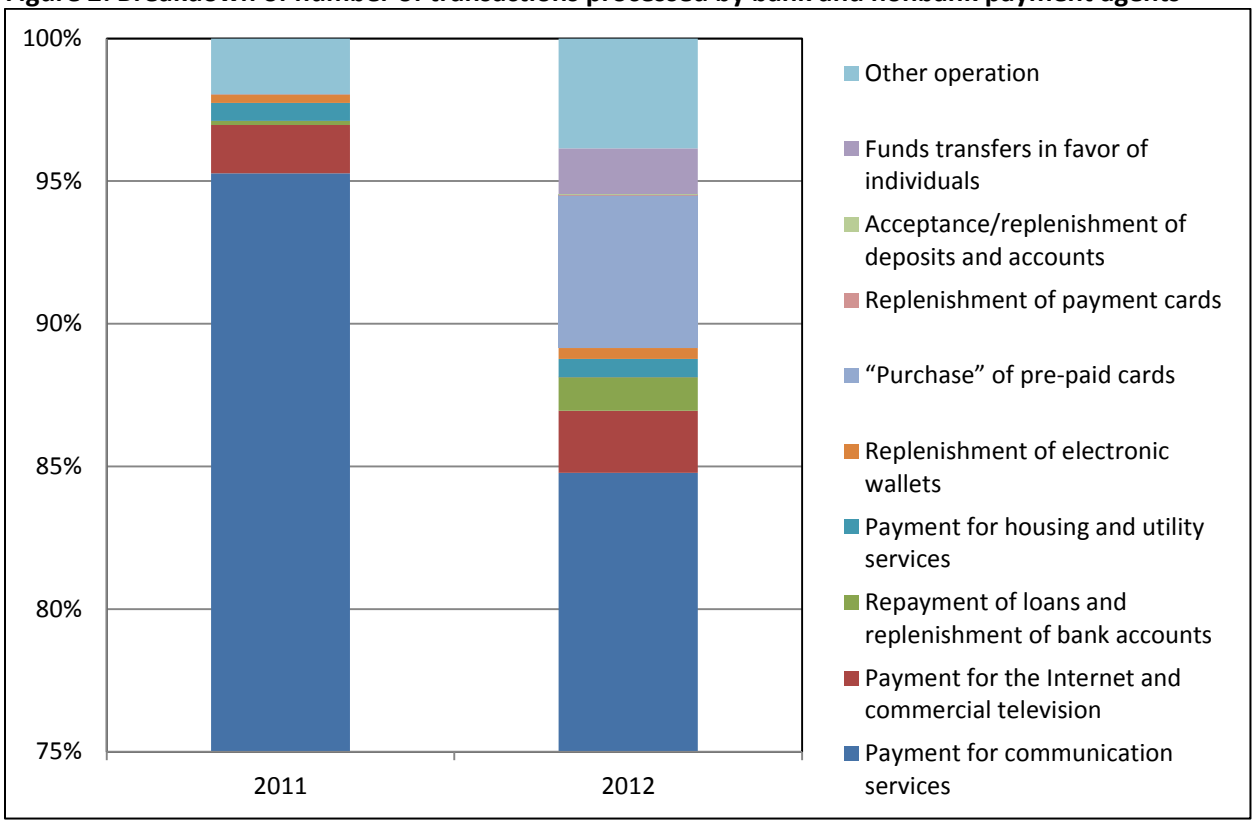
[149] Interview with Boris Kim, QIWI, 16 April 2012.

[150] Unless otherwise noted, the source of data for this section is Center for Research of Payment Systems and Settlements and RMC (2012).

[151] These are the respective sample sizes of research conducted by the Center for Research of Payment Systems and Settlements and RMC (2011 and 2012). The survey covered all major players and it is estimated that these numbers represent at least 90 percent of the total market. There is no other data available on the total number of agents and customer service points in Russia.

[152] See CBR (2012), p. 12.

Figure 2: Breakdown of number of transactions processed by bank and nonbank payment agents



Source: Center for Research of Payment Systems and Settlements and RMC (2012).

While the average payment amount has slightly increased mostly due to the higher share of payments with larger average amounts such as loan repayments (from RUB 145 or USD 4.69 to RUB 176 or USD 5.69), it is still clear that this channel is mostly used for small retail payments. The regional distribution of agents across the territory of the Russian Federation aligns well with the distribution of the population. Assuming that other payment services with a higher financial inclusion potential (such as deposits into bank accounts and person-to-person transfers) will continue to grow fast, the importance of payment agents in areas where bank branches are not profitable will also increase.

Regulation and Supervision

While Russia has been implementing incremental changes on payment regulations and applicable KYC rules for at least the past 6 years,[153] the Payment System Law will lead to some fundamental changes in the regulation of the retail payments sector. The law was implemented in phases, with a final date of September 29, 2012 for all operators to comply. As not all implementing regulations under the law have been issued yet, only the broad contours of the future legal framework are currently visible. By the end of December 2012, approximately 50 regulations are expected to have come out, specifying, among other things, the details on registration, prudential regulation, and supervision of various types of operators.

[153] For a brief summary on this, see CGAP (2010).

The Payment System Law distinguishes between the three types of operators introduced above: money transfer operators, electronic money operators, and mobile network operators. Banks and NBCOs can be part of any payment system. This means, for example, that a client using one of the money remittance operators to transfer funds can use the branches and offices of many different banks as long as they are connected to the specific payment system. The law also includes details on the use of bank payment agents (and their subagents) for rendering funds transfer services on behalf of banks and NBCOs (replacing earlier rules), but it simply refers to the existing rules for the use of nonbank payment agents (which are also considered as part of the national payment system).

The following table summarizes the main provisions of the law. More details on rules applying to money transfer operators and e-money operators can be found in Annex 1.

