INCLUSION, STABILITY, INTEGRITY, AND PROTECTION:

OBSERVATIONS AND LESSONS FOR THE I-SIP METHODOLOGY FROM PAKISTAN

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ADB	Asian Development Bank
AML/CFT	Anti-money laundering and countering the financing of terrorism
BB	Branchless banking
CNIC	Computerized National Identity Card
DFID	Department for International Development
eCIB	Electronic Credit Information Bureau
FATF	Financial Action Task Force
GBP	British Pound
GPFI	Global Partnership for Financial Inclusion
I-SIP	Inclusion, stability, integrity, protection
MCGF	Microfinance Credit Guarantee Facility
MFB	Microfinance bank
MF-CIB	Microfinance Credit Information Bureau
MFI	Microfinance institution (unregulated credit-only MFIs)
MFP	Microfinance provider (MFBs and MFIs)
MNO	Mobile network operator
MoIT	Ministry of Information Technology
NADRA	National Database & Registration Authority
NGO	Nongovernment organization
OTC	Over-the-counter
PMN	Pakistan Microfinance Network
PKR	Pakistani Rupee (local currency unit)
PTA	Pakistan Telecommunication Authority
SBP	State Bank of Pakistan
SECP	Securities and Exchange Commission of Pakistan
SIP	Stability, integrity, protection
STR	Suspicious transaction report
UBL	United Bank Ltd
USSD	Unstructured supplementary service data (mobile phone protocol)

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The core research team was led by Stefan Staschen (CGAP) and included Lara Gidvani and Ahmed Dermish (both from BFA) and Qazi Shoaib, Yousaf Malik, Noor Ahmed, and other SBP colleagues. A range of key SBP colleagues and industry actors contributed to the study through interviews. A complete list of persons interviewed appears in Annex 1.

The lead author of this report is Stefan Staschen, drawing on internal reports on each of the cases written by him, Lara Gidvani, and Ahmed Dermish. Kabir Kumar provided comments on drafts of the report, and Timothy Lyman provided input throughout, particularly on the final draft of the report.

The original concept for the study was developed by Martin Alsop, Timothy Lyman, and David Porteous In its capacity as Co-Chair of the Subgroup of the G20 Global Partnership for Financial Inclusion (GPFI) focused on engagement with the standard-setting bodies, DFID funded CGAP, as a GPFI Implementing Partner, to conduct an initial rapid research exercise in South Africa in 2012 to inform the work of the Subgroup. This study draws and builds on "Financial Inclusion and the Linkages to Stability, Integrity and Protection: Insights from the South African Experience" (CGAP 2012).

No endorsement of this report was sought from any party, nor should any be inferred from participation in the consultative process by which it was developed. CGAP is solely responsible for its content.

1. Introduction

Financial sector policy makers and international standard-setting bodies have traditionally pursued the objectives of financial stability, financial integrity, and consumer protection. Financial inclusion—a more recent addition to the list of core objectives—has received increasing global recognition by G20 leaders[1] and has found its way into country-level policy making. Relevant policy-making bodies in more than 40 countries around the world have committed to measurable targets for improving financial inclusion under the Maya Declaration.[2] In collaboration with such policy makers, CGAP has been developing a methodology that aims to understand how policy making changes with the addition of financial inclusion as the fourth core objective—and more specifically how the four policy objectives ("I" for financial *inclusion*, "S" for financial *stability*, "I" for financial *integrity*, and "P" for consumer *protection*, or "I-SIP" collectively) are linked and how the linkages can be optimized (minimizing tradeoffs and other negative outcomes and maximizing synergies). The emerging methodology is referred to in this report as the I-SIP Methodology.

An initial proposal for the I-SIP Methodology was developed in 2012, with South Africa being the first country studied.[3] The South Africa research team looked at five policy interventions that approached promoting financial inclusion in different ways. Four of the cases were *ex post* (i.e., previously implemented policy interventions) and one *ex ante* (i.e., policy interventions planned for the future). Each case sought to identify the following:

- The main policy decisions or regulatory changes
- Key stakeholders in the policy intervention
- The main linkage(s) between I-SIP objectives that were identified by the policy makers at the time of policy change and how these linkages were managed (if at all)
- With respect to the *ex post* analyses, the observed effects with regard to the I-SIP objectives and the linkages that materialized

The South Africa investigation was conducted using a rapid research exercise: collecting evidence by analyzing available data, reviewing secondary sources, and interviewing policy makers and other informed parties. The focus was on pair-wise linkages between financial inclusion and each of the other three objectives (stability, integrity, and protection). For each pair-wise linkage, nine different combinations of observed effects are possible as depicted in Figure 1. Only the green "linkage zones" represent effective policies with a positive effect on at least one of two objectives examined (in the example stability and inclusion) and either a positive effect or at least no negative effect on the other.

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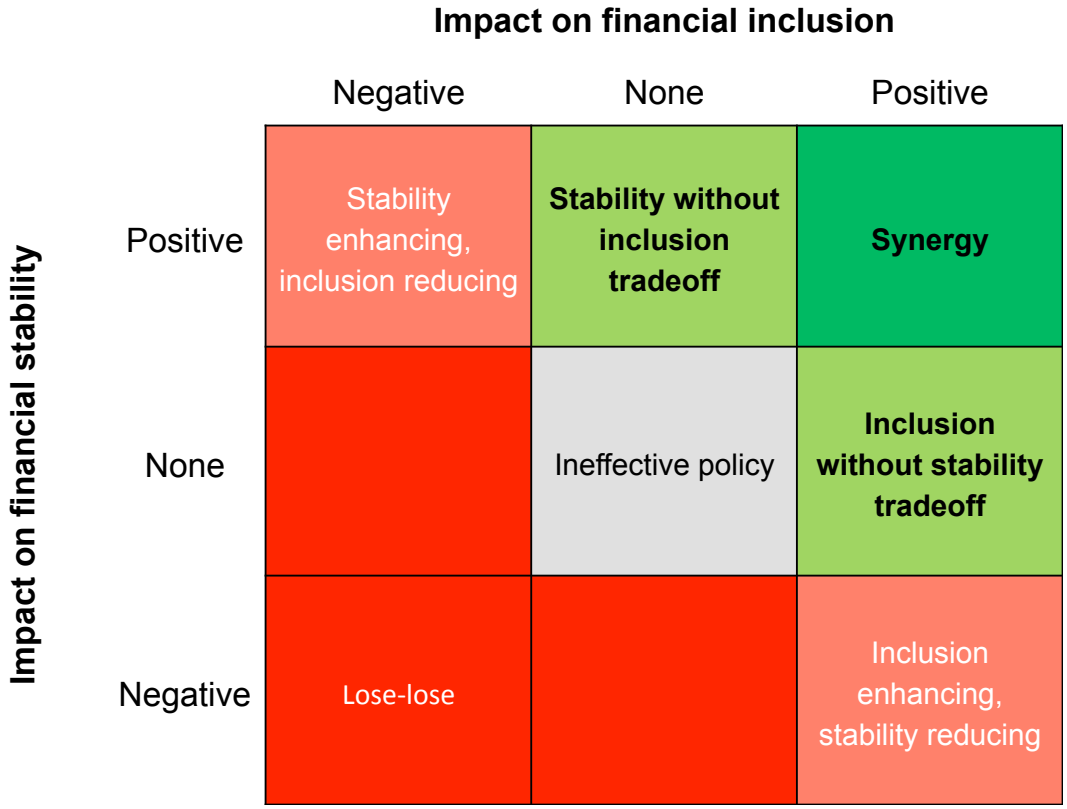
[1] Exemplified by the G20 Principles for Innovative Financial Inclusion and the establishment of the Global Partnership for Financial Inclusion (GPFI).

[2] See http://www.afi-global.org/maya-declaration.

[3] See CGAP (2012), henceforth this is referred to in text as the "South Africa report" or the "South Africa study."

Figure 1. Possible pair-wise linkage zones



Source: CGAP South Africa report.

The South Africa study yielded examples of observed effects in the green zones (i.e., a positive effect on inclusion and a positive or neutral effect on one of the other I-SIP objectives), in the gray zone (i.e., a neutral effect on both inclusion and the other I-SIP objective), and in the red zones (a negative effect on inclusion and a negative or neutral effect on the other I-SIP objective). In short, the study demonstrated that both synergies and tradeoffs among the I-SIP objectives are possible. The South Africa report concluded with an initial proposal for a methodology policy makers can use to identify and optimize the I-SIP linkages, with the goal of maximizing the synergies and minimizing the tradeoffs and other negative outcomes.

Pakistan was chosen as the second country for an I-SIP rapid research exercise because of its unique history in championing innovative financial inclusion initiatives for more than a decade and a central bank, the State Bank of Pakistan (SBP), that has been leading these initiatives with crucial support all the way up to the governor/deputy governor level (see Section 3.1). The main objectives of the research were to (*i*) develop and refine the I-SIP Methodology; (*ii*) raise awareness of the I-SIP linkages among relevant Pakistani regulators, supervisors, and policy makers, positioning them to better optimize the four policy objectives in their work; and (*iii*) help Pakistani policy makers, especially SBP, adopt the I-SIP Methodology in their future policy-making efforts.[4]

[4] Like the South Africa study, the Pakistan I-SIP rapid research exercise also sought to contribute insights that would be credible and useful to the standard-setting bodies in considering financial inclusion in their work.

The same general rapid research approach was used in Pakistan as had been employed in South Africa: a research team visited Pakistan twice, in March and July 2013, and conducted a detailed analysis of the following four policy interventions, three *ex post* cases and one *ex ante* case:

1. The regulatory framework for microfinance banks (which includes the Microfinance Institutions Ordinance and Prudential Regulations issued under the law)
2. The Microfinance Credit Guarantee Facility
3. The Branchless Banking Regulations
4. The Microfinance Credit Information Bureau (the *ex ante* case)

For each case, the research team drafted internal standalone reports that broadly covered the same topics as those covered in the South Africa research.[5] This report synthesizes the observations and lessons from all four cases.

It is organized as follows:

- **Section 2** provides background on the development of the I-SIP Methodology and its application in Pakistan.
- **Section 3** discusses the history and importance of financial inclusion in Pakistani policy making over the past decade and summarizes the four policy interventions examined.
- **Section 4** presents the main observations from applying an I-SIP "lens" to the four policy interventions, with a focus on those that are of potential broader relevance to similar policy interventions in other countries.
- **Section 5** revisits the I-SIP Methodology, drawing lessons from these observations. It elaborates on the concept of identifying, managing, and optimizing linkages; discusses the importance of developing indicators and targets; and presents a refined version of the I-SIP Methodology—now embodied in seven I-SIP Propositions.

[5] The reports include the following sections: (*i*) The case: What happened and why is it of interest for an I-SIP rapid research exercise? (*ii*) The policy change: Which linkages were of concern and how were they managed? (*iii*) The outcome: What were the observed effects on I-SIP objectives? and (*iv*) The lessons: What have we learned about managing linkages and optimizing results?

2. Background

The addition of financial inclusion as the fourth core objective pursued by financial sector policy makers has increased the complexity of policy making. In an ideal world, each policy intervention with an intended impact on one or more of the I-SIP objectives would be subject to a full-fledged regulatory impact assessment that measures changes in the attainment of each of the four objectives. But this is difficult to implement in practice. The I-SIP Methodology relies instead on a **rapid research approach** that guides policy makers in identifying, managing, and ultimately optimizing linkages among the four I-SIP objectives triggered by a given policy intervention. Such an approach requires vastly fewer resources as compared with a full-fledged regulatory impact assessment, yet can still increase the effectiveness of policies as measured by the achievement of I-SIP objectives. This section provides background on the I-SIP rapid research approach and I-SIP Methodology, focusing on main elements and challenges as they appear following the second rapid research exercise.

Selection of cases for analysis. The Pakistan research, as the second I-SIP rapid research exercise, built on the previous experience from South Africa, but added new elements that go beyond the earlier study. One such element was a more **systematic selection of policy interventions** to be used in the analysis. As a first step, the research team and its partners at SBP identified the policy interventions ("cases") for the analysis applying the following selection criteria:

- A policy or regulation with an expected positive effect on one of the I-SIP objectives and a potential tradeoff with one or more of the other I-SIP objectives
- An expected (positive or negative) effect on inclusion, even if this was not the primary objective of introducing the policy
- Availability of relevant data to support the analysis
- For the *ex post* cases, passage of sufficient time from the initial adoption of the intervention to ensure there are observable effects to consider

Overall, five *ex post* and five *ex ante* cases were assessed in detail and discussed internally (by the research team and SBP) and with the project steering committee. The final selection includes the above-mentioned three *ex post* and one *ex ante* case (described in detail in Section 3.2).[6]

Primary objective(s) and direct effect(s) of policy interventions. In each of the cases described below, the policy makers identified one or more **primary objectives** they wanted to pursue (or want to pursue, in the *ex ante* case) by implementing a policy change. Financial inclusion need not necessarily be among the primary objectives. The question of the primary objectives is different from the question of the **direct effect** (or direct effects) of the policy intervention. A direct effect is understood as a change relating to one of the I-SIP objectives that is directly caused by the policy intervention rather than brought about through a linkage among I-SIP objectives. An example would be a change in a stability-linked prudential rule (such as the lowering of minimum capital requirements) that has a direct effect on stability, yet the primary objective of the change is to advance financial inclusion (on the assumption that there is a linkage between lower barriers to entry and financial inclusion).[7] Stability-linked prudential rules might be changed in such a way that overall institutional and systemic stability is not

[6] As in South Africa, the research team reviewed relevant policy documents to identify the definitions of the four objectives—inclusion, stability, integrity, and protection—in the Pakistan context.

[7] In fact, most of the financial inclusion interventions (i.e., interventions with a primary objective of advancing financial inclusion) take advantage of linkages between inclusion and the SIP objectives rather than directly addressing inclusion rules (which would be, for example, mandates to provide specific products or services).

adversely affected (e.g., accompanying a lowering of minimum capital requirements for certain types of institutions with restrictions on the range of services that they may offer), yet there still is a positive linkage with inclusion. The assumption is that a direct and material effect on one of the objectives leads to linkages with the other objectives.

Linkage hypotheses. Linkages hypotheses are another element of the I-SIP rapid research approach that was enhanced in conducting the Pakistan study. To prepare for the field visits, the team developed hypotheses for each case regarding potential linkages among the four I-SIP objectives triggered by the direct effect(s) of the policy intervention in question. These hypotheses do not focus on the particular case examined in a specific country; they discuss a policy intervention on a more generic level (e.g., "the introduction of a special microfinance law" or "the issuance of agent regulations for banks"). The purpose of these hypothetical linkages is to understand the universe of linkages that might be triggered by a specific policy intervention and to allow for more strategic questioning during the interviews about which of these linkages was considered at the time the policy intervention was designed or revised. A useful by-product of developing linkage hypotheses for each case is that it creates a growing library of potential linkages among the four I-SIP objectives that can be considered in the analysis of similar policy interventions in other countries.[8]

The following are some of the important characteristics of the linkage hypotheses:

- Linkages between objectives can be positive (synergies) or negative (tradeoffs)
- The overall net effect on any one objective can be indeterminate as each single objective can be subject to positive and negative effects at the same time
- The analysis focuses on any changes in policy, and the benchmark is the comparison with what applied before the change[9]
- Strictly speaking, all policy interventions will affect all four I-SIP objectives even if to a different degree, as all I-SIP objectives are linked (though for practical reasons, it might still be useful to focus on those linkages that are material)[10]

See Annex 2 for an example of linkage hypotheses developed for the introduction of a special microfinance law.

Observations and lessons from I-SIP rapid research exercises. During the two field visits, the research team interviewed a wide range of stakeholders with relevance to the four cases, among them policy makers, regulators, and industry representatives (see Annex 1). The focus of these interviews was on (*i*) understanding the motivation for the policy intervention and which linkages among I-SIP objectives had been identified at the time of designing or revising the policy; (*ii*) recapitulating the discussion among various stakeholders and how concerns about linkages influenced the design of the policy; and (*iii*) assessing the observed effects of the policy (including any relevant data the respondent could share).

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[8] For this reason, there is value in keeping the linkage hypotheses relatively generic (e.g., considering potential linkages of introducing a special microfinance law in country X rather than the linkages of the specific law introduced in Pakistan).

[9] This is important as it makes a big difference whether, for example, a new microfinance law forces all microfinance institutions (MFIs) to apply for a license or is optional in the sense that MFIs can apply for a license if they want to go into deposit-taking, but they can also remain unregulated.