Table 6: Main Regulatory Provisions for Payment Service Providers

Type of financial service provider	Legal form	Operational rules
Money transfer operator	Bank or NBCO under Banking Law	• Initiate and receive payments in cash or from/to bank account • Settlement within 3 business days • Use of bank and nonbank payment agents permitted
Electronic money operator	Bank or NBCO under Banking Law	• Can open virtual accounts[154] • Customers increase balance of virtual account in cash, via bank transfer, or card payment • Withdrawals via personal bank account or (if customer is identified) via agents • Transfer from one bank account to another not permitted • Settlement immediately or at end of business day • Use of bank payment agents permitted • Max. balance in virtual account of RUB 100,000 (USD 3,230) (identified customers) or 15,000 (USD 485) (unidentified customers). Additional monthly transfer limit of RUB 40,000 (USD 1,300) for unidentified customers • If operating as NBCO, minimum capital requirement of RUB 18 million (USD 582,000), capital adequacy ratio of 2 percent and a liquidity ratio of 100 percent (ratio of cash and assets maturing within 30 days over liabilities)
Mobile network operator	Communications service provider under Communications Law	• Working in partnership with e-money operator • Payments are initiated from mobile phone, funds taken from prepaid balance held with MNO, channeled through a virtual account held with the e-money operator, and immediately transferred to ultimate beneficiary • Settlement between MNO and e-money operator by end of next business day • No fund safeguarding and fund isolation rules for protection of customers' funds

Source: Analysis by the authors.

[154] According to the Payment System Law, electronic money operators can hold customers' electronic money balances. The accounts where these balances are held can be referred to as 'virtual accounts'.

Money transfer operators: The law defines money transfer operators as organizations that have the right to transfer funds. All credit organizations (banks and NBCOs) are money transfer operators by definition and only credit organizations are authorized to operate as money transfer operators. In effect, this limits the role that institutions not licensed by CBR can play in the payment system to the provision of payment infrastructure, the definition of payment system rules and similar back end functions or to the operation as agents on behalf of banks and NBCOs.

Many of the existing payment service providers are already licensed as credit organizations (banks or NBCOs) or have an entity as part of their corporate group that holds such a license, so that it will be relatively easy for them to comply with the licensing requirement under the Payment System Law.[155] If they only define the payment system rules and operate the payment platform, but do not conduct the money transfers themselves, they are classified as payment system operators under the Payment System Law and do not need a license by the CBR.

Electronic money operators: E-money operators, as defined in the law, offer "electronic money transfers without opening a bank account." They fall under the definition of money transfer operator (and must therefore be a bank or NBCO), but are subject to some special rules. In particular, unlike money transfer operators they must settle with the payee either immediately or by the end of the business day, and they are not permitted to conduct money transfers from one bank account to another). If an e-money operator is a NBCO, it has to comply with the respective prudential regulations such as a minimum capital requirement of RUB 18 million (about USD 600,000) and a capital adequacy ratio of 2 percent. The law does not use the term e-money account (perhaps to avoid confusion with term "account" as used with respect to banks) nor is e-money issuance referred to. However, customers in practice can both transfer and hold e-money balances. These balances are referred to in this report as "virtual accounts" (to distinguish them from bank accounts as defined in Russian law).

E-money is explicitly not considered to be a deposit. However, the law does not set any restrictions on how long clients can keep e-money balances in their virtual account. To assure sufficient liquidity, e-money operators that are NBCOs rather than banks are required to keep the e-money float in cash or short-term instruments (convertible into cash within 30 days). There are no requirements for the e-money float to be isolated from any other funds owned by the e-money operator and to safeguard it against third party claims.[156] (However, as e-money operators organized as NBCOs are single purpose entities, there is no risk of losses or third party claims from unrelated business activities.)[157]

To date, some of the e-money operators already hold a license as a bank (e.g., QIWI bank) or NBCO (e.g., Yandex.Money), while others have an NBCO in their corporate group (e.g., WebMoney).

[155] For example, Unistream holds a bank license; the CONTACT money transfer system is offered by Russlavbank; Leader holds a license as NBCO; and Golden Crown has an NBCO in its corporate group.

[156] On fund safeguarding and fund isolation rules for e-money issuers, see Tarazi and Breloff (2010).

[157] There is no legal requirement for e-money operators to be single purpose entities, but this is what previously unregulated operators transforming into NBCOs typically are.

As the previously existing rules applying to prepaid cards have not been repealed with the introduction of the new Payment System Law, e-money and prepaid cards are now being regulated under two different legal regimes. While e-money has been brought under the law, prepaid cards continue to be regulated under a separate regulation.[158] They can be issued by banks and NBCOs and are not linked to a bank account. The maximum amount that can be held on a prepaid card is RUB 100,000 (USD 3,230) and monthly deposits onto the card cannot exceed RUB 40,000 (USD 1,300). There is some controversy regarding the question whether prepaid card balances should follow the same rules as electronic money balances. One option currently under debate is for prepaid card rules also to be brought under the Payment System Law.

Mobile network operators: MNOs can choose to become e-money operators themselves, which implies that they would have to get a license as a bank or NBCO and that they have to set up a subsidiary for their e-money business as credit organizations' business must be kept separate from the provision of mobile services. As an alternative, an MNO can work in partnership with an e-money operator as specified in a separate article of the Payment System Law (Art. 13). In this model, a client can instruct the MNO to transfer money out of her prepaid balance held with the MNO to an e-money operator, from where it can be used immediately to make a payment or transfer according to the e-money rules. In practice, the e-money balance is always zero as the prepaid balance held by the MNO is only transferred to the e-money operator once a client initiates a payment from the mobile phone, but then immediately transferred to the payee. The settlement between the e-money operator and the MNO has to occur not later than the next business day. As the prepaid balance of a mobile subscriber is considered an advance payment for a service provided by the MNO, customers cannot use it directly to buy goods and services other than those offered by the MNO (airtime, ring tones, etc.). Yet once they have transferred it to the e-money operator, it can be used in the same way as any other e-money balance (except that in practice it is not stored in a virtual account, but used immediately to effect a payment or transfer).

The advantage of this approach for MNOs is that they do not have to comply with the stricter regulations applying to e-money operators. Most importantly, they do not have to get a license as a NBCO and they are not subject to the 100 percent liquidity requirement applicable to NBCOs. They are also not currently subject to KYC rules under the AML/CFT Law.

From a legal point of view, MNOs do not issue e-money. However, from a customer perspective the prepaid balance held with the MNO is functionally identical to electronic money held in a virtual account with an electronic money operator with an important exception: the money paid by customers to MNOs for prepaid value, however, is not subject to prudential regulation requiring safeguarding or isolation of customers' funds. In practice, MNOs hold the money in a commingled corporate account with a bank, where it is exposed to the MNOs' general creditors and customers have no priority in the event of an MNO's insolvency.

[158] CBR Regulation 266-P of December 24, 2004 (as amended through 15 November 2011) "On the Issuance of Bank Cards and on Transactions Carried Out with Payment Cards".

Payment agents: Money transfer operators and e-money operators are credit organizations and can therefore make use of bank payment agents. The same rules apply described above in the section on Banks and NBCOs. In addition, nonbank payment agents can enter into a contract with a payee to accept payments on its behalf (regulated under the Payment Agents Law). Such nonbank payment agents are restricted to a narrow range of payment services that are not listed as bank operations in the Banking Law.[159] In particular, they can collect funds from natural persons for the purpose of paying suppliers of goods and services and for paying taxes.[160] They are not permitted to conduct money transfers from one bank account to another or to provide cash-out services. As payments and transfers made from prepaid balances held with an MNO that has not created a subsidiary for its e-money operations must be made through a partner e-money operator, the same rules apply regarding the use of bank and nonbank payment agents. An important relaxation for low-value transactions is that all payments below RUB 15,000 (USD 485) that do not involve the opening of a bank account do not require the identification of the customer, as they are exempted from the KYC requirements under the AML/CFT Law. The 42,000 post offices in Russia are also legally permitted to become bank or nonbank payment agents.

[159] This provision ensures that there is no overlap between the scope of payments provided by bank payment agents and nonbank payment agents.

[160] While the acceptance of tax payments by nonbank payment agents is not prohibited in the Payment System or Payment Agents Law, the Ministry of Finance has issued a letter (Number 03-02-07/1-257 dated 31 May 2010) explaining that nonbank payment agents are not permitted to accept payments for state duty (as one form of tax).

Box 4: Payment Service Providers – Key Challenges and Opportunities

This sector has been at the forefront of innovation making tremendous progress in offering clients products that are more convenient, more accessible, and cheaper, even in more remote and sparsely populated areas. Though it is still very much focused on a few payment transactions (predominantly payments for communication services) with only limited value for financial inclusion, recently other payment transactions such as person-to-person transfers, payments for utilities, loan repayments, and replenishing deposit and virtual accounts have experienced strong growth. At the same type, new partnerships between e-money operators, banks, and mobile network operators carry the potential of combining the advantages of different models.

The wide network of outlets (terminals and cashier-based services) operated by bank and nonbank payment agents make financial services much more accessible in areas without sufficient branch infrastructure. At the same time, it remains to be seen whether these channels will not only be attractive for the mostly young, well-educated, and technology-savvy current users, but also for those that currently lack access to finance most – the elderly, less educated, and more remote customers.

The permission for bank payment agents to provide cash-out services has the potential to make this channel much more attractive as a basic substitute for bricks-and-mortar branches. However, cashing out from virtual accounts and mobile wallets is still mostly done through existing bank accounts or by transferring the money to cards.

Russian money remittance operators have been among the most efficient operators globally. This brings important benefits to their users in the form of low commissions and efficient and easily accessible services. However, they have not been equally successful in linking the remittance flows to other financial services such as loans and savings accounts, and thus have made only a limited contribution to broader goals of financial inclusion. The Russian Post plays a dominant role in the domestic remittance market making use of its vast network of post offices. Even though post offices are legally permitted to act as bank or nonbank payment agents, the potential of this network for providing financial services in harder to reach areas has not been fully tapped yet.

There is need for further research about the impact of technological innovations by all different types of payment service providers on financial inclusion. While the numbers of transactions and volumes are impressive, the attractiveness of new products and channels for the elderly, poorer, less educated, and more remote customers is still an open question. There is also little information available about the geographic spread of alternative delivery channels – not even the overall number of terminals and agents is exactly known.

The new Payment System Law will bring all money transfer operators and e-money operators under direct CBR supervision and require MNOs offering payment services to partner with e-money operators. It will be important to see what it means for existing operators to either become or partner with NBCOs (or banks). For MNOs, the most attractive model will be to operate through NBCOs/banks, which does not bring them under direct Central Bank regulation.

4. Infrastructure and Other Initiatives with Relevance for Financial Inclusion

Progress in creating an inclusive financial sector does not only depend on demand-side issues (see Sec. 2), and the supply by and regulation of various financial service providers (Sec. 3), but also on the financial infrastructure, and support initiatives targeted at promoting access to finance. This is a diverse,

yet important field. This section discusses two elements of the financial sector infrastructure – the Universal Electronic Card (UEC) and credit reference services – and two initiatives – the Russian Financial Inclusion Strategy and the Russian collaboration with the Alliance for Financial Inclusion (AFI) – with a potentially significant impact on financial inclusion. The UEC is an electronic ID that can possibly play an important role in identifying customers for account opening and transaction purposes, but also in connecting them electronically to bank accounts. Credit reference services can facilitate healthy access and minimize risk of over-indebtedness if they are broad enough to include data on lower-income client segments and cover all types of lenders serving this market. Russia may be the only country in the region that has a comprehensive financial inclusion strategy which covers most of the financial sector players – but long-term results of the strategy are yet to be seen as it was adopted only recently. Russia's collaboration with AFI contributed to financial inclusion measurement activities, as well as market research and regulatory initiatives of the Russian Government in the area of agent banking. They suggest possibility for follow-up research and activities to encourage innovation to better understand and close the Russian financial access gap.

4.1 Universal Electronic Card

The introduction of the Universal Electronic Card (UEC) is part of the Russian Government's administrative reform initiative launched in 2003, implemented by the Ministry for Economic Development. The ambitious initiative aims, among other things, at facilitating access to (and efficiency of) state and municipal services of all types as well as commercial services. The UEC is intended to be used for certifying the identity of citizens as well as verifying a citizen's rights of access to state and municipal services. It will replace a multiplicity of documents that are currently used for these purposes (e.g., pension certificates, driving licenses, national medical insurance cards, car insurance certificates, etc.).[161] Services currently under consideration for UEC access include: medical, tax, migration, state registration, transport, traffic police, banking, utilities, education, and many others (it is estimated that the UEC will contain some 260 separate service-linked applications). While the participation in the program is voluntary, the card will be automatically issued to all citizens above the age of 14 unless a citizen has opted out by submitting a request to government authorities.[162]

The UEC is currently being piloted among a few select staff of the Moscow Government. The countrywide roll-out of the UEC will only start in January 2013 (by individual request) and January 2014 (to anyone who has not opted out). Three banks (state-owned Sberbank, Uralsib and Ak Bars Bank) set up the open joint stock company OJSC "UEC", which was appointed as the authority in charge of issuing and servicing UECs.[163]

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[161] In 3-5 years, the Russian Government is planning to launch a new generation of internal passports (the national identity document) that builds on the UEC technology and would replace the UEC (http://bit.ly/Uulfdr).