[10] The reason for this is that a policy intervention changes the market equilibrium with a defined value for each of the I-SIP objectives. It is, for example, impossible to have a policy intervention having an impact only on inclusion, and not affecting the SIP objectives via the linkages among the objectives.

The insights from these interviews together with a review of relevant data and documents built the basis for the case study reports, which in turn are the basis for this report. An important distinction in the analysis is between **observations** (see Section 4) and **lessons** (see Section 5). While the observations are descriptive in nature and reflect what the research team observed about Pakistani policy making with respect to the I-SIP objectives, the lessons extrapolate from the Pakistani experience and draw broader conclusions for the I-SIP Methodology more generally.

Identification, management, and optimization of I-SIP linkages. In Pakistan, the research team sought to differentiate systematically among **identification, management, and optimization** of linkages. Identifying potential linkages among the I-SIP objectives triggered by a given policy intervention or revision is a necessary first step. The next step is managing these linkages, which requires policy makers to consider not only direct effects of the policy intervention, but also the linkages among them. In doing so, they should follow a proportional approach, where the benefits of the policy intervention are balanced with their costs. Policy makers often do this intuitively (e.g., when changing stability-linked prudential rules with a view to advance financial inclusion), but not necessarily in a systematic way. The latter is what we call optimization of linkages. It requires a clear understanding of their materiality (as the number of hypothetical linkages is typically too large to be able to consider all of them) and a more holistic view than just looking separately at each pair-wise linkage. Instead, linkage optimization calls for the simultaneous consideration of multiple dimensions. Whereas the matrix of possible pair-wise linkages in Figure 1 shows a two-dimensional picture, there are four I-SIP objectives. Moreover, both the South Africa and Pakistan cases remind us that a given policy intervention is likely to have at least *some* effect on all four objectives—as well as effects on other policy objectives beyond the I-SIP objectives, including higher level objectives such as inclusive growth. Coping with this complexity calls for intentional and informed actions and policy decision making guided by a clear understanding about the optimum effect policy makers want to achieve.

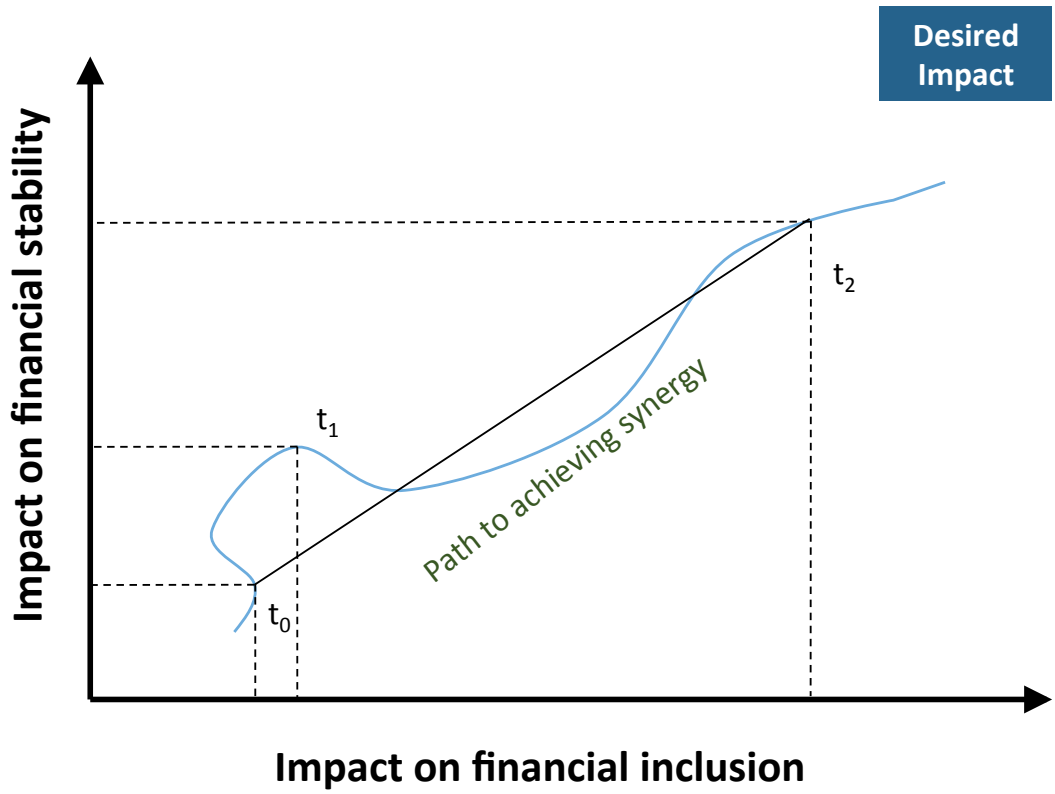
From a theoretical point of view, when trying to optimize multiple objectives simultaneously, more than one optimum exists (if the optimum is defined as a situation where it is not possible to improve on the attainment of any one objective without a negative impact on one of the others—also referred to as a Pareto optimum).[11] The optimization strategy then ultimately depends on the preference structure of policy makers with regard to the four I-SIP objectives. Policy makers have to make a value judgment about which of the Pareto optimums to pursue.

In practice, how the preferred optimum looks and how best to achieve it are impossible to predict from policy intervention to policy intervention, let alone from country to country. Moreover, the picture changes as market conditions are changing (among many factors). There are also wider economic and social policy objectives such as “inclusive growth” or “formalization” or “Black Economic Empowerment” (as in the case of South Africa) or objectives in other policy areas, such as immigration, which still have relevance for financial sector policy. Linkage optimization is, therefore, certain to be an incremental process, with an unknown and elusive end goal. The guiding principle is to avoid unnecessary tradeoffs and other negative outcomes and benefit from synergies among I-SIP objectives—and to strive for the political conditions necessary to achieve this. While the South Africa report concluded that “there is good reason to believe that, at the level of outcomes, I-SIP objectives may be mutually reinforcing and interdependent,” tradeoffs do exist and there might be a point beyond which more financial inclusion can be achieved only at the risk of a negative impact on any of the other objectives.

[11] In the two-dimensional case illustrated in Figure 1, these are all the dark and light green cells.

Figure 2 depicts a typical optimization strategy using the example of the same two objectives from the two-dimensional case shown in Figure 1. While there might be periods of tradeoffs (decrease in the value of one objective and increase in the other after t_0 and t_1), in the longer term both objectives are in synergy (a positive slope of the line between t_1 and t_2).[12] Tradeoffs can be tolerated for a limited period, if they are not unnecessary tradeoffs and if they are part of an explicit optimization strategy.

Figure 2: Optimization path



Inflection points. One challenge in analyzing the Pakistan cases has been the high frequency of revisions of the three *ex post* policy interventions since they were first introduced. This is not negative, but instead reflects exemplary attention to the performance of the interventions in practice (see I-SIP Proposition 6). At the same time, it added real-world complexity to the analysis and made it more difficult to attribute any observations to a specific change in policy. To accommodate this, the concept of "inflection points" was introduced. An inflection point is defined as a major turning point with material effect on at least one I-SIP linkage. Inflection points could be the implementation of a new policy, but also a change in an existing policy (or in the way the policy is implemented) triggered, for example, by an intervention not achieving an intended outcome or by it leading to unintended outcomes.[13]

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[12] This is in deviation to the Pareto criterion, which is typically used as a reference for optimization processes and requires that Pareto improvements do not involve a negative impact on any one of the objectives. The argument here is that temporary tradeoffs can be tolerated if in the policy makers' view the negative impact on one objective is more than made good by the positive impact on one or several of the other objectives.

[13] It is important that the policy change in question be material from an I-SIP perspective.

Measuring effects and linkages. Risks and benefits of financial inclusion are perceived and measured differently by different stakeholders and change depending on the level of financial inclusion achieved (CGAP 2011). The same is true—at least regarding the risks—of the other I-SIP objectives. Even if relevant stakeholders could agree on measurement, a significant challenge in conducting I-SIP research lies in finding relevant data. While there is an increasing consensus on how to measure financial inclusion for purposes of cross-country comparison,[14] the emerging measurement tools lack the country and context specificity to be useful in benchmarking a given policy intervention. And in the I-SIP context, the question is not merely whether the intervention is achieving a particular inclusion goal, but also what effects it is having on the other I-SIP objectives (as well as other social and economic policy goals). Even isolating just the question of effects on inclusion (which would defeat the purpose of I-SIP analysis), an increase in the value of inclusion indicators alone is not necessarily a sign of a positive effect of the policy.[15] Furthermore, a positive effect on inclusion might not be considered satisfactory if it remains far behind expectations.[16] Additionally, short-term and long-term effects of a policy can differ, and there might be situations where a short-term tradeoff among I-SIP objectives is acceptable if it leads to more synergistic long-term outcomes.

An even higher order challenge results from the fact that the nature of the linkages varies from one I-SIP objective to another, and even from one financial product to another. There is a potential gain for financial integrity, for example, every time an additional customer stops transacting in cash and moves permanently to the more traceable world of digital financial services; yet that gain is very different from the gain resulting from the same customer getting access to a microloan and has different consequences for stability, for example. It is even theoretically possible that a given policy intervention could have a positive effect on access to and use of one type of financial service, yet a negative effect on another.[17]

I-SIP Propositions. The South Africa study concluded with an initial proposal of a methodology on how to identify and optimize the I-SIP linkages, which was summarized in seven I-SIP guidance statements (see Annex 3). The Pakistan research—and grappling with the challenges to the I-SIP analysis summarized above—precipitated a revisiting of the term "guidance statements" and substituting that term with the term "I-SIP Propositions"—a term that more accurately reflects the current state of knowledge (and mitigates the risk of confusion with guidance published by, for example, global standard-setting bodies). The I-SIP Propositions themselves have also evolved significantly based on observations emerging from the Pakistan research, as explained in Section 5.2.

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[14] The G20 Basic Set of Financial Inclusion Indicators distinguishes 24 indicators measuring access, use, and quality of financial inclusion. See http://datatopics.worldbank.org/g20fidata/.

[15] Any changes in indicators must be compared to a (hypothetical) situation without any changes, which might still have led to positive growth in inclusion indicators.

[16] This is one of the limitations of the diagram in Figure 1, as it cannot express the *degree* to which objectives have been achieved.

[17] For example, a loan guarantee scheme could increase bank lending to deposit-taking MFIs, yet also decrease MFIs' interest in mobilizing savings.

3. Pakistan financial inclusion policy interventions

This section provides a short history of policy making for financial inclusion in Pakistan before introducing the four policy interventions examined as part of the I-SIP research and the main observed effects to date in more detail.

3.1. Financial inclusion in Pakistan and SBP's role

Financial inclusion-related initiatives in Pakistan go back to the 1980s, with activities of the Aga Khan Rural Support Programme, which were subsequently replicated by the National Rural Support Programme. These early microfinance activities were part of broader rural support. However, by 1996, some of the rural support programs began to create specialized microfinance units and, eventually, Kashf Foundation, the first specialized nongovernment organization (NGO) microfinance institution (MFI) was formed (Duflos et al. 2007).

The Government of Pakistan supported financial inclusion-related initiatives by backing the creation of an apex institution for MFIs in 1999 and the country's first regulated microfinance bank, Khushhali Bank, in 2000. It has since been supportive of necessary legal reforms.

Since 2000, SBP has played an instrumental role in financial inclusion initiatives through a specialized microfinance division, one of the first in the world at a central bank, which subsequently became part of the Agricultural Credit & Microfinance Department. In 2001, then SBP Governor Ishrat Husain, a development economist with microfinance experience in Latin America, was instrumental in championing microfinance and providing strategic guidance to the fledgling microfinance division. SBP became one of the first countries worldwide (and the first in South Asia) to introduce a special legal framework for deposit-taking MFIs by promulgating a special law for microfinance banks (MFBs) in 2001. Unregulated MFIs (also referred to as NGO-MFIs) have continued to coexist with regulated MFBs (jointly referred to as microfinance providers [MFPs]).

Husain's successor, Governor Shamshad Akthar, brought relevant experience from previous posts she had held with the Asian Development Bank (ADB), and she, too, became an advocate for a more inclusive financial sector. Under Akthar's guidance, SBP undertook, in 2007, the first review of Pakistan's microfinance sector (SBP 2007b) and released its first microfinance strategy, in which specific suggestions were made on how to reach scale (SBP 2007a). The promotion of branchless banking models, the introduction of (partial) guarantee facilities for MFPs, and the establishment of a credit bureau for microfinance borrowers were all mentioned as potential policy interventions. That same year, SBP joined a handful of pioneering regulators to provide specific legal guidance on branchless banking models when it issued its Branchless Banking Regulations.

Shortly after the release of the 2007 Strategy, the microfinance market suffered a public crisis that would serve to inform SBP's desire to promote policies that created a more robust industry capable of withstanding shocks. The crisis involved the Kashf Foundation, one of the largest NGO-MFIs at the time, which faced a rapidly deteriorating portfolio due in part to high growth rates and a borrower rebellion that was widely acknowledged to be tacitly supported by local politicians encouraging borrowers to withhold payments as a way to curry political capital (Burki 2009). Kashf Foundation's loan portfolio at risk swiftly sank from less than 1 percent before October 2008 to more than 20 percent by February 2009 (SBP 2007a).

In 2008 to 2012, SBP became an implementing agency for a range of market development initiatives under a comprehensive Financial Inclusion Program funded by the UK Department of International Development (DFID). Among these initiatives were the establishment of a Microfinance Credit

Guarantee Facility in 2008 and a regional pilot for a Microfinance Credit Information Bureau in 2009, which has, since 2012, been rolled out on a nationwide level.[18] In 2011, the Microfinance Strategy was revised and updated (SBP 2011).

While the inclusion objective is embodied in SBP's Agricultural Credit & Microfinance Department, other SBP departments have also been closely involved with policy making for financial inclusion. A separate Consumer Protection Department was set up in 2008, which is the lead agency with regard to protection issues; the Banking Inspection Department is particularly concerned about stability issues triggered by new policy interventions; while the Banking Policy & Regulation Department is in charge of policy making in all areas except microfinance (which is under the Agricultural Credit & Microfinance Department). The Financial Monitoring Unit is hosted at SBP, but it is independent and is responsible for supervising integrity issues.

Despite these financial inclusion initiatives, Pakistan has remained behind in terms of overall financial inclusion figures, not only in international comparisons, but also in comparison with its regional peers such as India and Bangladesh. According to the World Bank's Global Findex data, in 2011 only 10 percent of adults (those over age 15) had an account at a formal financial institution;[19] 1 percent had saved at and 2 percent had borrowed from a formal financial institution in the past year.[20] Considering Pakistan's overall population of about 180 million, the supply gap is enormous.

3.2. The four policy interventions

The I-SIP research in Pakistan closely examined four policy interventions, with three of them categorized as *ex post* cases and one as an *ex ante* case (see Table 5 for a summary):

- **MFB** case. The creation of a regulatory framework for MFBs with the adoption of the Microfinance Institutions Ordinance in 2001 and Prudential Regulations in 2003
- **Microfinance Credit Guarantee Facility** (MCGF) case. The adoption of MCGF in December 2008 covering part of the loss of banks lending to NGO-MFIs and MFBs
- **Branchless banking** (BB) case. The introduction of a specific regulatory framework for BB with the issuance of the Branchless Banking Regulations in 2008
- **Microfinance Credit Information Bureau** (MF-CIB) case. The establishment of a specialized credit information bureau for the microfinance sector, first as a pilot with limited geographic coverage in 2009 and then gradually being rolled out nationwide since 2012

In all four cases SBP is the primary regulatory authority involved with implementing the policy change. Two of the *ex post* cases—MFB and BB—involve the introduction of a new law and/or regulations, while the other two—MCGF and MF-CIB—are part of SBP's market development initiatives.

3.2.1. The regulatory framework for microfinance banks

In the late 1990s, providing financial services to the poor was still mostly socially driven and highly subsidized with credit-only microfinance NGOs being the main players (Duflos et al. 2007). In 2000 the Ministry of Finance and ADB formulated a comprehensive Microfinance Sector Development Program, which championed the cause of commercial microfinance, with the Government of Pakistan adopting a "microfinance policy that mainstreams the concept of sustainable microfinance, recognizes the need to

[18] See http://www.sbp.org.pk/MFD/FIP/inclusion.htm.

[19] For comparison, in Bangladesh the same figure is 40 percent and in India it is 35 percent.

[20] See http://datatopics.worldbank.org/financialinclusion.

enhance social capital, and considers risk mitigation as a necessary safety net measure for the poor."[21] Under this program, an initial microfinance bank, later named Khushhali Bank, was launched as a proof of concept for a "sustainable community-based service delivery system."[22] Khushhali Bank was regulated under its own law, the Micro-Finance Bank Ordinance (2000), and was initially owned by 16 public, private, and international banks.