[162] According to newspaper report, in Moscow the UEC will even be issued to children at birth (http://bit.ly/OcgGgh).

[163] According to reports, two more institutions (the technology company Sitronics and the investment bank Troyka Dialog) have since joined. See http://bit.ly/N1ovZa (in Russian).

Two applications on the card are of particular interest from a financial inclusion perspective: the electronic identification of the holder of the card[164] and an electronic banking application linking the card to a bank account and allowing for it to be used for various payment transactions. Citizens can choose from a list of pre-qualified banks (the exact list of banks will depend on the region). It is not yet clear whether the activation of the account function will be automatic or whether citizens can decide not to link the card to a bank account (though they can of course decide not to receive a UEC).[165] For account opening and servicing purposes, the OJSC "UEC" plans to engage a huge agent network with at least one outlet in each of the more than 23,000 municipalities in the Russian federation.[166] Many of these agents might be existing payment agents and bank payment agents. Depending on how many citizens decide to opt out of the UEC and how many of those with a UEC activate the bank account function, this can potentially lead to a massive increase of bank account penetration in the Russian federation.

Box 5: UEC – Key Challenges and Opportunities

The fact that UECs will be offered to all Russian citizens unless they opt out makes it likely that the uptake will be high and thus a majority of Russian citizens will be issued with a UEC in the near future.[167]

From a financial inclusion perspective, the potential lies in simplifying customer identification and in providing previously unserved people with convenient access to a bank account. As regards the first, the UEC will establish a simple means of identifying customers as part of KYC requirements. As regards the latter, the overall impact on financial inclusion will not only depend on the share of people who will activate the bank account function of their card, but also on their actual usage of the bank accounts thereafter.

Reaching all Russian citizens with bank accounts linked to the UEC will require an upgrade of the current banking infrastructure. Bank payment agents will play an important role in this. An issue to explore is whether they could play a stronger role in account opening then just collecting documents.[168]

A challenge of which the Government is aware and already engaged in addressing is to ensure the data security and privacy of such a ubiquitous system.

[164] No biometrics are used for identification, but the card and a unique passcode are considered by the authorities to be sufficient as an access key to the databases of all the relevant government agencies. (For security reasons, there will be no single, consolidated, database of all UEC data.) Basic information will be stored on the card itself (name, date of birth, photo, signature, pension fund number, medical insurance policy number, and bank account number). See http://mfc44.ru/uek/security.

[165] The rules for producing, operating, and connecting the banking application have not yet made public. However, as cardholders would have to enter into an agreement with a bank (Art 23, item 17 UEC Law), it might be legally impossible to force them to do so.

[166] Because of the above-mentioned restrictions on account openings via agents, the agents might only collect the documents and forward them to the bank (see for a discussion on this http://marker.ru/news/4669).

[167] There is, however, some opposition to the UEC from Orthodox Christians. See http://marker.ru/news/517429.

[168] One option would be to authorize them to open accounts subject to transaction limits and that full identification would only be required once a client wants to transact higher amounts.

4.2 Credit Reference Services/Credit Reporting

As lending expands to the massive financial market of lower-income consumers, the need for reliable, accurate information on existing and potential low-income borrowers is also growing. In Russia this is especially relevant as the growth in consumer lending in the recent years has resulted in the significant increase in arrears level which almost doubled from 2008 to reach RUB 291 billion (USD 9.4 billion) in 2011.[169] Credit reporting systems are essential in ensuring sound coverage of lower-income segments with credit services and preventing reckless lending which may lead to borrower over-indebtedness. This said, there are challenges to effective credit reporting systems covering lower-income customers, some of the most important being (i) establishment of credit reporting systems that cover all types of lenders in a given market; (ii) regulatory or cost barriers that limit participation; (iii) comparatively high costs of obtaining and processing high-quality data on lower-income borrowers; (iv) establishing the identity of lower-income borrowers; and (v) protection of data privacy and accuracy at a reasonable cost given high transaction volume and low loan sizes.[170]

Credit reporting in Russia is regulated by the Law on Credit Histories adopted in 2004 and in force since 2005. The law provides for a two-tier credit reporting system:

- Private credit bureaus that hold borrower credit information.
- The Central Catalogue of Credit Histories (the Catalogue) at the Central Bank that keeps information on the credit bureau(s) where credit histories of borrowers are held.

As of January 2012 there were 31 credit bureaus all over the country, including 10 in Moscow and 3 in St. Petersburg. Reporting to at least one credit bureau is mandatory for banks and NBCOs (provided there is explicit borrower consent); for other institutions – both financial (e.g., MFIs) and non-financial (e.g. telecom companies) – it is optional.

A credit history consists of 3 parts: (*i)* the "title" containing identification information of a borrower, (*ii)* the "core " containing additional borrower information such as loan terms (including amounts, duration, repayment dates, classification of arrears, etc.); and (*iii)* the "additional (closed) part" containing information about the source of credit history (creditor) and users of the credit history. Credit bureaus must submit the title of the credit history to the Catalogue within two working days after its creation and keep each credit history for 15 years. Thus, the Catalogue contains only borrower ID information and information on the credit bureau(s) where credit histories are held, but no information on borrower performance.

Among the credit bureaus, there are four leaders[171] that cover up to 95 percent[172] of the market, claiming to maintain over 60 million individual credit histories. According to *Doing Business 2012,* the

[169] See Prusakov (2012).

[170] See CGAP and IFC (2011).