The Microfinance Sector Development Program also recognized the need for additional deposit-taking MFBs to exist alongside Khushhali Bank. The 2000 law for Khushhali Bank formed the basis for the legal, regulatory, and supervisory framework for MFBs, with the relevant law—the Microfinance Institutions Ordinance[23]—being promulgated in 2001 (**Inflection Point 1**).[24] The Microfinance Institutions Ordinance enables previously unregulated credit-only MFIs to integrate into the broader financial sector and also allows them—once licensed as MFBs—to take deposits from the public. As the regulation and supervision of microfinance was new to SBP, it set up a specialized microfinance division and a consultative group with the industry.

At the time, there were few legal frameworks for microfinance globally to use as a reference (and none in the region). SBP, therefore, had little guidance on the likely market response to the creation of a new category of deposit-taking MFIs, including its effect on the I-SIP objectives. The new law's primary objective was financial **inclusion** by expanding the range of services to be offered by microfinance providers—which could be existing MFIs transforming into MFBs or greenfield institutions—to also include savings and deposit products and at the same time providing MFBs with a sustainable funding base that would allow them to grow their lending business. To emphasize financial inclusion of low-income clients and to deter MFBs that were not focused on providing financial services to the poorer segments of the population from taking advantage of the lower capital requirement than for banks (referred to as regulatory arbitrage), SBP introduced loan size limits and required MFBs to serve a prescribed client segment with a maximum annual income.

SBP appeared to be very much aware of a potential tradeoff between inclusion and **stability** as the introduction of a new category of deposit-taking financial institutions subject to modified regulatory provisions—with some of them being less onerous than those for commercial banks—can lead to stability risks, such as bank runs and contagion. To mitigate any such risks, SBP identified minimum capital requirements as the main lever for ensuring soundness of institutions. At the same time, it allowed for smaller players to start operations with a narrower regional focus by introducing tiered minimum capital requirements depending on the geographic scale of operations. Further, all NGO-MFIs that continue providing credit-only services remained outside the regulatory purview.

In terms of consumer **protection**, SBP also appeared to be aware that the prudential regulation of providers that take deposits from the public is as much a consumer protection mechanism—to protect small depositors—as it is critical for stability. MFBs have also been required to create a Depositor's

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[21] Minister of Finance Shaukat Aziz, in "Development Policy Letter," 4 November 2000, published as Annex 1 to ADB (2000).

[22] Ibid.

[23] The name of the law is somewhat confusing as it regulates MFBs, but is called Microfinance Institutions Ordinance.

[24] Khushhali Bank has since come under the Microfinance Institutions Ordinance (with its own law, the Microfinance Bank Ordinance, having been repealed); in 2012 it was acquired by a consortium led by United Bank Ltd.

Protection Fund, which can be viewed as both stability and protection measures. SBP appears to have managed the tradeoff between inclusion and protection by adding new disclosure standards over time and requiring MFBs to follow appropriate pricing policies.[25] Further, SBP is considering requiring MFBs to set up customer complaint redress mechanisms in the prudential regulations under the law.

Finally, the legal framework for MFBs recognized a potential tradeoff between inclusion and **integrity** by providing for some flexibility with regard to identification of customers. Customer identity can be ascertained by the Computerized National Identity Card (CNIC) or by "other appropriate means."[26]

The Microfinance Institutions Ordinance was amended in 2006 and 2007 and the Prudential Regulations under the law have been revised almost every year since they were first issued in 2003, with each of these revisions reflecting how SBP has managed linkages and adjusted rules accordingly. Yet the policy change with the most significant effect on I-SIP linkages has been the permission granted to Tameer MFB in 2009 to get direct access to the clearinghouse (**Inflection Point 2**). This policy change did not require a change in regulation, but required only that Tameer MFB be recognized by SBP as a "scheduled bank," as only scheduled banks have direct access to the automatic clearinghouse. SBP is now working on "Guidelines for Clearing House Membership for MFBs," which would allow other MFBs to follow the precedent set by Tameer MFB.

Direct access to the clearinghouse (rather than clearing checks through another commercial bank) has expected benefits in terms of cost and speed of clearing checks. It helps Tameer MFB to raise deposits from higher-value customers that request checking facilities and thus could have a positive effect on **inclusion** by creating another funding source for the loan business and on **stability** by making it possible for Tameer MFB to access a sustainable source of funding. The potential tradeoff SBP has been most concerned about is an increase in settlement risk that may create **stability** risks for the entire banking sector if a payments system participant is not able to meet its settlement obligations at the specified time. SBP clearly identified this linkage between inclusion and stability and, therefore, permitted direct access only to the top-performing MFB, which is led by experienced commercial bankers with substantial experience in treasury operations and backed by a strong board of directors and funders with deep pockets.

Observed effects

The relatively strict prudential regulations for MFBs, in particular high capitalization requirements and portfolio quality rules, have kept any **stability** risks in check. However, it is hard to say whether they have led to a tradeoff with inclusion with fewer providers entering the field than hoped. It is noteworthy that, in the first seven years after the promulgation of the Microfinance Institutions Ordinance, only one MFI transformed into an MFB, with two more transformations since in 2008 and 2009. These institutions' safety and soundness should have improved through the application of higher regulatory standards. While there were a few early greenfield foundations, only one has reached any noteworthy scale.[27] In 2007, it appeared to many observers that the overall expansion of this still young industry had

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[25] These provisions are now part of the Prudential Regulations issued under the Microfinance Institutions Ordinance.

[26] See Section 17 of the Prudential Regulations for Microfinance Banks. While, to date, the coverage of CNIC is close to 100 percent of the adult population, this was not the case at the time the Microfinance Institutions Ordinance was adopted.

[27] Khushhali Bank constitutes a different a case, as it was initially regulated under its own specialized law, and not under the Microfinance Institutions Ordinance.

been less rapid and less solid than expected. The total number of loans outstanding was still negligible compared with the total potential demand, and deposit services were not well-developed (Duflos et al. 2007).

The one potentially increased risk for the microfinance sector is that NGO-MFIs continue to operate outside the regulatory purview and any issues among MFIs can potentially spill over to MFBs, leading to ultimately more serious stability (systemic) issues because MFBs can intermediate client funds. This risk was one of the concerns in the Kashf crisis. The risk did not materialize because Kashf's competitors responded by strengthening their loan underwriting procedures (Burki 2009).

In recent years more new players have entered the market (among them, two MFBs fully owned by mobile network operators [MNOs]), so that the total number of MFBs is 10. The overall effect on **inclusion** is likely positive, although ultimately difficult to determine, as it is impossible to know how the sector would have developed without the introduction of the legal framework for MFBs. There is a general consensus that the effect on inclusion has been positive overall, even if it is generally below expectations. The growth rates both for lending and deposit-taking have only recently accelerated. The target set in the 2007 Microfinance Strategy of MFPs reaching 3 million borrowers by 2010 (SBP 2007a) had still not been reached by end of 2013 (2.83 million borrowers), while the number of savers had reached 6 million.[28] For many years, the NGO-MFI sector—which has continued to exist since the Microfinance Institutions Ordinance did not prohibit NGO-MFIs from operating outside this law—has remained larger than the MFB sector. This has changed only recently, at least in terms of the gross loan portfolio, of which MFBs now make up 57 percent of the total. Of the total number of active microfinance borrowers, 39.5 percent has received loans from MFBs. In terms of physical outreach, MFB branches account for only 26.6 percent of the total MFP branches/outlets countrywide. On the savings side, the number of MFB savers constitutes only 49.3 percent of the total number of savers, but MFBs are capturing 94.8 percent of the value of the PKR 34.8 billion (approximately US$330 million) savings collected.[29] In 2013, the total savings collected by MFBs had for the first time exceeded their gross loan portfolio.

The loan size and borrower income limits have kept MFBs clearly focused on the lower end of the market as far as their lending operations are concerned, with an average loan size of PKR 28,822 (US$275).[30] Even though MFBs are not subject to a similar restriction on the size of deposits because SBP recognizes the need for larger deposits to keep funding costs low, the average savings balance is even lower and stands at PKR 12,368 (US$117). Average savings balances vary a lot among MFBs (between PKR 1,588 and PKR 33,406 or US$15 and US$318).

Since Tameer MFB joined the clearinghouse, its deposits have grown in line with the average growth of the industry (a compound annual growth rate of 54 percent between end 2011 and end 2013, both for Tameer MFB and for the eight largest MFBs) with all of the larger MFBs except First Microfinance Bank experiencing even higher deposit growth of up to 106 percent per year, albeit starting from a lower

[28] The Pakistan Microfinance Network (PMN) collects data across the entire microfinance sector (MFIs and MFBs) and has been publishing the data in a quarterly newsletter called MicroWATCH. These data allow for a comparison of the two subsectors. This analysis draws on the most recent edition, PMN (2014).

[29] NGO-MFIs are not permitted to hold or intermediate savings, but they can collect them from their clients and place them with commercial banks.

[30] The analysis in this and the following paragraph is based on MFB data provided by SBP.

base. Tameer MFB's deposit growth rate has not been higher than in the preceding years.[31] Since Tameer MFB gained access to the clearinghouse the bank sustained its growth in deposits, but did not have a sudden increase in the deposit growth out of line with the rest of the industry. Tameer MFB's average savings balance did not change much, which may indicate that the type of depositors it attracts remained unchanged.[32]

Table 1: Observed effects in the MFB case

	Stability	Integrity	Consumer protection
Synergy with inclusion	Transformation of existing MFIs into MFBs improved their soundness through new regulatory standards. MFBs are well-capitalized and can withstand shocks.	Clients are brought into the formal sector using simplified know your customer (KYC) procedures with assumed positive effect on integrity (supported by high coverage of CNIC)	Standards are in place for MFB clients (even if these standards are lower than comparable standards for banks)
Neutral with inclusion	The introduction of new deposit-taking providers introduces new risks to stability. However, SBP has addressed these through prudential regulations and is carefully considering initiatives that have implications for systemic stability, such as access to the clearinghouse. NGO-MFIs are still unregulated and may create instability for the MFB sector because the two sectors are closely related and conduct of business issues in the MFI sector can spill over to MFBs.		
Tradeoff with inclusion	No tradeoff could be observed	No tradeoff could be observed	No tradeoff could be observed

While no systematic analysis of **integrity** and consumer **protection** data was available, the fact that MFBs are now subject to anti-money laundering and combatting the financing of terrorism (AML/CFT) regulations (Regulation 17 of the Prudential Regulations for MFBs) and that most customers have been identified through CNIC should have a positive effect on integrity. Similarly, MFBs are subject to a variety of consumer protection provisions (e.g., nondisclosure of information by MFBs; disclosure of lending and deposit rates; the establishment of a depositors' protection fund, etc.), which provides MFB clients with a higher degree of protection than NGO-MFI clients (even if standards are lower than for commercial banks). Table 1 summarizes the observed effects in the MFB case.

[31] The annual growth rate has been fluctuating widely over the years. Between 2008 and 2010, i.e., before Tameer MFB got direct access to the clearinghouse, it was even higher at 115 percent (albeit starting from a relatively low base).

[32] Comparing Tameer MFB with other MFBs that do not have direct access to check clearing facilities, Tameer's average deposit size (an indicator not tracked by SBP) has consistently been one of the lowest in the industry (together with Kashf's and Khushhali Bank's) and has not changed significantly with its gaining access to the clearinghouse (data provided by SBP).

3.2.2. The Microfinance Credit Guarantee Facility

By 2007 the microfinance industry in Pakistan had grown to the degree that several top tier-MFPs—both MFBs and MFIs—had begun to seek various sources of funding to sustain lending to their respective customer base. In the course of 2007, the loan portfolio had increased by 41 percent from PKR 10.7 billion to PKR 15.1 billion, with the value of savings growing at an even higher rate of 71 percent, but still the funding gap increasing (total savings of MFPs increasing from PKR 2.2 billion to PKR 4 billion) (PMN 2008). However, even at that stage of development, the commercial financing market was still insufficiently familiar with microfinance as a business model to justify regular credit lines. As such the microfinance industry still largely relied on donor and grant funding. During this period, SBP began to consider the use of a guarantee facility to encourage commercial banks to lend more regularly to MFPs. This policy direction was publicly acknowledged in the 2007 Microfinance Strategy: "The government should also consider use of new instruments like bonds and guarantees to attract domestic resources through capital markets for microfinance activities. However, it is strongly felt that this would only be possible if the business models of the sector participants using resources so generated are profitable" (SBP 2007b). Shortly after the release of the strategy, the microfinance market in Punjab went through the 2008–2009 delinquency crisis (see Section 3.1) that would serve to reaffirm SBP's desire to create a more robust industry capable of withstanding shocks. The crisis sent ripples of concern throughout the microfinance industry and, importantly, commercial banks, which were at the time being urged by the government to lend to the microfinance industry, but were hesitant to do so because of their own liquidity problems as the international financial crisis affected Pakistan in the same year.

It was at exactly this time that SBP launched the Microfinance Credit Guarantee Facility (MCGF) in December 2008, which was part of its market development initiatives under the DFID-financed Financial Inclusion Program. Initially GBP 10 million (about US$15 million at the time) was provided for the facility—this was subsequently increased to GBP 15 million. The facility allows SBP to cover part of the bank's loss in case an MFP defaults on a loan (both MFIs and MFBs are eligible for borrowing under the facility). When designing the facility, SBP had to ensure that all stakeholders were incentivized to participate. SBP initially presented to the banks a 25 percent first loss defaults guarantee on the principal disbursed. Later—and still during the design phase of the facility—SBP added a second option of a 40 percent partial guarantee on the principal outstanding. In addition, lenders were allowed to deduct the total value of the funds provided under the guarantee from their liquidity requirement.[33] Under the facility, commercial banks remained responsible for carrying out due diligence in evaluating the borrowers and any recovery efforts. The process of creating and agreeing on the incentive structure of the guarantee reflects the main **inflection point**.

Since the initial release of MCGF it has been revised twice, in 2009 and 2012. In 2009, MFIs were allowed to avail financing under the facility (initially only MFBs were eligible).[34] In 2012, MFPs were permitted to issue bonds such as Term Finance Certificates, thereby providing MFPs with the opportunity to source funding from the capital market as an additional source of funds.[35] It also allows them to test the market's perception of MFPs as a mainstream investment option. As the I-SIP linkages

[33] Banks are required to hold a 20 percent statutory liquidity reserve of their total demand and time liabilities, and the loan amount can be deducted from the demand and time liabilities.

[34] BPRD Circular Letter No. 26 of 2009.

[35] AC&MFD Circular No. 3 of 2012.

are not significantly different from the initial launch of MCGF, this was not considered a separate inflection point.

SBP's primary objectives in launching the guarantee were to increase the **stability** of the microfinance sector by providing MFPs with a new and sustainable source of funding and by doing so alleviating MFPs' funding constraints that hindered their ability to expand their lending activities in support of financial **inclusion**. As both objectives can be considered synergistic, it was possible to pursue both of them at the same time. The Central Bank was aware of a potential tradeoff with the stability of the lending banks, yet did not go as far as putting a cap on the overall exposure of banks to MFPs. The guarantee itself was seen as sufficiently mitigating the risk of over-exposure to a new, mostly unknown, type of borrowers. The permission for banks to deduct any lending provided under the facility from their statutory liquidity reserve requirement can potentially increase stability risks if the amount is material as a share of the overall amount of liquid assets to be held. SBP believed that this would not be the case, but that this provision might provide an additional incentive for banks to participate in the scheme.

SBP did not consider a potential effect of the guarantee on **integrity** and **protection** when it designed the facility. A potential negative effect of a credit guarantee on access to savings facilities—as one aspect of financial inclusion—did not play a prominent role in the deliberations about MCGF. Depending on the cost of borrowing under the facility compared to the cost of mobilizing deposits, the risk is that a guarantee reduces financial institutions' incentives to mobilize deposits. To the extent that guaranteed funding increases the lending activities of MFPs, the facility can also lead to a positive effect on integrity and protection by bringing excluded customers into the formal system.

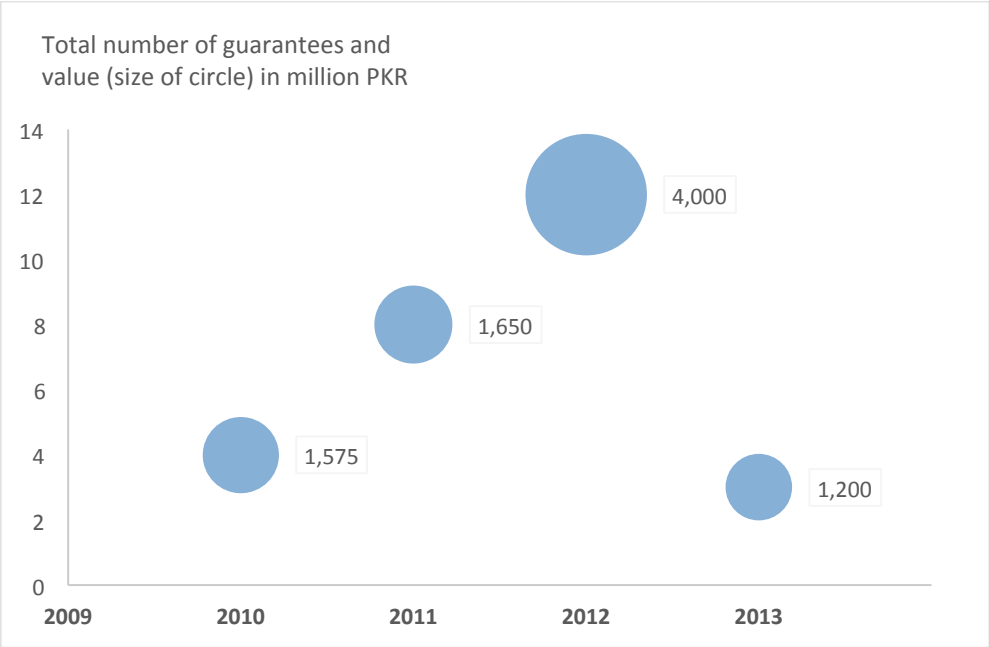
Observed effects

It took almost two years before the first loan was issued under MCGF, which is mostly because the launch of the facility coincided with the onset of the global financial crisis. Since then, 27 deals between commercial banks and MFPs have been successfully concluded. As of March 2014, a total of PKR 8.425 billion (US$80 million) of bank lending to MFPs has been guaranteed under the facility with the outstanding amount of the facility being PKR 3.5 billion (US$33 million). The number of guarantees has also steadily been increasing over the years, but has dropped sharply in 2013 as MFPs have been able to access other sources of funding (see Figure 3). In nine cases, banks chose the 25 percent first loss guarantee, while in 18 cases they selected the 40 percent partial guarantee. Three MFBs and two NGO-MFIs have taken part in the scheme, making funding arrangements with 14 commercial banks. Tameer MFB alone has arranged 13 agreements with eight commercial banks and was the beneficiary of all three Term Finance Certificates. There has been no call on the facility to date.

Assuming that most of this funding would not have been availed without the guarantee, a few of the largest MFPs have benefitted from additional access to funding, which allowed them to grow their lending operations. As far as the credit business of MFPs is concerned, MCGF should have had a positive effect on **inclusion**. At the same time, no negative effect on the deposit business of MFBs can be observed. Comparing the growth rates of MFBs' deposit base for the period before and after the guarantee was introduced, it has remained consistently high.[36]

[36] According to data provided by SBP, the compound annual growth rate was 58 percent in the years 2008 to 2010—albeit starting from a low base—and has since come down to 48 percent per annum.

Figure 3: Bank lending guaranteed under the MCGF



Source: MCGF Analysis and Brief, SBP, June 2013, and SBP Microfinance Programme Statistics, 2008-2013.

As far as the **stability** objective is concerned, there are a number of considerations. To begin with, the data collection efforts regarding MCGF are purely focused on the lending activities under the facility without establishing a link with performance data of MFPs or banks. However, a positive effect on the stability of MFPs can be assumed since they have availed themselves of a new source of stable funding, which allows them to diversify their funding sources. In addition, the conditions of the facility and the fact that banks take a nonguaranteed exposure of at least 60 percent, if not 75 percent of the loan amount, require that commercial banks conduct a full due diligence of their respective counterparties. This has resulted in MFPs *de facto* changing and improving processes (such as introducing a treasury function, hiring qualified staff, strengthening balance sheets, etc.) to gain access to funding.[37] These changes are likely to create more robust institutions with greater capacity to address market shocks (either internal or external) that might test the stability of the sector. It also reduces the risk of MFPs (in particular less mature MFIs) overburdening themselves with commercial lending that they do not have sufficient capacity to manage.

Lending to a new class of borrowers could theoretically compromise the stability of the lending banks, in particular as assets of MFPs are perceived as being difficult to realize in case of default.[38] However, the guarantee itself mitigates part of this risk. Furthermore, even though the facility does not set a limit for

[37] Interviews with MCB Bank and JS Bank, July 2013. MCB Bank noted that it had required its borrowers to make specific improvements to the respective treasury functions needed to manage the conditions of the guarantee. JS Bank also noted that it has previously required particular organizational capacity as a condition of borrowing under MCGF.

[38] Interview with United Bank Ltd, July 2013.

the overall exposure of banks, it generally makes up only a small percentage of their total lending and is therefore not material.[39]

Table 2: Observed effects in the MCGF case

	Stability	Integrity	Consumer protection
Synergy with inclusion	Stability of borrowers: MFBs now have a wider set of funding options, which allow for diversification of risk exposure Improvement of institutional systems and processes, as a condition of lending agreements, created more robust operational integrity that carries over to quality and management of microlending and peripheral activities.	Serving more borrowers through formal financial sector with minimum AML/CFT standards (as far as lending by MFBs is concerned)	Serving more borrowers through formal financial sector with minimum consumer protection standards (as far as lending by MFBs is concerned)
Neutral with inclusion	Stability of lenders: Possible negative effect by exposure to new class of borrowers, but sufficiently mitigated by guarantee and because of overall low exposure to MFPs Stability of borrowers: Possible tradeoff for MFIs in particular that are exposed to market risks that cannot be managed by a robust treasury function, but due diligence conducted by lenders should sufficiently mitigate against this		
Tradeoff with inclusion	No tradeoff could be observed	No tradeoff could be observed	No tradeoff could be observed

MCGF does not directly change any rules on **integrity** or consumer **protection**. The positive linkage between inclusion and integrity/protection can also lead to positive effects on integrity and protection by the simple fact that more borrowers are served via formal sector providers (at least as far as lending by MFBs is concerned). Table 2 summarizes the observed effects in the MCGF case.

3.2.3. Branchless Banking Regulations

Pakistan was one of the first countries globally to consider establishing a specific regulatory framework for branchless banking. Following a workshop convened by SBP with industry actors on branchless banking in November 2006, the Ministry of Information Technology (MoIT) and SBP formed the MoIT-State Bank Joint Committee for Improvement of Access to Financial Services, which was chaired by MoIT and looked into mobile banking, among other things (CGAP 2007). Establishing a policy and regulatory framework for MFIs and MFBs (banks were not mentioned) to "exploit branchless banking modes" was also part of the SBP's National Microfinance Strategy in 2007 (SBP 2007c). While MoIT was heavily involved in the beginning, SBP eventually became the driving force. In May 2007, SBP published for

[39] SBP does not track this ratio, although relevant data should be easily available and it might be a useful indicator for potential stability risks caused by lending under the facility.

comment a draft policy paper on the regulatory framework for mobile banking in Pakistan, which was followed by draft branchless banking guidelines later that year (24 November 2007).

On 31 March 2008, SBP issued the Branchless Banking Regulations, which broadly followed the approach suggested by the earlier policy paper (**Inflection point 1**) (SBP 2008a). According to the Regulations, "the essential spirit of Branchless Banking is financial **inclusion**." This was to be achieved by promoting the penetration of banking services in more remote, rural areas. SBP saw the impressive penetration of mobile telephony as a huge potential.

From the beginning, SBP was very clear that it would initially allow only the "bank-led model," (SBP 2007c) while the nonbank-led model was supposed to be permitted once the sector had reached sufficient maturity and necessary controls had been put in place (Section 3 of the Branchless Banking Regulations).[40] Allowing only banks to offer the services was expected to lead to a wider range of banking products to be offered (and not just payment services) and to prevent any negative effect of branchless banking on **stability**. The latter was in fact a dominant concern for SBP. The Branchless Banking Regulations were first introduced at a time when the Pakistani financial sector faced a challenging economic environment with growing macroeconomic imbalances and high levels of inflation (despite being largely unscathed from the global financial crisis) and high political instability after the assassination of Benazir Bhutto in late 2007 (SBP 2008b). In the initial Branchless Banking Policy Paper, SBP summarized its reservations against a nonbank-based approach as follows: "The non-banks in Pakistan are subject to less stringent regulations which may lead to significant risks w.r.t transaction security, documentation and AML/CFT beside e-money related risks" (SBP 2007c).

The fact that Pakistan was blacklisted by the Financial Action Task Force (FATF) in early 2008 increased the pressure on SBP to put a strong emphasis on **integrity** concerns. SBP saw the use of retail agents raising specific concerns regarding compliance with AML/CFT rules.[41] At the same time, the Central Bank was aware of the tradeoffs between inclusion and integrity and, therefore, opted for a risk-based approach that balances both objectives: "To optimize the gains of Branchless Banking and to extend financial services outreach to the unbanked strata of the society without compromising the requirements of AML/CFT, a risk-based approach to customer due diligence is [used]" (Section 4 Branchless Banking Regulations 2008). The Regulations introduce a tiered KYC system with generally lower KYC requirements for lower-level accounts and the possibility to open level 1 accounts (the lowest level account in terms of transaction limits) remotely through the use of agents, who have to conduct a biometric fingerprint scan at account opening.

Finally, SBP was aware of the importance of consumer **protection** for the achievement of at least two of the other three I-SIP objectives—inclusion and stability. Protection, including rapid compensation of aggrieved customers, was perceived to be important to create trust and consumer confidence.[42] Trust, in turn, was seen as essential for the system's stability and "is the single most necessary ingredient for growth of BB" and, ultimately, for inclusion.

By end of 2008, not a single BB license had been issued. This confirmed CGAP's initial concerns that the limitation to bank-based approaches might stifle the growth of BB models as MNOs were perceived as being the more likely drivers of innovative models (CGAP 2007). However, this was subsequently

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[40] In Pakistan, banks are commercial banks, Islamic banks, and microfinance banks. Nonbanks are nonfinancial institutions such as MNOs or technology service providers.

[41] Ibid.

[42] Interviews with SBP, March 2013.

mitigated by SBP's decision to permit MNOs to acquire an MFB and then launch BB services (MFBs being easier to acquire than banks as they are subject to lower minimum capital requirements). The acquisition of 51 percent of Tameer MFB's shares by Telenor in 2009 set the precedent, which required SBP's approval according to the Microfinance Institutions Ordinance (**Inflection point 2**). Tameer MFB brought the necessary banking skills and had the financial institution license needed to apply (commercial banks, MFBs, and Islamic banks all qualify), while Telenor had the necessary financial muscle and brought a wide airtime distribution network and huge subscriber base to the table. SBP at the time clearly considered the potential tradeoffs between **stability** (allowing a nonbank without much experience in financial services provision to hold a majority stake in an MFB) and **inclusion** (the expectation that new customers would be reached through BB channels). For its final decision to allow the acquisition, SBP did not look only at the "deep pockets" of the MNO, but it also took into consideration that Telenor was subject to high reputational risk, if its involvement with BB operations led to any problems, and that MNOs had substantial technological expertise conducive to launching BB operations.

Six months later United Bank Ltd launched its own service, UBL Omni, which is an MNO-agnostic model not building on a special relationship with an MNO or a technology service provider. Subsequently, two more MFBs have launched BB operations that are fully owned by MNOs.[43] In many cases, MNOs were also permitted to play a leading role in managing agent networks and driving customer acquisition. The use of the term "bank-*led*" is therefore potentially misleading insofar as nonbanks such as MNOs are permitted to take the lead in establishing and implementing the BB system, even though the bank is, from a legal and regulatory perspective, the provider of the service. This report therefore uses the term "bank-*based*" instead.[44]

On 20 June 2011, SBP issued revised Branchless Banking Regulations (Branchless Banking Regulations 2011), which reflected the experience gained over the preceding three years and, as a result, serve as evidence of SBP's "test and learn" approach (**Inflection Point 3**). The most important changes in the 2011 version of the Regulations compared to its 2008 version are as follows:

- The requirement for biometric fingerprint information at the time of opening level 1 accounts was withdrawn, as it turned out to be expensive to implement at thousands of agent locations. Instead a digital photo of the account holder taken during account opening and a copy or image of CNIC are now sufficient
- A new "level 0" account with very low balance and transaction limits was introduced, which can be opened electronically without any physical paperwork by using a digital account opening form
- The transaction limits for "level 1" accounts (previously the lowest level account) were increased
- Person-to-person fund transfers by nonaccount holders (also referred to as over-the-counter [OTC] transactions) and account-to-person transfers were for the first time explicitly permitted recognizing the early evolution of BB activities and the demand from the industry (Tameer MFB had been offering OTC transactions even earlier under a waiver by SBP)

[43] SBP insisted that these MFBs not only offer BB services, but also traditional microfinance services.

[44] This follows a similar change of terminology used by CGAP, as explained in Lyman, Pickens, and Porteous (2008).

Most of these changes reflect SBP's considerations about the linkage between **integrity** and **inclusion**. SBP was dissatisfied with "the very slow take-up" of branchless banking models.[45] In particular, biometric identification and physical delivery of account opening forms to the bank were expensive to implement and therefore held back the number of agents with account opening capability and the number of accounts being opened. Account-based transactions are not only superior from a financial inclusion perspective as a wider range of products can be provided than just retail transfers and payments (as in the case of OTC transactions), but they also pose lower integrity risks as identification requirements are stricter (even after the relaxation in the 2011 version of the Regulations).

Despite this general preference for account-based transactions, SBP still permitted OTC transactions as they were seen as an essential intermediate step to quickly scale up account-based transactions.

In 2011, SBP did not introduce major changes to the sections of the Branchless Banking Regulations most relevant to consumer protection (Section 9) and stability (authorization procedures in Section 10). Consumer **protection** issues in particular with regard to agent fraud and agents' lack of compliance with standard operating procedures have recently moved to the top of the agenda with issues such as some isolated fraud cases and providers being overly lenient with regard to blacklisting agents. These cases together with exponential growth of the number of agents can have a negative impact on the quality of the agent channel and its reputation. SBP is concerned about protecting customers operating through agents, but it is also concerned about systemic implications if the use of agents as an important channel becomes more generally discredited. This might be a future inflection point of the BB case.

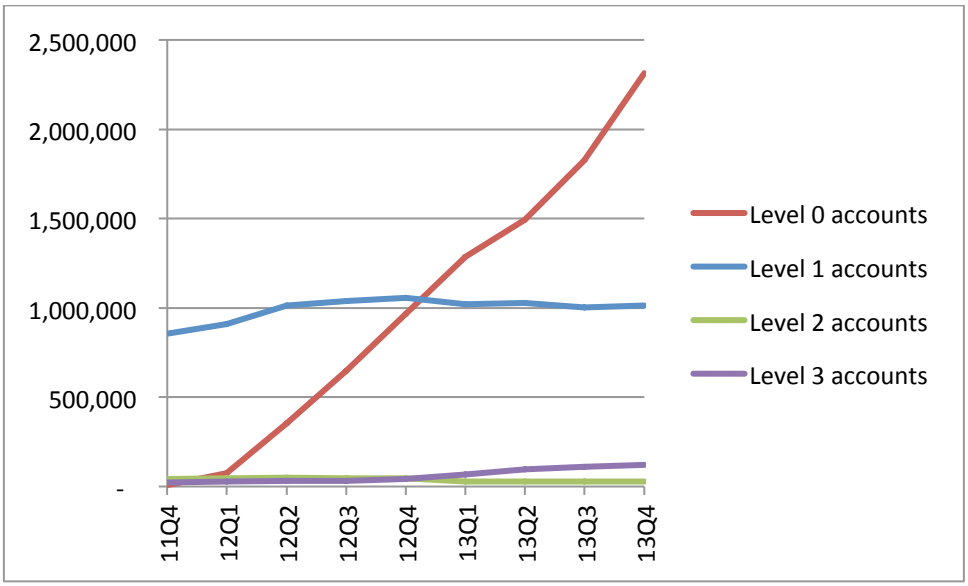
Observed effects

BB had a relatively slow start. It took two years after the issuance of the Branchless Banking Regulations for the first bank—Tameer MFB—to launch BB operations. In 2011, the Director Banking Policy & Regulations Department, SBP, expressed his dissatisfaction with "the very slow take up" and the fact that only about half-a-million BB accounts had been opened by then.[46] Inflection Point 2 (the permission for Telenor to acquire Tameer MFB) had a profound impact by permitting the first provider to launch BB operations. Since 2011, four more services have been licensed with two in late 2012, one in early 2013, and one in mid-2013, which brings the total number of deployments to six. Inflection Point 3 (the revision of the Branchless Banking Regulations in 2011) also had a positive effect on inclusion by removing the biometric identification requirements and leading to high growth rates of level 0 accounts (see Figure 4).