[171] These are Equifax Credit Services, the National Bureau of Credit Histories, Russian Standard, and the United Credit Bureau "Experian Interfax".

private credit bureau coverage in Russia is somewhat lower – 35.8 percent of the adult population,[173] or 43.4 million people. At the same time, FFMS, the supervisor of credit bureaus, is much more conservative in the estimates of the current number of credit histories and believes the high figures are due to the data overlap among several credit bureaus and the fact that the latter tend to report the number of loans rather than individuals.[174] As mentioned above, credit organizations must receive explicit borrower consent for checking and submitting their credit histories to credit bureaus. Many borrowers are concerned about their personal data security, which keeps them from giving consent for submitting their credit information to credit bureaus as there have been some reports of data protection breaches.

Thus, there are at least two reasons why the market coverage by credit bureaus is not comprehensive – (i) absence of a mandatory credit reporting requirement for types of providers besides licensed credit organizations[175] (although there are many MFIs and credit cooperatives that do report, and leading credit bureaus develop special offers for them), and (ii) the borrower consent requirements of the current legislation.

The Law on Credit Histories and its supporting regulations provide for a 2-stage process for checking credit information, both for borrowers and for creditors – first a free of charge request is submitted to the Catalogue which provides information about the credit bureau(s) where a borrower history is kept; then creditors and borrowers can send requests to respective credit bureau(s). Each borrower has a right to receive information about his credit history from each credit bureau where it is kept free of charge once a year, and an unlimited number of times for a fee. Although the Catalogue has an online facility for information requests, it is available to borrowers only in case they know their code as a credit history subject (which is assigned by a creditor); in other cases, borrowers should apply through their creditor, credit bureau, a post office or a notary. While this system should work well for borrowers who gave their consent for reporting their credit information (provided that they know their codes as credit history subjects), a person who did not give such consent cannot easily check whether he has a credit history or not – for example, when a credit history was created by mistake or as a result of personal data theft.

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[172] Russian Business Gazette, http://www.rg.ru/2010/10/12/buro.html.

[173] See Doing Business (2012). The private credit bureau coverage indicator reports the number of individuals and firms listed by a private credit bureau with information on their borrowing history from the past 5 years. The number is expressed as a percentage of the adult population (the population age 15 and above in 2010 according to the World Bank's World Development Indicators).

[174] Interview with Nadezhda Serikova, FFMS, November 2011.

[175] There are currently discussions in place to introduce a requirement to report for MFIs and credit cooperatives.

Box 6: Credit Reporting – Key Challenges and Opportunities

Consolidation of the credit bureau market would be beneficial, as currently 87 percent of all credit bureaus have information on no more than 5 percent of the market. This fact works against the kind of comprehensiveness needed for credit bureaus to serve as an effective tool (especially in averting over-indebtedness among lower-income segments of the population).

A level playing field for all types of loan and credit providers – in terms of reporting to and getting information from credit bureaus, loan conditions disclosure and other data-related consumer protection requirements – will be useful in preventing regulatory arbitrage and similar problematic market conduct detrimental to the interests of lower-income clients.

In the absence of mandatory reporting requirements for NFOs and personal data confidentiality requirements, the credit bureau coverage in Russia is far from comprehensive. While mandatory reporting can be addressed relatively easily, addressing the challenge of personal data confidentiality presents significant difficulties. Though there have been discussions in the banking community[176] with respect to the need to waive the requirement to obtain explicit borrower consent for checking and reporting his or her information, this would go against the national law as well as such international data protection standards as the European Commission Directive on Use of Personal Data; in addition, it seems that credit bureaus are not presently immune from potential data protection breaches.

The process of checking personal credit histories is rather burdensome for consumers as it requires information other than personal ID data. While justifiable for checking the content of a credit history, this seems excessive for checking for the existence of a credit history.

4.3 Russian Financial Inclusion Strategy

NFOs are recognized in Russia as important in advancing financial inclusion. In 2006, ARB and the Russian Microfinance Center (RMC) initiated the creation of an association to advance the interests of the NFO sector - the National Partnership of Microfinance Market Stakeholders (NAMMS).[177] NAMMS developed a medium-term strategy: "Increasing Access to Retail Financial Services and Microfinance Development in the Russian Federation" for 2008-2012 and 2012-2016. The strategy focuses primarily on MFIs, CCs, and innovative branchless solutions for financial service and is an update of the first such strategy document developed for 2008 – 2011.

One of the NAMMS co-founders, RMC, deserves a special mention. Established in 2002, RMC has developed into a strong institution possessing a comprehensive knowledge of and expertise in the microfinance sector in the country. It has been able to present interests of broad and various stakeholder groups present in the NFO market and beyond it in the wider Russian financial system. This

[176] See http://bit.ly/Uw0nlW.

[177] NAMMS was founded in 2006 by ARB, RMC, Association of SME Support Agencies "Development", and the National Union of Non-Profit Organizations for Mutual Financial Assistance. It currently has 10 members – in addition to the 4 founders, the other members include: the Union of Agricultural Credit Cooperatives, a non-profit partnership "Microfinance and Development", the Association of MFIs "People's Treasury", the Mutual Insurance Society "People's Cash", the E-Money Association, and the OPORA Association. See http://www.rmcenter.ru/naumir.

position of the RMC has led government authorities (as well as some international organizations such as the World Bank) to use RMC data and advice with respect to financial inclusion-related policy decisions and projects.

The mentioned NAMMS strategy (which also relied on RMC data and expertise in the sector) has been extensively used the market; it was also considered by the Government as it worked to form its own strategy and develop activities vis-à-vis financial inclusion – specifically, concerning the NFO sector and branchless banking activities. These include regulatory initiatives covering MFIs and CCs as well as banking and payment agents, and a Ministry of Economic Development (MED) report to the Government on ways to increase access to financial services.[178] The MED report developed in 2010 on the basis of key strategy documents of the Central Bank, the Ministry of Finance, ARB, NAMMS, the E-Money Association and other important stakeholders, identified the following three priorities as key in advancing access to financial services: (i) the implementation of the G-20 Principles for Innovative Financial Inclusion; (ii) improving financial inclusion data and developing financial inclusion indicators; and (iii) the development of a methodology for assessing target financial inclusion indicators.

The existence of a comprehensive financial inclusion strategy makes Russia stand out in the region as very few countries in Eastern Europe an Central Asia have such strategies.[179]

Box 7: Russian Financial Inclusion Strategy – Key Challenges and Opportunities

The Russian strategy may benefit from the harmonization of various stakeholder views on the future of the financial market and the development of a shared agenda for the whole financial sector. For example, there are different views with respect to the banking sector consolidation, the regulation and supervision of NFOs and agents, as well as the regulation and supervision of the CC and agricultural CC sectors – to name just a few. The solution of these issues will largely depend on further development of inter-agency coordination in the Russian Government with respect to financial inclusion issues.