[45] See interview with BPRD Director Mansoor Hassan Siddiqui, in July 2011 (available at http://bit.ly/11mEfi1).

[46] See interview with BPRD Director Mansoor Hassan Siddiqui, July 2011 (http://bit.ly/11mEfi1).

Figure 4: Growth in number of BB accounts



Source: Data provided by SBP.

The adoption of Branchless Banking Regulations apparently has had a positive impact on financial **inclusion**. Assuming that there were no significant substitution effects between traditional bank accounts and BB accounts, nearly 3 million new accounts had been opened by the end of September 2013; on average, 577,000 transactions were conducted per day using about 110,000 agents and amounting to a total value of PKR 224 billion (US$2.1 billion) for the third quarter of 2013.[47]

While these are certainly impressive figures, a closer look at some of the key indicators reveals some challenges:

- 1.45 million (49 percent of accounts) are classified as inactive,[48] although the share of inactive accounts has recently come down (in July 2013 it still stood at 57 percent).
- More than 25,000 agents (23 percent of the total) are inactive, i.e., has neither been opened during the past 90 days nor performed at least one transaction (an increase from 17 percent in the previous quarter).
- The number of unique agents is estimated to be much lower as an increasingly high proportion of agents offer services for more than one BB provider.[49]

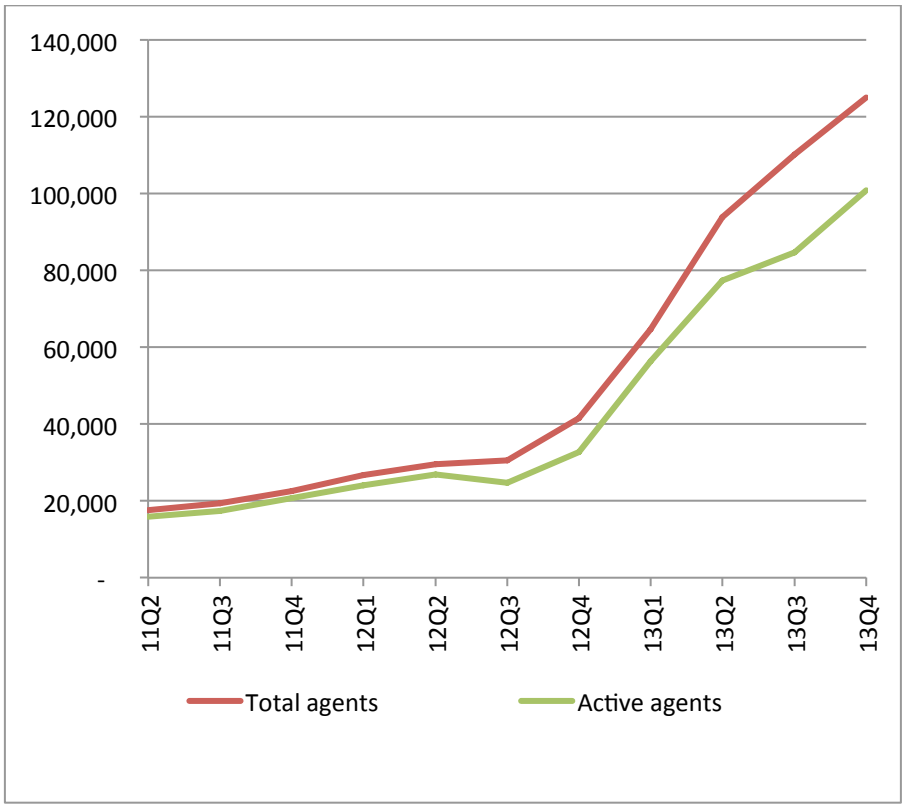
[47] Unless otherwise noted, the source of data for this section is SBP (2013b).

[48] Active accounts are defined as those that have performed at least one transaction during the past 180 days or have been opened during the past 180 days; have not been suspended, closed, or terminated; and are fully compliant with KYC requirements, which means there could be a variety of reasons for an account being classified as inactive.

[49] SBP does not track the number of unique agents. According to estimates, there is an overlap between 20 percent to more than 50 percent.

- At the end of 2013, only 16 percent of agents could open accounts, while the others provide only cash-in and cash-out services.[50] See Figure 5 for the growth in number of agents over the years.

Figure 5: Growth in number of agents



Source: Data provided by SBP.

- In the third quarter of 2013, a majority of transactions were still OTC transactions: 85 percent in terms of number of transactions and 90 percent in terms of their value. Forty-six percent of OTC transactions were for utility and internet bill payments, and 44 percent were for fund transfers (person-to-person or person-to-account).
- Regarding account-based transactions, 38 percent of transactions were cash deposits or withdrawals and 35 percent were mobile top-ups. A majority of BB accountholders were those who receive government funds, pensions, or salaries into their accounts and usually withdraw most of the funds once they have received them into their accounts (SBP 2013a).

OTC transactions are believed to have a more limited impact on financial inclusion than account-based transactions as they are not linked to accounts held in the individual customer's name (which could more easily be linked to products with a higher utility from a financial inclusion perspective such as

[50] Data provided by SBP. The BB Newsletters have not published this figure except once in December 2012, when it stood at 27 percent. See SBP (2013c).

loans, insurance, or savings).[51] However, they are also regarded as an entry-level product to help customers become familiar with using agents, and it might eventually lead to higher growth rates in account-based transactions.

It can be concluded that BB has definitely made inroads in advancing financial inclusion, but it has not yet led to the widespread adoption of BB accounts as an alternative to traditional bank accounts offering a variety of financial services. Recent growth rates have been impressive, in particular among entry-level accounts (level 0), which were permitted only in 2011. Government-to-person (G2P) payments made a substantial contribution to the impressive growth of BB transactions, even if funds do not remain for long in the accounts.

The potential tradeoff between stability and financial inclusion did not materialize, as SBP chose a conservative approach with regard to BB that permits only a bank-based approach (and thus eliminates prudential risks of nonbanks electronic-money issuance) and also until recently did not permit smaller banks to enter the field without having a strong sponsor.[52]

Some observers believe that the heavy involvement of nonbanks—in the extreme case with an MFB fully owned by an MNO—can have a potentially negative effect on stability as the banks are responsible for regulatory compliance, while the strategic directions and operations (e.g., agent management, running of the technology platform) are dominated by their MNO partner. However, so far there is no empirical evidence for this. It is also hard to tell how much the stability—inclusion balance would have been affected if SBP had permitted smaller players to enter the market with a potentially positive impact on inclusion, but also a higher risk for stability.

The predominance of OTC transactions also has implications for the overall risks of BB operations as the overall amount of depositor funds at risk is relatively low (total deposits held are lower than the average value of transactions per day) and typical risks in payment transactions such as settlement, liquidity, and operational risk are more a concern than are prudential risks.

BB had a positive—if not necessarily a deliberate—effect on the stability of MFBs offering BB services mostly due to capital infusion by their MNO partners and the shift to transaction-based costs of delivery rather than fixed costs of branches. At the same time, strong foreign investors were attracted to invest in MFBs because of the opportunities they see in BB (e.g., FINCA in Khashf; a consortium of investors in Khushhali Bank).

Regarding **integrity**, available data are not sufficient to determine whether BB transactions are subject to higher incidences of money laundering and terrorist financing than financial services delivered through traditional channels because BB transactions have not been separated from traditional banking transactions in the suspicious transaction reporting (STR) form.[53] However, the fact that many of the previously informal transactions are now conducted in the formal sector and thus traceable (even if with more limited KYC) should have a positive effect on integrity. In particular, before the revision of the Branchless Banking Regulations in 2011, KYC requirements were generally perceived as being too costly and thus having a negative effect on the growth of BB services (and thus on inclusion). The lower KYC

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[51] A recent demand-side survey produced similar results with 87 percent of the transactions estimated to be OTC transactions. See InterMedia (2013).

[52] In 2012 and 2013, a few smaller banks have been permitted to first pilot and then later on launch branchless banking operations . It is too early to tell what the effect on stability will be.

[53] It would be possible to indicate this only by using the "other" fields under nature of account, and the Financial Monitoring Unit has not tried to track BB transactions separately from other banking transactions.

requirements for OTC transactions are widely regarded as one of the reasons for the predominance of OTC transactions over account-based transactions.

The 2011 relaxation of KYC requirements has led to higher growth in lower-level account openings and is therefore evidence of the tradeoff between integrity and inclusion—conservative KYC requirements had previously led to subdued growth.

The effect of the policy change on **protection** is difficult to confirm, as very little information exists on consumer protection issues in BB. SBP's Consumer Protection Department receives reports only about those complaints that could not be resolved internally, and it is not known how many complaints regarding BB transactions the providers resolved internally.[54]

According to SBP, a few incidences of agent fraud and agent overcharging have occurred. Some agents have been found not to follow the Standard Operating Procedures agreed in the Service Level Agreement between the agent and the financial institution. Regarding disclosure requirements about complaint lodging procedures at agent locations, SBP mostly relies on the banks to enforce this, but also conducts some mystery shopping and a few onsite inspections of agents. The number of complaints does not seem to be significantly higher than the number of complaints relating to the use of traditional bank channels.

Table 3: Observed effects in the BB case

	Stability	Integrity	Consumer protection
Synergy with inclusion	Attracting funding by reputable companies (in particular MNOs) and microfinance investment vehicles	Bringing transactions into the formal financial system	Consumer protection standards higher than alternative offerings in informal sector
Neutral with inclusion	No negative impact on stability due to SBP's policy to allow only nonbank model and only large banks or small banks with a strong partner. However, this might have led to lower than expected growth of BB. Prudential risks of OTC transactions are lower than for account-based transactions, but OTC transactions are also of lower utility to customers.	Potential tradeoff when lowering KYC for level 0 accounts, which was countered by lower functionality of the account and thus did not materialize. Positive impact on inclusion as evidenced by high growth rate of level 0 accounts.	Anecdotal evidence for consumer grievances, noncompliance with standard operating procedures, and isolated cases of agent fraud, but nothing out of line with what can be observed elsewhere
Tradeoff with inclusion	No tradeoff could be observed	No tradeoff could be observed	No tradeoff could be observed

Similar to the integrity objective, the achievement of the protection objective has benefitted from a larger share of financial transactions being conducted in the formal financial sector and through electronic channels, which are easier to monitor. Tameer MFB believes that customer satisfaction is still

[54] The Banking Mohtasib (Ombudsman) also offers independent complaint resolution services. However, it does not provide services to customers of MFBs, and its 2011 Annual Report does not mention any complaints about BB services provided by banks.

high compared to the only alternative most customers have, which is to operate through informal channels.[55] Recipients of government payments through BB channels have expressed their satisfaction about technology-driven solutions as transparency and accountability have improved. While they previously had to use a middleman such as a postman, who would claim part of the payment as a "commission," they now receive the full amount (MEDA 2012).

Table 3 summarizes the main observed effects.

3.2.4. The Microfinance Credit Information Bureau

The fourth policy intervention—MF-CIB—is different from the previous three because it was treated as an *ex ante* case and it was not primarily perceived as an inclusion intervention. At the time of the field visit, MF-CIB was still in the process of being rolled out nationwide. While the design of the policy intervention had been completed, any observations on the effect of the policy on I-SIP objectives were based on the effects of a previous pilot phase with limited geographic coverage.

Ideas for an MF-CIB emerged as early as 2004, with a feasibility study conducted in 2005. However, at the time, the sector was considered to be too small with too little competition among MFPs to warrant the establishment of an MF-CIB. The 2007 Microfinance Strategy took the idea up and called for the creation of a credit bureau for MFPs (SBP 2007b). In 2006 to 2008, microfinance in Pakistan became more competitive, at least in parts of the country with both MFIs and MFBs targeting similar markets, often providing parallel loans to the same clients.[56] According to data from the Pakistan Microfinance Network (PMN), the number of borrowers almost doubled and the value of microloans more than doubled between end 2006 and September 2008, before decreasing in the fourth quarter of 2008. Most of the lending was concentrated in a few districts in Punjab.[57] This issue came to a head in the delinquency crisis in parts of Punjab described above, which threatened to destabilize the sector by spilling over to the rest of the MFPs since the revolt occurred in one of the largest lenders, Kashf, and marketwide credit discipline was at risk because the MFPs shared many of the same clients (Burki 2009). This created major concerns about the stability of the microfinance sector, with a repayment crisis potentially having systemic implications not only for other credit-only MFIs, but also for MFBs taking public deposits.

As a direct result, in 2009, PMN launched a pilot for an MF-CIB in Lahore and Kasur, the two districts most affected by the delinquency crisis. While all commercial banks and MFBs (along with nonbank financial institutions regulated by the Securities and Exchange Commission of Pakistan [SECP]) were already required to report all loans to the Electronic Credit Information Bureau (eCIB), which is run and housed by SBP, nonregulated MFIs did not have access to eCIB, which serves only the closed user group of financial institutions regulated by SBP or SECP. The MF-CIB pilot was aimed at both MFIs and MFBs, with each of them estimated to serve about half of the market.[58] In fact, for MFBs it was much more relevant to know about lending activities of MFIs than of other banks reporting to eCIB, as there was more of an overlap in the customer base. The launch of the MF-CIB pilot was a joint initiative of SBP, PMN, Pakistan Poverty Alleviation Fund, and the private provider DataCheck.

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[55] Interview with Tameer MFB, July 2013.

[56] The extent of multiple lending by different MFPs became apparent only after the launch of MF-CIB.

[57] According to data in the MicroWATCH reports published by PMN.

[58] MFD Circular No. 01 of 2009. Sharing of Customer Data with Pilot/Private CIB.

Based on positive results of the Lahore pilot, in 2012, the pilot was expanded to include MFPs nationwide (main **inflection point**). SBP has been instrumental in creating MF-CIB, which it counts among its "market development initiatives," and is providing financial support to MF-CIB as well as support through enabling regulatory conditions.

In particular, SBP has taken the following action:

1. Microfinance Department Circular No. 01 of 2009 providing MFBs with certainty that they may share data with a private credit bureau
2. Amendment to the Microfinance Prudential Regulations allowing MFBs to seek credit reports for loans below Rs 30,000 from either the eCIB or other private bureaus (while loans exceeding this amount still require a check with the eCIB).
3. Strong support from SBP for MF-CIB, including grant funding through the SBP Financial Inclusion Program to support capacity building for MFIs in the national rollout.[59]

MFIs are not mandated to report to a credit bureau. However, as most of the MFIs in Pakistan are receiving funding from the Pakistan Poverty Alleviation Fund, the Fund has now added a requirement to its loan conditions to report to MF-CIB. It remains to be seen how effective this requirement is in increasing MFI participation in MF-CIB.

According to the 2007 Microfinance Strategy, the rationale for setting up an MF-CIB has been the following:

> [T]o have correct information about multiple borrowing, which also facilitates credit decision-making process of the market players, the setting up of a credit bureau exclusively for the service providers in the microfinance sector shall greatly reduce the credit risk and the transaction cost. The credit bureau is also instrumental in bringing the entry of commercial players (SBP 2007b).

From this it is clear that SBP's major concern was the effect of multiple borrowing on the portfolio quality of MFPs and thus on the **stability** of the microfinance sector. This fear was validated and reinforced by the repayment crisis in Punjab. SBP has been acutely aware of the close relationship between the MFI sector and the stability of the MFB sector, which could be addressed only by setting up a reference bureau both MFIs and MFBs report to and inquire from. The MFI sector on its own poses low systemic stability risks, as it does not intermediate funds from the public. Yet "in the absence of a regulatory/supervisory mechanism for MFIs, the risk remains of MFIs' unchecked and risky practices (if any) transmitting to the entire sector" (SBP 2011).

This case, therefore, differs from the other policy interventions to the extent that **inclusion** had not been the primary objective, but it is mainly regarded as the outcome of a positive linkage between the stability of the sector and its growth via the entry of commercial players. At the same time, it was conscious of the costs associated with double inquiries from MF-CIB and eCIB (with a potentially negative effect on inclusion) and thus did not mandate MFBs to also participate in MF-CIB.

According to SBP, MF-CIB is expected to mitigate the risk of multiple lending and over-indebtedness and thus have a positive effect on **protection**. At the same time, SBP was conscious of data confidentiality

[59] As MFIs are not under the purview of SBP, all legal guidance issued with regard to MF-CIB applies only to MFBs. Only the funding support by the SBP Financial Inclusion Program also benefits MFIs.

risks and included provisions to this effect in a Circular issued to MFBs.[60] While SBP did not consider any specific integrity issues, the fact that MF-CIB requires all participating MFIs to uniquely identify each customer with the use of CNIC can have an unintended positive effect on **integrity**. However, it could at the same time create a barrier to entry for some clients if they do not have a CNIC. It appears that providers and SBP have considered this potential tradeoff with inclusion, but concluded that it would not be material because of the extremely wide coverage rate of CNIC.[61]

Possible effects

MF-CIB was treated as an *ex ante* case, as it is still too early to observe any effects. Therefore, this section covers expected effects based on the linkage hypotheses of introducing MF-CIB. In line with its primary objective to increase the **stability** of the microfinance sector, MF-CIB should have a positive effect on the portfolio quality of MFPs and on its transaction costs by providing them with detailed information about previous and current loan performance of applicants and reducing the risk of over-indebtedness. To observe this positive effect on stability, MFPs have to report on time and consistently, request credit reports from MF-CIB for each new loan, and incorporate MF-CIB data into their decision making.[62] According to some early analysis by DataCheck, in December 2012 about 19 percent of the records having received requests for credit reports had more than one loan outstanding.

A possible, most likely short-term tradeoff of stability with **inclusion** can be a decrease in lending activity of MFPs as they stop lending to borrowers with bad credit risk and/or with multiple loans outstanding from different lenders. MFBs are subject to a cap on lending amounts (including lending from NGO-MFIs) under the Prudential Regulations, which will be easier to monitor with all MFPs reporting to the same credit bureau.[63] However, in the long run the improved portfolio quality and reduced transaction costs in lending should make microlending more attractive and create a positive effect on inclusion by increased interest in the sector.

MF-CIB needed to make use of a unique identifier for each borrower and, therefore, requires reporting MFPs to make use of CNIC for customer identification. Because MFBs do not have a similar requirement —MFBs under the Prudential Regulations are permitted to use different types of documents for KYC purposes (let alone NGO-MFIs)—MF-CIB should have a—unintended—positive effect on **integrity**. Because 97 percent of the population is covered by CNICs, this is unlikely to become a barrier for inclusion.

Finally, sharing customer data with a credit reference bureau can potentially have a direct negative effect on customer **protection** due to shortcomings in the quality of information, clients' ability to get access to their data and ask for corrections, and the risk of keeping negative records for very long periods thus hindering clients' ability to borrow. At the same time, MF-CIB can also have a positive effect by reducing the risk of clients getting over-indebted.

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[60] See MFD Circular No. 01 of 2009 enabling MFBs to share data with the private credit bureau: "Microfinance Banks may like to share their customers' data with pilot/private CIB(s) subject to development of comprehensive customer protection and confidentiality guidelines duly approved by their Board of Directors. Further, express customer consent is mandatory for sharing customer data with other institutions/CIB and the duty of maintaining confidentiality will remain with the Microfinance Bank."

[61] According to NADRA, 97 percent of adults have been issued with CNIC cards (interview with NADRA, July 2013).

[62] At the time of the field visit in July 2013, only a few MFIs had started reporting to MF-CIB.

[63] Under Prudential Regulation 11, the limit is PKR 150,000 for general loans and PKR 500,000 for housing loans.

Table 4 summarizes the possible effects of introducing MF-CIB on the linkages between stability as the primary objective and the other I-SIP objectives.

Table 4: Possible effects of MF-CIB case

	Inclusion	Integrity	Consumer protection
Synergy with stability	Improvement of portfolio quality and lower transaction costs in lending increase investment in the sector.	Unintended benefit of all borrowers of participating MFPs being identified by CNIC	Reducing the risk of over-indebtedness
Tradeoff with stability	Temporary dip in lending due to refusal to lend to bad credit risks and better enforcement of legal limits on overall credit exposure		Risk of keeping bad records for unduly long periods; low quality of credit data; and lack of ability of clients to correct false information

At the risk of oversimplification, Table 5 summarizes the four policy interventions analyzed as part of the Pakistan research.

Table 5: Summary of linkages in policy interventions

Policy intervention	***Inflection points***	***Primary objective(s)***	***Tradeoff SBP was concerned about***	***Observed effects to date***
Regulatory framework for MFBs (*ex post*)	Inflection point 1: Creation of regulatory framework (2001)	Inclusion (new type of financial institutions and products mostly catering to the unbanked)	Stability (allowing new type of bank with some relaxed regulatory requirements)	Positive effect on inclusion (even if below expectations) without compromising stability
	Inflection point 2: Granting Tameer MFB access to clearinghouse (2009)	Inclusion (better access to deposit-funding)	Stability (systemic risk in payment system)	Positive effect on inclusion; neutral on stability
Microfinance Credit Guarantee Facility (*ex post*)	Inflection point: Offering commercial banks incentives to take advantage of guarantee (2008)	Inclusion (better access to funding for MFPs) and stability	Stability (on the part of lending banks)	Positive effect on inclusion (with potential disincentive for MFBs to pursue deposit-taking)
Branchless Banking Regulations (*ex post*)	Inflection point 1: Issuing Branchless Banking Regulations (2007)	Inclusion (new delivery channel)	Stability (agents introducing new risks) and integrity (lower KYC accounts)	No license issued before 2009 (see inflection point 2)
	Inflection point 2: Permitting Telenor to buy Tameer MFB (2009)	Inclusion (take advantage of strengths of MNO)	Stability (stronger role of nonbank)	Positive effect on inclusion (but mostly limited to OTC transactions); neutral on stability
	Inflection point 3: Revision of Branchless Banking Regulations (2011)	Inclusion (removing barriers under previous Regulations)	Integrity (lowering KYC rules)	Positive effect on inclusion (strong growth of level 0 accounts); neutral on integrity
Microfinance Credit Information Bureau (*ex ante*)	Inflection point: Ongoing nationwide rollout (since 2012)	Stability (soundness of MFPs and sector) with positive impact also on protection and stability	None	Too early to tell

4. Observations from Pakistan

This section presents some general observations from the Pakistan research about how the central bank—as the main policy makers in the four cases under investigation—has identified the effects of its policies on the I-SIP objectives and the linkages among the objectives, how it has managed such linkages, and—to a more limited extent—how it has sought to optimize the linkages. Most the observations are descriptive and draw heavily on interviews conducted during visits to Pakistan. Note that Section 5 returns to some of the observations and draws more general lessons for the I-SIP methodology applicable not only to Pakistan, but also to other countries designing and implementing financial inclusion policies.

4.1. Defining objectives and measuring effects

The analysis in Section 3 shows that SBP capably identifies I-SIP objectives and the linkages among them. As described in Section 3.1, SBP has been systematically pursuing a financial inclusion agenda, and the four policy interventions discussed here as cases constitute some of the most prominent elements of its overall approach to financial inclusion. The I-SIP Methodology applies the I-SIP Propositions, discussed in more detail in Section 5, to identify, manage, and optimize linkages among the I-SIP objectives. The Pakistan rapid research exercise sheds light on the methodological and practical challenges in doing so.

Unlike South Africa, Pakistan does not have definitions of the four I-SIP objectives that are broadly accepted and widely used by policy makers. However, SBP has a general understanding of each of them, as is evidenced by the examples from public statements (inclusion) and public documents (stability, protection) quoted in Box 1.

Box 1: Examples of Public Statements on I-SIP Objectives

Inclusion: "Financial Inclusion refers to the process of promoting affordable, timely and adequate access to a wide range of regulated financial products and services and broadening their use by all segments of society through the implementation of tailored and innovative approaches including financial awareness and education with a view to promote financial well-being as well as economic and social inclusion" (Muktadir 2013).

Stability: "Financial stability is defined as a situation in which the function of efficient financial intermediation and payment services continues without disruptions despite internal and external shocks, and financial risks are monitored and managed well such that the possibility of systemic crises is minimized" (SBP 2012).

Protection: "Consumer protection is a strong tool to empower poor clients such that they know their rights and make informed decisions. Specifically, clients' protection can be based on widely-accepted principles such as avoidance of over-indebtedness, transparent pricing, appropriate collection practices, ethical staff behavior, mechanisms for redress of grievances, privacy of clients' data, and consumer awareness through financial literacy" (SBP 2011).

While definitions of the I-SIP objectives on the national level provide general guidance in the design of policy interventions, it is even more important to define the objectives in the context of a specific policy intervention and to specify what indicators can be used to measure effects with regard to each of the I-SIP objectives (see I-SIP Proposition 4). Definitions require sufficient granularity to inform linkage optimization with respect to a specific policy intervention.

SBP has shown a great awareness and perspicacity of the direct effects and linkages of the policies on the I-SIP objectives, but has not been noticeably successful at using a systematic approach in identifying targets and indicators for each policy intervention to manage those linkages. While SBP may be further along than most regulators in collecting data, those data collection efforts could be enhanced if they explicitly considered SBP's interest in managing and optimizing I-SIP linkages.

One example is SBP's data collection efforts on BB. SBP's quarterly *Branchless Banking Newsletter* collates data on BB, not seen in most countries,[64] yet with a focus on documenting the effect on inclusion (and not so much on the other I-SIP objectives), and even with regard to inclusion important indicators have been added only more recently. For instance, it was only in the second quarter of 2013 that an indicator was added for the share of OTC versus account-based transactions, while before it was not possible to specify the overall share of both types of transactions.[65] It is widely believed that account-based transactions are of a higher utility from a financial inclusion perspective, as they can be linked to products such as loans, insurance, or savings. Similarly, SBP has not systematically monitored the share of agents that can open accounts, even though this is an important indicator for the geographic reach of BB services.[66] Another indicator that is useful to track is the number of unique agents (rather than the number of total agents, of which many are shared). SBP started estimating this number only in September 2013.[67]

The effect of BB on integrity and protection is more difficult to measure. As Pakistan is on the list of jurisdictions with strategic AML/CFT deficiencies (mostly due to terrorist financing concerns) and thus under increased scrutiny with regard to its AML/CFT policies, SBP has understandably been cautious about implementing AML/CFT policies. Yet in the absence of agreed indicators and data segmented by delivery channel, it is not possible to compare integrity risks of BB transactions with those of traditional banking transactions based on prevalence level or nature of suspicious transactions reported.[68] For a systematic analysis of consumer protection issues in BB, data would have to be collected through customer surveys rather than regular offsite reporting, which is admittedly more difficult and resource intensive to do.

SBP relatively consistently considered the effect of policies on I-SIP objectives at the design stage, but did not put equal attention on the definition of relevant indicators that can be used to track progress with regard to each of the I-SIP objectives. A more systematic approach to monitoring effects of policies would allow for a better adjustment of policies to observed developments in the market.

4.2. Linkage management

An important lesson for the I-SIP Methodology is that policy makers need to not only consider the direct effects of a policy intervention on the I-SIP objectives, but they also need to manage linkages among objectives. This section discusses observations from the four Pakistan cases, analyzing the extent to which policy makers considered each of the pair-wise linkages with inclusion. The assumption is that disregarding some of these linkages can lead to under- or overestimation of certain benefits and risks

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[64] See http://www.sbp.org.pk/publications/acd/branchless.htm.

[65] This was because some of the categories reported by BB providers such as, e.g., bill payments and mobile top-ups aggregated OTC and account-based transactions, which have now been disaggregated.

[66] This number is much lower, as all BB providers (except UBL Omni) are opening customers' accounts *only* through their franchisees and sales centers, not through retailers. Since SBP maintains regular data on type of agents (franchisee, sale center, retailer, etc.), it would be easy to systematically monitor the number of agents that can open accounts.

[67] Banks now report agents in three categories: exclusive, double sharing, and multiple sharing. To calculate unique access points, SBP applies appropriate discount factors to the last two categories. At the end of 2013, the total number of agents stood at 125,000, but there were only 58,000 unique agent locations.

[68] This said, SBP's easing of KYC rules for lower-risk accounts and transactions is an example of I-SIP linkage management in practice, even without STR data distinguishing BB and traditional banking transactions.

and suboptimal outcomes. A more systematic process of linkage identification and management will mitigate the risk that important linkages are disregarded.

The inclusion–stability linkage

SBP has been most concerned about the linkage between **inclusion and stability**: All four policy interventions aimed to promote financial inclusion (though MF-CIB's primary objective was identified as stability). And for all of them, SBP has clearly considered any potential tradeoffs and synergies between both objectives based on its understanding that promoting financial inclusion is critically important, and that it would have to be done in a manner that does not compromise stability.[69]

As a result, all policy interventions with a potentially negative impact on stability included risk mitigants to cater to this risk and in fact have been successful in averting any observable negative effect on stability:

- SBP permitted only a bank-based approach to **branchless banking** due to concerns that "the non-banks in Pakistan are subject to less stringent regulations which may lead to significant risks w.r.t transaction security, documentation and AML/CFT beside e-money related risks" (SBP 2007c). SBP's concern was that nonbanks' involvement in branchless banking would not only lead to a potential tradeoff with stability, but also to a possible tradeoff with integrity and consumer protection.[70]
- The **Microfinance Institution Ordinance** introduced a new, lower tier of deposit-taking financial institutions with some regulatory provisions relaxed as compared with commercial banks. However, SBP followed a conservative approach regarding minimum capital requirements for setting up new MFBs, initially requiring PKR 500 million (about US$8 million at the time) in paid up capital to establish an MFB at the national level.[71] Among a peer group of eight countries that had specific microfinance legislation in 2002, this was the highest amount (both in absolute terms and in relation to gross domestic product (GDP) per capita) (Staschen 2003).
- **MCGF** is targeted at commercial banks as an incentive to lend to MFPs, but it also includes strong safeguards against banks taking on too much risk. The guarantee itself obviously covers part of the risk. In addition, banks are required to conduct full due diligence on their respective counterparties to gain access to the facility.

One challenge with assessing stability risk is that it is a "low-probability-high-impact" risk—even a single systemic event would be one too many. As explained in Section 3, the growth of both the MFB sector and of BB activities initially did not meet expectations, but more recently both sectors are growing. It is not clear whether more relaxed stability measures (e.g., lower capital requirements for MFBs or the permission for nonbanks to offer BB services) would have led to better inclusion results without compromising stability.

The inclusion–integrity linkage

Another pair-wise linkage SBP has considered in its policy making is between **inclusion and integrity**. Evidence of this includes relaxed KYC requirements for MFBs as compared with those applicable to

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[69] Interview with Banking Policy & Regulation Department, SBP, March 2013.

[70] Another reason for favoring a bank-based approach was that it was expected to lead to a wider range of products (not only OTC transactions) than a nonbank-based approach (interview with SBP, March 2013).

[71] PMN had advocated for PKR 100 million for a national-level MFB (PMN 2001).

commercial banks, as SBP recognized, at the time the law was passed, that a significant part of the population in more remote areas did not have a CNIC or any other official ID (this has now changed). The Prudential Regulations for Microfinance Banks (Section 17) therefore allow "in remote areas where people, particularly women, don't have identity cards" for the establishment of the identity "through other appropriate means." Similarly, the Branchless Banking Regulations (Section 4) establish a tiered, risk-based approach to KYC with the goal "to optimize the gains of Branchless Banking and to extend financial services outreach to the unbanked strata of the society without compromising the requirements of AML/CFT."

Inclusion also has a positive linkage with integrity by the simple fact that financial transactions are moved from the untraceable world of informal transactions into the formal financial sector—something that seems not to have been explicitly noted in Pakistan (even though it could be considered implicit in policy moves such as the easing of KYC rules for lower-risk BB accounts and transactions). As highlighted again in the recent FATF Guidance on AML/CFT Measures and Financial Inclusion, bringing more people into the formal financial sector has an inherent positive impact on integrity (FATF 2013).

The inclusion–protection linkage

The inclusion–protection linkage has not featured prominently in the discussions about any of the four policy interventions. MFB customers do not benefit from the same consumer protection provisions as commercial bank clients, yet they are certainly better protected than customers in the informal sector.[72] SBP did not want to impose costly consumer protection rules in the early stages of market development, as it was more concerned about keeping the regulatory framework simple to encourage new players to enter the market. This is now changing both with the MFB sector becoming more mature and with the concept of responsible finance gaining prominence after the global financial crisis.

By contrast, the Branchless Banking Regulations include a separate section on "Customer Protection and Awareness" (Section 9), because protection was seen as important to create trust and consumer confidence in the new delivery approach, which, in turn, was regarded as essential for systemic stability and as "the single most necessary ingredient for growth of BB" (SBP 2008a) and thus for inclusion. The synergy between the two objectives—inclusion and protection—thus was explicitly recognized. Recently consumer protection issues in BB have moved up on SBP's agenda due to the exponential growth of agents and BB transactions. As a consequence, SBP is in the process of setting up an "agent bureau" for purposes of blacklisting noncompliant agents.