4.4 Alliance for Financial Inclusion Collaboration

Represented by MED, since 2009 Russia has been a member of the Alliance for Financial Inclusion (AFI) – a global network of financial regulatory institutions. Supported by AFI and in coordination with the Central Bank, MOF, RMC, the E-Money Association and the two associations of banks (ARB and the Russian Regional Banks Association), MED has been involved in the implementation of a project "Promotion of Innovative Regulation and Supervision over Banking Agents to Improve Access to

[178] The Ministry of Economic Development Report on p. 76 of the Plan of the Realization of the Main Anti-Crisis Activities and the Policy for the Modernization of the Russian Economy of the Government of the Russian Federation for 2010 "The Realization of Measures of Increasing Accessibility of Financial Services, Including Credit, for the Population and Entrepreneurs".

[179] The authors are aware of the existence of microfinance development strategies in Kyrgyzstan and Uzbekistan which however do not cover the whole financial sectors of these countries.

Finance" during 2010-2012. The project pursued three main objectives: the development of a system of national financial inclusion indicators; research of the development of the bank and nonbank payment agents market over the course of two years; and the development of supporting regulations to the Payment Agents Law and Payment System Law. Completed in April 2012, the project provided an important contribution to the current financial inclusion measurement activities, as well as market research and regulatory initiatives of the Russian Government in the area of agent banking.[180]

Box 8: Alliance for Financial Inclusion Collaboration – Key Challenges and Opportunities

The financial inclusion measurement activities undertaken as well as market research and regulatory initiatives of the Russian Government in the area of agent banking may provide a good foundation for follow-up research and activities to encourage innovation and get a deeper understanding of what is necessary to close the Russian financial access gap.

5. Summary of Key Challenges and Opportunities

5.1 Demand and Usage

To date, there has been no specific research on the demand for financial services in Russia – and there is no comprehensive picture of the demand, as a result. Rather, research has focused on the current use of financial services and thus could not fully capture the gaps in supply.

Despite impressive progress in outreach and a fivefold increase in the per capita supply of retail banking services since 2008, significant regional disparities remain, with remote and sparsely populated areas (which are generally among the poorest) having just a small percentage of the retail banking services supply level enjoyed by residents of Moscow.

Though some innovations in financial service delivery (in particular, payment terminals) are becoming increasingly popular and ubiquitous, helping meet the demand for one of the most used services – bill payment, they are not well aligned to close financial access gaps for the financially underserved categories (older, lower-income, living outside of large cities, less educated).

As the increased availability of financial services (see Sec. 2.1) does not automatically increase uptake, further study of the financially underserved categories could provide insights into the reasons for their continued financial exclusion.

To build trust in financial services, there is an ongoing need for a centralized, specialized financial consumer protection and dispute resolution agency covering all types of financial service providers that has sufficient independence, authority and capacity to handle and resolve complaints.

[180] E.g. the following reports were prepared within the MED project with AFI: Center for Research of Payment Systems and Settlements and RMC (2011 and 2012).

5.2 Banks and NBCOs

Despite a period of consolidation in the banking industry triggered by higher capital requirements, banks have overall been successful in expanding their physical footprint. The higher number of access points is mostly due to the opening of more "light" branches and the introduction of bank payment agents, yet it is still mostly branch-based and thus relatively expensive to maintain. The recent permission for bank payment agents to conduct cash-out transactions might help to change this.

There is a risk that more regional banks will be forced to close down or merge with larger banks, which might have a negative impact on accessing banking services in less populated areas.

Banks face difficulties and have no strong incentives to move down-market and to offer innovative financial services for customers at the base of the economic pyramid. At the same time, increasingly high capital requirements for banks constitute a high barrier for MFIs that might consider transforming into banks. Inflexible regulations on issues such as non-face-to-face account opening and high costs of compliance can lead to an unfavorable cost-benefit ratio for providing microfinance services under the legal structure of a bank.

Disaggregated data, both in terms of geographic distribution (urban versus rural) and in terms of client profile (e.g., by age and gender) is needed to understand why banks and NBCOs are not realizing their financial inclusion potential. For example, the MSME sector has been experiencing strong growth, but it is not clear how much of this reaches microfinance clients rather than providing relatively larger loans to SMEs.

Without clear initiatives to adapt to the needs of the most excluded segments – particularly the elderly and poorer Russians - it is difficult to say whether innovative delivery channels hold a financial inclusion promise for broader customer groups – beyond those already reached by financial services.

5.3 MFIs, CCs, and Other NFOs

While bringing most types of financial cooperatives under the common legal, regulatory and supervisory framework was a significant step in terms of the harmonization of the Russian financial service market for lower-income customers, there still remains a huge market of agricultural CCs that are regulated separately and are subject to the oversight of the Ministry of Agriculture rather than any financial market-related authority.

As some larger CCs may be of systemic importance – at least in terms of the share of the population they serve in their regions – the involvement of the Central Bank as the supervisory authority with the greatest experience and capacity related to preserving systemic stability may be justified.

Individual member savings and shares placed with CCs in the economic sense are very similar to deposits with Central Bank-licensed credit organizations, yet they are not protected by either the deposit insurance scheme or its equivalent.

The Law on Microfinance Activity and Microfinance Organizations has set the stage for the harmonization and increased transparency of the microfinance sector and set basic rules for its regulation and supervision. But the absence of significant entry barriers and a very general definition of 'microfinance institution' has resulted in a situation where virtually any company can obtain registered MFI status, (even if lending or microlending is not its core activity), and has spawned the rapid

proliferation of extremely heterogeneous registered 'MFIs'. This in turn creates various risks – particularly reputational risk for the industry due to irresponsible activities of some market players, and increased burden for FFMS supervising market conduct of registered MFIs. One approach to mitigating the problem would be the introduction of additional classes of registered NFOs, allowing for differentiation between development-oriented MFIs on the one hand and various types of consumer and payday lenders on the other.