In the case of MF-CIB, linkages between inclusion and protection were not an important consideration for policy makers. While the bureau was primarily regarded as a stability-linked intervention, SBP also mentioned protection as an important motivation, as the risk of over-indebtedness would be reduced.[73] SBP seemed to be more concerned about the stability–protection linkage, as any consumer protection issues in the unregulated MFI sector (where consumer protection issues are more prominent) can spill over to the MFB sector and cause stability concerns, as mentioned in the 2011 Microfinance Strategy: "In the absence of a regulatory/supervisory mechanism for MFIs, the risk remains of MFIs' unchecked

[72] SBP has not issued any specific consumer protection regulations/guidelines for MFBs yet (something currently being worked on), and MFB customers do not have access to the Banking Ombudsman.

[73] Interview with Agricultural Credit & Microfinance Department, SBP, November 2013.

and risky practices (if any) transmitting to the entire sector" (SBP 2011).[74] A linkage between inclusion and protection was not considered at all in the case of MCGF.

In all cases, a positive linkage between inclusion and protection can be identified to the extent that customers are integrated in the formal financial sector, where they benefit from at least some degree of protection as compared with the informal sector, which by definition does not offer any protection.

4.3. Incremental linkage optimization

The analysis reveals that SBP has identified and managed linkages, but not necessarily in an explicit and systematic manner. Arguably, SBP has been an **intuitive manager** displaying perspicacity for managing I-SIP linkages that stands out. SBP has also been an **incremental optimizer** of linkages by continuously monitoring the development of the sector in response to the policy interventions studied and amending its policies based on what was observed. All of the policy interventions studied as part of this I-SIP rapid research exercise have been revised over time at least once; most of them have been revised several times. SBP's Microfinance Division (now part of the Agricultural Credit & Microfinance Department) has played a key role by collecting inclusion-related data and promoting necessary policy changes. The linkage optimization has not necessarily been a deliberate process, as the focus has been on facilitating market uptake and promoting inclusion without at the same time systematically monitoring the linkage with any of the other I-SIP objectives.

The following are some examples of changes in policies in response to SBP's market monitoring:

- **BB, inflection point 2.** Inflection points 2 and 3 in the BB case were primarily about relaxing some existing policies with a view to promote the growth of BB. Inflection point 2—the decision to allow Telenor (and subsequently other MNOs) to acquire a bank—was a significant departure from SBP's policy to have banks take the lead in any BB deployments. SBP's concerns about higher risks in models where nonbanks play a more prominent role have so far not materialized, but it continues to monitor the respective roles of MFBs and MNOs closely in those deployments where the MNO owns the MFB. The increased role of MNOs has certainly contributed to the high growth rates observed in recent years.
- **BB, inflection point 3.** The revision of the Branchless Banking Regulations in 2011 directly affected the inclusion–integrity linkage and led to higher growth rates without any observable adverse effect on integrity (though SBP does not track STRs for BB accounts separately). Policy makers felt comfortable with relaxing identification requirements only for level 1 accounts and introducing a new level 0 account (the latter had already been proposed at the time the Branchless Banking Regulations were introduced) once they felt comfortable with BB not having led to any apparent negative effects on the integrity of the financial sector.
- **MCGF.** MCGF has been subject to revisions at the design stage (adding a 40 percent partial guarantee of the outstanding principle as a second option, and permitting lenders to deduct the total value of the funds provided under the guarantee from their liquidity requirement). The latter could have had a potentially negative effect on stability by reducing the liquidity cushion of the lending institution, but it was thought of as a "sweetener" to increase uptake of the facility (with a positive effect on the stability of MFPs).[75] In practice, this provision was moot, as

[74] SBP is currently in discussions with SECP as the regulatory authority of the nonbank financial sector about the introduction of a regulatory framework for unregulated MFIs.

[75] Interview with SBP, July 2013.

the tight liquidity situation in the banking sector had changed soon after the introduction of the facility and most banks were holding more than enough liquidity in any event.

- **MFBs.** In the case of MFBs, the Microfinance Institution Ordinance and the Prudential Regulations have been revised numerous times since they were initially introduced in 2001 and 2003, respectively.[76] Some of the changes had a profound impact on the sector. One significant example has been the permission for MFBs to build provisions net of gold. SBP's initial concerns were whether the value of the collateral could easily be realized in the case of default. In practice, this turned out to be the case, and the change in regulations has given a boost to loans secured by gold ornaments without at the same time introducing additional stability risks.[77] Other relaxations have been introduced regarding the definition of a poor person and the addition of new loan categories with higher maximum loan sizes, both of which MFBs advocated for to allow them to serve the "missing middle" between the commercial banking sector and microloans. The exclusive focus on microloans was seen as one reason why few MFBs were sustainable. This had to be balanced against the risk of mission drift (with a negative effect on inclusion) and regulatory arbitrage (using an MFB license to conduct commercial banking) (Ahmed and Shah 2007). At the same time, minimum capital requirements—even though relatively conservative from the beginning—have been increased over the years as the most important stability measure in the eyes of SBP.[78]
- **MF-CIB.** The MF-CIB case exemplifies how SBP has managed a potentially negative linkage. SBP recognized the high costs associated with contributing to and requesting credit reports from the credit reference bureau. While SBP could have mandated from the start that MFBs use MF-CIB (in addition to eCIB), it has not yet taken any regulatory action and instead is monitoring uptake. It will mandate the participation in MF-CIB only once a critical mass of MFIs report data regularly and accurately, at which stage the additional costs would be justified by the benefit of using the second bureau.

An integral element of SBP's incremental approach is consultation among different SBP departments. It is common for SBP to set up committees that include representation of various departments for policy changes that are of direct concern to more than one department.[79] Each department brings to the table natural priorities depending on its main responsibility: the Banking Inspection Department, for example, is strongly focused on stability, while the Agricultural Credit & Microfinance Department has a keen interest in promoting financial inclusion and has good links to the donor community (partly because it is also involved in implementing donor-funded projects such as the DFID-funded Financial Inclusion Program). As a result, the potential tensions among various objectives are reflected in the composition of the committee and are brought into the open and discussed during these meetings. This is particularly the case with policy interventions that go beyond the narrow domain of MFPs and that might have repercussions for the broader banking sector (e.g., the question of MFBs becoming members of the clearinghouse).

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[76] For a description of changes up until 2007, see Ahmed and Shah (2007).

[77] Eighty percent of Tameer MFBs loan portfolio is now backed by gold (interview with Tameer MFB, July 2013).

[78] For nationwide operating MFBs, minimum capital has been increased from the initial PKR 100 million to PKR 500 million and to PKR 1 billion at the end of 2013.

[79] Examples are the committees set up for developing the Branchless Banking Regulations and, more recently, for drafting Guidelines for Clearing House Membership of MFBs.

SBP also has a long tradition of consulting with a broad range of industry stakeholders through special events, by publishing draft policies for comment, and through consultative groups with representation from the industry, government, regulatory bodies, industry associations, and donor agencies.[80]

In addition to the regular reports SBP receives as part of its offsite supervision, it has at least once (in the case of BB) conducted a special diagnostic exercise for the main purpose of better understanding the current BB deployments and their risks.

The ultimate objective of the consultation and market diagnostics is to better understand how the market operates and to more accurately predict the market response to any changes in regulation. By following a "test and learn" approach of incrementally changing policies over time, SBP has the opportunity to respond to market observations and optimize the I-SIP linkages over time.[81] Such an iterative approach allows for gradual improvement in the overall outcomes as measured against the four I-SIP objectives. However, it also bears the risk of delaying impact by starting with overly conservative policies. In the worst case, a superior policy might not be tried if it would require a more radical, rather than incremental, change in approach (see Box 2).

Box 2: Incremental changes to banking regulation versus permitting nonbank e-money issuance

An example of the potential downside of an incremental approach is the decision by SBP to allow only a bank-based approach to BB. The Payment System and Electronic Fund Transfer Act (2007), which was promulgated the year before the Branchless Banking Regulations were first issued, authorizes the Central Bank to issue regulations for electronic-money (e-money) institutions and license them under the law. There is increasing evidence from other countries that such a tailored licensing regime for nonbank e-money issuers has the potential to increase competition in the market without unduly increasing the risks.[82] This could have been implemented as a complementary approach to a bank-based approach permitted under the Branchless Banking Regulations and would have allowed MNOs and other nonbanks to play a stronger role in providing BB services, as also recommended in a recent CGAP report "Interoperability and the Pathways towards Inclusive Retail Payments in Pakistan" (CGAP and Bankable Frontier Associates 2012). However, it would not have been in line with the approach of incrementally changing policies over time and would instead have required a big step with higher uncertainty about the impact on the SIP objectives.

An incremental "test and learn" approach is more likely to be used in cases of innovative policies, that is, of policies that have not been tried elsewhere (or at least not extensively). The introduction of a special legal framework for deposit-taking MFPs, of Branchless Banking Regulations, and of a specialized credit bureau for microfinance all fall into this category, because, at least at the time they were introduced, there was very little international experience to draw on.[83] In fact, most financial inclusion policies have at some point been innovative in the sense that they offered new solutions to meet the needs of previously excluded clients (or more appropriate solutions to existing clients). Because the market response to innovative policies is hard to predict, policy makers often prefer a more gradual,

[80] An example of this is the Microfinance Consultative Group, which was set up in 2001, and has since played a key role in discussing any legal changes to the regulation of MFBs.

[81] Also see Principle 7 of the G20 Principles for Innovative Financial Inclusion "Knowledge: Utilize improved data to make evidence based policy, measure progress, and consider an incremental 'test and learn' approach acceptable to both regulator and service provider" (Access Through Innovation Sub-Group 2010).

[82] Tarazi and Breloff (2010) discuss how to regulate nonbank e-money issuers.

[83] This is different for MCGF, as similar guarantee facilities had already been implemented many times before.

incremental approach. It is therefore not surprising that the three policy interventions considered to be innovative have also been those subject to the most frequent revisions (or, in the case of MF-CIB, subjected to a limited pilot before nationwide rollout).

5. Lessons for the I-SIP Methodology

The previous sections introduced the four policy interventions that were the subject of the Pakistan rapid research exercise and summarized the main observations from their analysis with regard to the process of identifying, managing, and optimizing linkages. This section discusses lessons from the Pakistan research for the I-SIP Methodology more generally. Section 5.1 discusses how linkage hypotheses, targets, and indicators might be used in policy making, while Section 5.2 revisits the I-SIP Propositions from the South Africa report in light of the new evidence from Pakistan.

5.1. Linkage hypotheses, targets, and indicators as tools in policy making

The ultimate objective of the I-SIP Methodology is not primarily to serve as a tool for researchers conducting similar rapid research exercises to the one conducted in Pakistan, but to be used by policy makers planning and implementing policy interventions. Pakistan represents only the second I-SIP rapid research exercise, and therefore, the evidence base is still relatively limited. It yields, nonetheless, new insights into how the I-SIP Methodology can be used as a tool in policy making.

The definition of linkage hypotheses for specific policy interventions as introduced in Section 2 can be one element of such a policy-making tool. At the beginning of the design phase for a new policy intervention—or when considering significant changes to an existing one—policy makers can engage in a structured exercise to identify the universe of linkages to be considered, which will help manage and optimize them.[84]

To do so effectively, policy makers must estimate the **materiality** of linkages so that they can focus on those that will likely have the strongest effect on I-SIP objectives (positive or negative) and ignore others that are expected to have only minor relevance. Drawing on the evidence from Pakistan, relevant factors SBP used to determine materiality include the following:

- **Value of transactions.** As far as stability is concerned, the value of transactions as a portion of the total assets is an important variable to examine. SBP was able to dismiss stability concerns regarding MCGF both with regard to the banks providing the funding or MFPs receiving the funds. The amount of money to be loaned via the fund was considered insignificant as a percentage of the total bank assets and the total liabilities of the borrowing MFBs.
- **Number of transactions.** There is a risk of dismissing impacts as immaterial simply because of their limited total value in relation to some relevant aggregate (e.g., total banking assets). However, the number of transactions enabled by a given policy intervention can still be high, thus affecting many people (positively or negatively) and therefore qualifying as material. SBP therefore tracks not only values, but also volumes of transactions. An example is SBP's recent increased interest in consumer protection measures for BB providers triggered by the exponential growth of BB transactions. Conversely, SBP has estimated certain potential linkages to be immaterial. For example, using the CNIC number as the unique identifier for loans reported to MF-CIB was considered not to lead to a material negative linkage with inclusion, because the coverage of CNICs was regarded as being sufficiently wide as to not lead to many loan customers being excluded.

[84] As similar interventions give rise to similar linkages even if implemented in different countries, it might be possible to build a "case library" of linkage hypotheses that can be used by countries implementing the same or similar types of policy interventions.

- **Transaction size.** SBP has considered integrity risks material for higher transaction sizes, which is in line with FATF's risk-based approach to AML/CFT (FATF 2013). Tiered KYC requirements for BB accounts permitting different transaction sizes on a daily, monthly, and yearly basis are an example of this and have been used to manage the linkage between inclusion and integrity.
- **Consequences if risks materialize.** In the case of "low-probability-high-impact" risks such as systemic risk, even a single incident can have grave consequences. For this reason, policies that increase such risks are always considered to have a material impact on I-SIP objectives. An example is the case of granting MFBs direct access to the clearinghouse: the systemic consequences of a possible default have been a major concern for SBP because insufficiencies at the level of the individual MFB could have repercussions for the entire clearing system. The likely impact of a risk also varies by product type. Deposit-taking activities, for example, are generally of a higher concern to SBP than lending activities, and therefore only regulated and supervised MFBs are permitted to offer savings products (which are, obviously, also important from an inclusion perspective).

Of course a positive effect on the primary objective(s) of a given policy intervention might not be sufficient in the eyes of the relevant policy makers. Both the regulatory frameworks for microfinance banks and BB were clearly targeted at financial inclusion and led to positive observed effects on this dimension (without tradeoffs with any of the other objectives). However, expectations were not fully met; SBP had perceived the potential impact on financial inclusion to be even higher. **Targets** based on a discussion of expected market responses can be used as an important benchmark to assess the success of a policy with regard to the I-SIP objectives. For some of the objectives, the target might simply be not to have a negative effect (e.g., no compromise on stability), while for the primary objective(s) it is more likely to be a specific positive effect.[85]

In addition to targets, **indicators** have to be defined to measure the effects with regard to these targets. As described in Section 2, a linkage optimization strategy requires continuous adjustment of policies based on observed effects. Predefined indicators allow for measuring the effects and targets for assessment purposes. Each of the four objectives can be measured by a multitude of indicators reflecting different aspects of the objective.

On the national level, the G20 has recommended a similar approach embodied in a set of 24 indicators measuring access, use, and quality of financial inclusion[86] and suggested the definition of clear targets for financial inclusion (CGAP and IFC 2013). The same could be done on the level of a specific policy intervention. Whenever a new policy is proposed, an important step will be to choose the most relevant indicators for measuring progress with regard to the I-SIP objectives. A precondition for identifying these indicators is to have clear definitions for each of the I-SIP objectives in the context of the specific policy intervention.[87]

The Pakistan rapid research exercise provides a few examples highlighting the challenges of measuring effects with regard to the I-SIP objectives and the potential role indicators can play:

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[85] A rare example from Pakistan is the target set in the 2007 Microfinance Strategy of MFPs reaching 3 million borrowers by 2010 SBP (2007a).

[86] See http://datatopics.worldbank.org/g20fidata/.

[87] This process of identifying indicators for each objective is similar to what has been described as the rationale-objectives-indicator approach in regulatory impact assessments. For a summary, see Staschen, Dermish, and Gidvani (2012).