There is still risk of unregulated financial intermediation since on-lending of loans from the public is not restricted for those NFOs that do not have registered MFI status (and borrow and lend instead under the Civil Code). It is also currently impossible to assess the size of the unregistered NFO market – and there are industry experts[181] who believe it may be even larger that the market of registered MFIs. Policy makers in Russia therefore face a challenging task of offering the right incentives for microlending institutions to obtain registered MFI status (and remain registered) and while providing an adequate level of market conduct supervision for registered MFIs, as well as appropriate levels of and types of prudential supervision in the case of those that borrow from natural persons. The effectiveness of the delegated supervision model is yet to be evaluated – both FFMS and SROs currently have no prior experience and very limited capacity and resources to ensure compliance with the prudential norms set forth in the law and reporting requirements for CCs. Experience shows that the chosen model of the delegated supervision has worked in some countries where the government financial supervisor closely monitored the quality of the delegated supervisor's work, although it is not clear that this model reduces total supervision costs.[182]

Neither MFIs nor CCs are integrated well with the financial sector – there are very few options for refinancing. While this is less of an issue for CCs that have strict limitations for external borrowing established by the law, limited access to finance for MFIs significantly restrains their growth.

CCs and MFIs, though many of them located close to their lower-income customers, are yet to make use of the new delivery channels – such as payment terminals and agents. This may be an important opportunity for them to further expand outreach to the under-served segments.

5.4 Payment Service Providers

This sector has been at the forefront of innovation making tremendous progress in offering clients products that are more convenient, more accessible, and cheaper, even in more remote and sparsely populated areas. Though it is still very much focused on a few payment transactions (predominantly payments for communication services) with only limited value for financial inclusion, recently other payment transactions such as person-to-person transfers, payments for utilities, loan repayments, and replenishing deposit and virtual accounts have experienced strong growth. At the same time, new partnerships between e-money operators, banks, and mobile network operators carry the potential of combining the advantages of different models.

The wide network of outlets (terminals and cashier-based services) operated by bank and nonbank payment agents make financial services much more accessible in areas without sufficient branch infrastructure. At the same time, it remains to be seen whether these channels will not only be attractive for the mostly young, well-educated, and technology-savvy current users, but also for those that currently lack access to finance most – the elderly, less educated, and more remote customers.

[181] Interviews with Mikhail Mamuta, NAMMS, June – September 2012.

[182] See CGAP (2012).

The permission for bank payment agents to provide cash-out services has the potential to make this channel much more attractive as a basic substitute for bricks-and-mortar branches. However, cashing out from virtual accounts and mobile wallets is still mostly done through existing bank accounts or by transferring the money to cards.

Russian money remittance operators have been among the most efficient operators globally. This brings important benefits to their users in the form of low commissions and efficient and easily accessible services. However, they have not been equally successful in linking the remittance flows to other financial services such as loans and savings accounts, and thus have made only a limited contribution to broader goals of financial inclusion. The Russian Post plays a dominant role in the domestic remittance market making use of its vast network of post offices. The potential of this network for providing financial services in harder to reach areas has not yet been fully tapped.

There is need for further research about the impact of technological innovations by all different types of payment service providers on financial inclusion. While the numbers of transactions and volumes are impressive, the attractiveness of new products and channels for the elderly, poorer, less educated, and more remote customers is still an open question. There is also little information available about the geographic spread of alternative delivery channels – not even the overall number of terminals and agents is exactly known.

The new Payment System Law will bring all money transfer operators and e-money operators under direct CBR supervision and require MNOs offering payment services to partner with e-money operators. It will be important to see what it means for existing operators to either become or partner with NBCOs (or banks). For MNOs, the most attractive model will be to operate through NBCOs/banks, which does not bring them under direct Central Bank regulation.

5.5 Universal Electronic Card

The fact that UECs will be offered to all Russian citizens unless they opt out makes it likely that the uptake will be high and thus a majority of Russian citizens will be issued with a UEC in the near future.[183]

From a financial inclusion perspective, the potential lies in simplifying customer identification and in providing previously unserved people with access to a bank account. As regards the first, the UEC will establish a simple means of identifying customers as part of KYC requirements. As regards the latter, the overall impact on financial inclusion will not only depend on the share of people who will activate the bank account function of their card, but also on the actual usage thereafter.

Reaching all Russian citizens with bank accounts linked to the UEC will require an upgrade of the current banking infrastructure. Bank payment agents will play an important role in this. An issue to explore is whether they could play a stronger role in account opening then just collecting documents.[184]

A challenge the Government is aware about and already working on is to ensure data security of such a ubiquitous system.

[183] There is, however, some opposition to the UEC from Orthodox Christians. See http://marker.ru/news/517429.

[184] One option would be to authorize them to open accounts subject to transaction limits and that full identification would only be required once a client wants to transact higher amounts.

5.6 Credit Reporting

Consolidation of the credit bureau market would be beneficial, as currently 87 percent of all credit bureaus have information on no more than 5 percent of the market. This fact works against the kind of comprehensiveness needed for credit bureaus to serve as an effective tool (especially in averting over-indebtedness among lower-income segments of the population).

A level playing field for all types of loan and credit providers – in terms of reporting to and getting information from credit bureaus, loan conditions disclosure and other data-related consumer protection requirements – will be useful in preventing regulatory arbitrage and similar problematic market conduct detrimental to the interests of lower-income clients.

In the absence of mandatory reporting requirements for NFOs and personal data confidentiality requirements, the credit bureau coverage in Russia is far from comprehensive. While mandatory reporting can be addressed relatively easily, addressing the challenge of personal data confidentiality presents significant difficulties. Though there have been discussions in the banking community[185] with respect to the need to waive the requirement to obtain explicit borrower consent for checking and reporting his or her information, this would go against the national law as well as such international data protection standards as the European Commission Directive on Use of Personal Data; in addition, it seems that credit bureaus are not presently immune from potential data protection breaches. The process of checking personal credit histories is rather burdensome for consumers as it requires information other than personal ID data. While justifiable for checking the content of a credit history, this seems excessive for checking for the existence of a credit history.

5.7 Russian Financial Inclusion Strategy

The Russian strategy may benefit from the harmonization of various stakeholder views on the future of the financial market and the development of a shared agenda for the whole financial sector. For example, there are different views with respect to the banking sector consolidation, the regulation and supervision of NFOs and agents, as well as the regulation and supervision of the CC and agricultural CC sectors – to name just a few. The solution of these issues will largely depend on further development of inter-agency coordination in the Russian Government with respect to financial inclusion issues.

5.8 Alliance for Financial Inclusion Collaboration

The financial inclusion measurement activities undertaken as well as market research and regulatory initiatives of the Russian Government in the area of agent banking may provide a good foundation for follow-up research and activities to encourage innovation and get a deeper understanding of what is necessary to close the Russian financial access gap.

[185] See http://bit.ly/Uw0nlW.

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National Agency for Financial Studies
National Bureau of Credit Histories
National Partnership of Microfinance Market Stakeholders
QIWI Bank

Russian Microfinance Center
SRO “Cooperative Finances”
State Duma
The World Bank
WebMoney
Yandex.Money

Annex 1: Regulatory Provisions Applying to Money Transfer Operators and Electronic Money Operators

The Payment System Law does not only regulate money transfer operators, electronic money operators, and mobile network operators (referred to as communications service providers under the law), but it also defines *payment system operators*, who define the payment system's rules and provide the payments platform.[186] In many cases, one organization plays more than one role under the law. For example, Golden Crown is the name of a particular payment system, but at the same time it provides money transfer services.[187] MNOs are not regulated under the Payment System Law, but under the Communications Law. If they offer e-money business, they have to comply with operational rules described in the main body of this report. This Annex describes in more detail the regulations applying to money transfer operators and e-money operators.

Money transfer operators: The law defines money transfer operators as organizations that have the right to transfer funds. The following rules apply to their operations:

- A money transfer operator must be a credit organization (a bank or NBCO) that is authorized to effect funds transfers.[188]
- A payment can either be effected by providing cash to the money transfer operator (or its agent) or by debiting the payer's bank account. The payee can receive the money in cash or in a bank account. The transfer must be completed within 3 business days (meaning that money transfer operators cannot maintain virtual accounts as electronic money operators can).
- Money transfer operators can make use of bank payment agents and subagents for cash-in and cash-out transactions. Only bank payment agents (and not subagents) are authorized to identify clients, if such identification is required under AML legislation (i.e. for cash-in transactions in excess of RUB 15,000 (USD 485), and for all cash-out transactions and suspicious transactions).[189] Bank payments agents and subagents have to use a "special bank account" (which is a dedicated account only used for this purpose) for crediting and debiting money transfers.

The law distinguishes between payment system supervision and oversight.[190] Money transfer operators are subject to CBR supervision, while payment system operators (which can operate without license

[186] In addition, it also specifies rules for payment infrastructure service providers, operations centers, payment clearing centers, settlement centers, and payment system participants, which however will not be discussed here.

[187] According to the law, a payment system operator, money transfer operator, and payment infrastructure service provider can all be one and the same organization.

[188] In addition to credit organizations also the CBR and Vnesheconombank (a development bank regulated under a special law) can be money transfer operators.

[189] Art. 7, item 1.1 of AML/CFT Law.

[190] Art 14 of Payment System Law.

from CRB) only to CBR oversight. Supervision entails CBR monitoring of operator compliance with the Payment System Law, while oversight consists of CBR efforts to improve the services operators render. Supervision includes on-site inspections not more than once every two years and allows CBR to impose corrective measures. Oversight is less intrusive and includes gathering and analyzing information to provide recommendations for improving operations.

Electronic money operators: The law defines e-money operators as offering "electronic money transfers without opening a bank account" and a special type of money transfer operator.

E-money operations are subject to a number of rules:

- They must be registered as a credit organization - either a bank or a nonbank credit organization (NBCO) - under the Banking Act and must be authorized to transfer funds through virtual accounts. If they are NBCOs, they are subject to more limited prudential regulations, most importantly a minimum capital requirement of RUB 18 million (USD 582,000), a capital adequacy ratio of 2 percent and a liquidity ratio of 100 percent (cash and assets maturing within 30 days over liabilities).[191] E-money operators must notify CBR not later than 10 days after they have launched e-money services.

- With reference to the AML/CFT Law, an individual client[192] need not be identified by the e-money operator. Unidentified clients can only hold a maximum balance of RUB 15,000 (USD 485) and transfer a maximum of RUB 40,000 (USD 1,300) per month. Identified clients can hold a maximum balance of RUB 100,000 (USD 3,230) (there is no limit on transfers).

- Clients can build electronic money balances by replenishing their virtual account either from a bank account (bank transfer) or without the involvement of a bank account (transfer from mobile wallet or by paying cash at agents or automated payment acceptance terminals). They can use their balance for e-money transfers to a payee (who could be the client of the same or another e-money operator) or for transferring it to a bank account. Only clients that have been identified according to the KYC rules in the AML/CFT law can withdraw e-money in cash.

- Other operational rules are that e-money operators are not permitted to pay interest (or any other remuneration) on e-money balances, and that clearing has to be immediate or (in the offline mode) at the end of the business day.

- As electronic money operators are either banks or NBCOs, they are subject to the same supervision rules as these.

The following table summarizes the main rules applying to e-money operators.

[191] CBR Instruction 137-I from 15 September 2011.

[192] The rules are different for legal entities or "individual entrepreneurs".

Table 7: Rules Applying to Electronic Money Operators

	Natural person (unidentified)	Natural person (identified)	Legal person
Who can open virtual account operator	No restrictions	No restrictions	Only entities registered with Russian Tax Authorities
No. of virtual accounts per person	No limits	No limits	No limits
Top-up	Bank payment from **any personal account**; money transfer; card payment; cash (including via agents)	Bank payment from **own account** money transfer; card payment; cash (including through agents)	Bank payment from **own account**
Receiving e-money from	Only natural persons	Anybody	Only natural persons
Paying e-money to	Anybody	Anybody	Only **identified** natural persons
Withdrawals	To any **personal** bank account	To any **personal** bank account; by money transfer; by cash (including through agents)	To **own bank account**
Virtual account balance limit	RUB 15,000 (USD 485)	RUB 100,000 (USD 3,230)	RUB 100,000 (USD 3,230) at the end of the day
Virtual account turnover limit	RUB 40,000 (USD 1,300) per month	No limits	No limits

Source: Adapted from Zavalishina (2011).