- Stability, of course, is not only about preventing individual institutions from failing (the microprudential dimension, which is closely related to the consumer protection objective that is the P in I-SIP), it is also about preventing risk affecting individual institutions, from spreading across a number of institutions or even affecting the entire financial sector (the macroprudential dimension). Measuring changes in systemic risk with reference to the observed effects of a given policy intervention can be a challenge, as the fact that nothing has happened could be due to good fortune or could be an indication of sufficient safeguards. Defining indicators that sufficiently measure the stability dimension of a given intervention is therefore subject to inherent limitations.[88] Institutional arrangements such as deposit insurance or access to a lender of last resort facility (in the case of deposit-taking financial institutions) might be at least as important as the performance of microprudential indicators such as capital and profitability ratios.
- In comparison, it is quite straightforward to measure access and use of financial services (as SBP's quarterly Branchless Banking Newsletters exemplifies well). It is more difficult to measure progress with regard to the quality of the financial inclusion enabled by a given intervention.[89] The BB case is a good example of this, where more guidance would have been useful on the question of whether OTC transactions have the same or a lower utility for customers than transactions involving the use of a mobile wallet.
- Integrity and protection are inherently more difficult to measure than inclusion (at least as measured by access and use). Yet steps are possible beyond those that were taken in Pakistan. In the BB case, for example, one important element of the revision of the regulations in 2011 was relaxing identification requirements for account openings. This relaxation could have been followed by closer monitoring of AML risks, separating BB transactions from traditional banking transactions in the STR form to measure the extent of integrity risks introduced through BB. Similarly, with regard to consumer protection, SBP receives monthly reports about consumer complaints concerning BB channels, but does not currently analyze these systematically.
- There is a risk of underestimating some linkages that can have a substantial effect on financial inclusion. In Pakistan, the positive effect of bringing more people into the formal financial sector and making their transactions traceable has not been sufficiently taken into account when assessing changes in integrity risks. FATF (2013) now explicitly recognizes the positive impact entry-level banking or other financial products can have on the effectiveness of AML/CFT policies. In a similar vein, clients being served by the formal sector typically enjoy better protection than those having to rely on informal services, which are not subject to any consumer protection rules.
- Commendably, SBP has managed changes in the materiality of risks triggered by the increased scale of operations (both in BB and in regard to MFBs). Nonetheless, there is room to improve I-SIP linkage management by comparing the volume and value of operations to benchmarking indicators. Examples of possible indicators include the value of BB accounts as a share of total liabilities of a financial institution, the total value of BB transactions in relation to some market aggregates such as GDP, or the total number of BB clients as a share of the overall population. In

[88] Profitability, solvency, and liquidity can be used as indicators for stability, but they are not sufficient to predict the risk of contagion among institutions, which can even affect safe and sound institutions.

[89] In September 2013, the G20 leaders endorsed an enhanced set of financial inclusion indicators that not only measure access and use, but also quality of financial inclusion. See http://www.gpfi.org/news/g20-leaders-endorse-enhanced-financial-inclusion-indicators.

relation to the size of the financially excluded population, BB has made only minor inroads. According to the Financial Inclusion Tracker Surveys Project, in mid-2012 only 5 percent of households had a mobile-money user among its household members (a figure that also includes customers who exclusively engage in OTC transactions), and only 0.3 percent of respondents had a registered BB account holder in the household.[90] In regard to the credit guarantee facility, SBP did not set a limit for banks' lending under MCGF as a share of its total advances, although this would seem to be a useful indicator for the total risk exposure under the guarantee scheme.

A linkage optimization strategy will be possible only if the objectives and relevant indicators are clearly defined and monitored over time.

5.2. Refining the I-SIP Propositions

The South Africa I-SIP report summarized the I-SIP Methodology in seven "guidance statements" (see Annex 3). As observed, the Pakistan research—and grappling further with the challenges to I-SIP analysis summarized in Part 2—precipitated revisiting the term "guidance statements" and the substitution of the term "I-SIP Propositions"—a term that more accurately reflects the current state of knowledge (and mitigates the risk of confusion with guidance published by, for example, global standard-setting bodies).

Box 3: Revised I-SIP Propositions

The following propositions are intended to support regulators and policy makers—both in the design and implementation of a policy intervention—in identifying, managing, and optimizing the potential linkages among the objectives of financial inclusion, financial stability, integrity, and consumer protection (collectively called the I-SIP objectives).

1. Clear definitions for each of the I-SIP objectives at the national level and at the level of specific policy interventions are needed to guide policy makers in policy design. The definitions on the policy intervention level should be detailed enough to allow for measuring the effects of the intervention with regard to I-SIP objectives.
2. A structured approach to identifying material linkages among I-SIP objectives that may arise in the implementation of a specific policy intervention helps to manage and optimize linkages, thereby avoiding false or unnecessary tradeoffs between objectives and maximizing synergies among them.
3. Inter- and intra-agency collaboration is critical to design, monitor, and adapt policy interventions to optimize the linkages among I-SIP objectives, as well as linkages with national objectives beyond I-SIP objectives.
4. Regularly collected and analyzed data based on indicators and targets specific to a given policy intervention enable the monitoring of its effects on I-SIP objectives and the calibration of linkages over time.
5. Periodic structured consultation with providers in proportion to the scale of the proposed changes helps to identify and manage linkages as the market develops.
6. Optimization of I-SIP linkages requires a commitment by policy makers to manage I-SIP linkages by adapting policy and regulation as necessary in light of the data and other evidence collected and effects observed.

[90] See http://m-moneydata.org.

These propositions have been revised based on the I-SIP rapid research exercise in Pakistan and the additional four policy interventions that have been analyzed. This section introduces the revised I-SIP Propositions (as summarized in Box 3) reflecting the collective evidence from South Africa and Pakistan, and discusses each I-SIP Proposition with examples and insights from the Pakistan cases.[91]

I-SIP Proposition 1: Clear definitions for each of the I-SIP objectives at the national level and at the level of specific policy interventions are needed to guide policy makers in policy design. The definitions on the policy intervention level should be detailed enough to allow for measuring the effects of the intervention with regard to I-SIP objectives.

While South Africa has defined financial inclusion and the other I-SIP objectives at the national level in general ways in its policy documents, in Pakistan such definitions are lacking. The Pakistan experience shows on the one hand that progress can be made on financial inclusion—and without significant observed adverse effects on the other I-SIP objectives—even in the absence of such definitions.

On the other hand, the Pakistan experience also exemplifies the challenges of managing and optimizing the I-SIP linkages without clear definitions at the national and specific policy intervention level. The lack of national level definitions (see Section 4.1) did not allow defining the contribution of a specific policy intervention to the broad-based I-SIP objectives. While all four policy interventions were expected to have a positive effect on financial inclusion, which aspect of financial inclusion (type of product and services, specific segment of the population, etc.) was to be promoted was not defined in more detail.

Explicit definitions on the policy intervention level do not exist either. However, implicit definitions do exist, as can be seen from the specific rules cited in law. An example of this is the rules for MFBs on the maximum income of borrowers and their maximum loan exposure, which restricts the reach of MFBs to a specific target group with limited income and a demand for loans up to a certain size. Similarly, the Branchless Banking Regulations have set transaction limits for different types of accounts. While these limits have been the subject of controversy over the years, they have provided guidance to the sector on what SBP understands as inclusive financial services. In both cases, the definitions in the regulations have not necessarily been driven only by an interest in advancing financial inclusion.[92]

The advantage of clear definitions on the policy intervention level is that they form the basis for the setting of specific indicators and targets (see I-SIP Proposition 4) and thus the monitoring of progress against I-SIP objectives. Without clear definitions, the progress on inclusion and the linkages with the other I-SIP objectives cannot be effectively monitored and, in turn, linkages cannot be effectively managed or optimized. An example of this is the question of the effect of BB on inclusion, which requires an assessment of how much more utility BB accounts have for clients compared to the utility for clients who only make OTC transactions (see Section 3.2.3).

I-SIP Proposition 2: A structured approach to identifying material linkages among I-SIP objectives that may arise in the implementation of a specific policy intervention helps to manage and optimize linkages, thereby avoiding false or unnecessary tradeoffs between objectives and maximizing synergies among them.

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[91]The order of the I-SIP Propositions has also changed to reflect a recommended order in which policy makers should consider them, although in some contexts a different order could be indicated.

[92] The limits for MFBs, for example, have been set not only to prevent mission drift of MFBs by serving better-off loan clients, but also to reduce the risk of regulatory arbitrage. The transaction limits for BB also serve the important purpose of putting a cap on the overall risk exposure of clients and minimizing AML/CFT risks.

SBP has been good at identifying the most relevant linkages among the four policy interventions analyzed as part of the I-SIP research in Pakistan. The single most important linkage for SBP has been potential tradeoffs between inclusion and stability because SBP was very clear that financial inclusion initiatives must not lead to a compromise on stability. Linkages with consumer protection have received the least attention. Synergies between inclusion on the one hand and integrity and protection on the other hand brought about by integrating customers into the formal financial sector (enabling at least minimal consumer protection and transaction monitoring impossible in the information sector) have not consistently been taken into account.

SBP could benefit from a more explicit and systematic approach in identifying and managing linkages. While tradeoffs have for the most part been avoided, such an approach might have led to even stronger synergies. The suggested instrument of using linkage hypotheses (see Section 2) can play an important role in this, according to which policy makers systematically identify the universe of potential linkages that might be triggered by a specific policy intervention in advance of any policy change. To manage and optimize linkages, policy makers need to focus on those linkages estimated to be most material. SBP has thus far not taken a systematic approach to estimating the materiality of linkages, and doing so in the future has the potential to improve their capacity to manage and optimize I-SIP linkages.

I-SIP Proposition 3: Inter- and intra-agency collaboration is critical to design, monitor, and adapt policy interventions to optimize the linkages among I-SIP objectives, as well as linkages with national objectives beyond I-SIP objectives.

The degree of interagency and intra-agency collaboration required clearly depends on the allocation of public mandates with regard to the I-SIP objectives. Unlike in South Africa, where the main responsibility for different cases rested with different agencies (CGAP 2012), in Pakistan the main responsibility for all the studied cases as well as all four I-SIP objectives rests with SBP. The collaboration among different departments within SBP thus plays an essential role.[93] As described in Section 3.1, the I-SIP objectives are reflected in the departmental structure so that in all policy interventions more than one department was involved. Collaboration among different SBP departments appears to have been weakest with regard to the Consumer Protection Department, which has only limited involvement on consumer protection issues of BB services and could have played a stronger role in understanding the linkages between a credit information bureau and consumer protection.[94]

Still, there are a few examples underlining the importance of interagency collaboration. One such case is MF-CIB, where collaboration is indeed happening and seems to work well. Here SBP's main role is that of a funding agency and of an advocate making use of its soft power, while PMN is taking the lead in implementation and the Pakistan Poverty Alleviation Fund is using its leverage over MFPs to increase MFPs' participation in MF-CIB.

Some of the ministries have been involved in the early stages of policy making (e.g., the Ministry of Information Technology with regard to BB and the Ministry of Finance with regard to the Microfinance Institution Ordinance), yet this was less about identifying linkages and more about getting the necessary political support. A few specific issues require interagency collaboration with other regulators and are

[93] The Financial Monitoring Unit, an independent body housed at SBP, plays a limited role in AML/CFT supervision. It is in charge of receiving and analyzing suspicious transaction and currency transaction reports, while AML/CFT regulations are issued by the respective regulatory authority (SBP or SECP).

[94] Precisely because of these linkages eCIB is housed in the Consumer Protection Department, which is different for MF-CIB, which is managed by PMN, a private industry association.

directly relevant for linkage optimization. One example is the role of the National ID authority, NADRA, in verifying CNICs for AML/CFT purposes, which still has not been resolved satisfactorily.[95]

One conclusion from the South Africa rapid research exercise was that not only linkages among I-SIP objectives could be relevant, but also linkages with national objectives beyond I-SIP. In the case of South Africa this included high-level objectives of economic policy generally, such as improved efficiency and growth, as well was the post-Apartheid objective of black economic empowerment. Such national objectives did not feature prominently in the four cases analyzed as part of the Pakistan research. One reason for this could be that all of the cases were genuine financial inclusion objectives, and that SBP is clearly the lead agency with regard to financial inclusion. The fact that SBP has regarded financial inclusion as such an important objective of its work is a sign of the strong political support the topic has received over the years.

I-SIP Proposition 4: Regularly collected and analyzed data based on indicators and targets specific to a given policy intervention enable the monitoring of its effects on I-SIP objectives and the calibration of linkages over time.

For each policy intervention, specific data needs should be defined based on a clear definition of the I-SIP objectives to be pursued by the intervention (as described in I-SIP Proposition 1). Progress on any of the I-SIP objectives can be measured by defining clear targets and indicators and tracking these over time. Ideally, data on the same indicators would be collected predating the policy intervention, which allows for estimating the effect of the intervention.[96] In Pakistan, explicit definitions on the policy intervention level do not exist (see I-SIP Proposition 1), and SBP has also generally not set specific indicators and targets that policy interventions are expected to achieve.

As a result, while different departments within SBP and also the Financial Monitoring Unit collect comprehensive data relevant to all four objectives and all four policy interventions analyzed here, these data are not necessarily the most relevant or put to their best use. Without agreed indicators and targets, data gathering will be inefficient and possibly ineffective as a means of monitoring effects on the I-SIP objectives and calibration of linkages over time. SBP has not linked indicators tracked as part of its general offsite surveillance to specific policy objectives.[97]

A particular challenge is that reporting is frequently fragmented among different departments, with each department focusing on issues specific to its mandate (a reminder of the importance of intra-agency collaboration highlighted in I-SIP Proposition 3). For example, the Banking Policy & Regulation Department receives monthly reports on customer complaints and fraud and forgeries in connection with BB, but it does not systematically analyze the data, and the Consumer Protection Department does not review it on a regular basis.

An example of a data collection exercise that has benefitted from continuous revisions of the indicators being tracked as specific data needs became apparent is the quarterly Branchless Banking Newsletter, which is a globally unique publication on the state of branchless banking. While the newsletter was initially lacking key indicators to measure certain aspects of financial inclusion, these have been added over time (e.g., the addition of an indicator looking at the share of OTC versus wallet-based transactions

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[95] CGAP has recently facilitated discussions among NADRA, SBP, and the industry to solve this issue.

[96] It is not sufficient to look only at changes in indicators to estimate effects of a policy, but instead at changes of trends (difference-in-differences approach). See Staschen, Dermish, and Gidvani (2012).

[97] The one exception is the target of 3 million borrowers to be reached by 2010, which has frequently been used as a reference to prove that expectations regarding microfinance outreach have not been met.

to measure the utility of BB transactions and the more recent addition of an indicator looking at the number of unique agent locations to measure their geographic reach—see Section 3.2.3).[98]

I-SIP Proposition 5: Periodic structured consultation with providers in proportion to the scale of the proposed changes helps to identify and manage linkages as the market develops.

The consultative approach is a hallmark of SBP policy making, as is widely acknowledged by industry actors. Consultation with providers was featured in all four of the policy interventions studied and plays a central role in SBP's approach of incremental policy change over time. In the BB and MFB regulation cases, consultative groups with wide industry participation were set up and have been meeting regularly since. For MCGF, SBP had intensive consultations with banks, which led to structuring the facility to be sufficiently attractive to banks in order to induce them to participate, but it also needed to be acceptable to SBP. Regarding MF-CIB, industry consultation has been conducted via the PMN (of which both MFIs and MFBs are part) as the main implementing agency, which in turn coordinates closely with SBP's Agricultural Credit & Microfinance Department. In addition, SBP routinely publishes new regulations for comment before they are issued.

Notwithstanding this highly consultative approach, the rapid research exercise uncovered no indications of regulatory capture. SBP has maintained its distance when it thought it necessary to make tough decisions (such as increases in minimum capital requirements for MFBs).

The consultations have helped SBP to better understand the likely market response to regulatory changes and to address any potential tradeoffs between I-SIP objectives by lowering any barriers to entry or removing any regulatory provisions that were not proportional to their expected benefit. An example of this is the tradeoff between inclusion and integrity in the BB case, where SBP responded to industry concerns with regard to high cost of customer identification by lowering the requirements in a way that did not at the same time lead to any observable increase in integrity risks.

I-SIP Proposition 6: Optimization of I-SIP linkages requires a commitment by policy makers to manage I-SIP linkages by adapting policy and regulation as necessary in light of the data and other evidence collected and effects observed.

All of the *ex post* policy interventions studied have gone through several rounds of revisions based on the assessment of market responses and consultations with the industry.[99] There are several examples of SBP acknowledging linkages between I-SIP objectives by adapting regulation. In both the BB and MFB cases, when observed effects on financial inclusion remained behind expectations, SBP responded by lowering KYC requirements (in the BB case) and relaxing some of the provisions for MFBs such as the limitation to lend only to poor persons and the permission to build provisions net of gold. This is what is described as incremental optimization of the I-SIP linkages (see Section 4.3).

Such an approach of gradual adaptation has proven to be even more important in cases where the initial policy was relatively conservative with a strong focus on stability (such as the Branchless Banking Regulations and some elements of the regulatory framework for MFBs). However, it is important to

[98] A potential downside of frequent revisions is that providers incur additional compliance costs in generating the respective data fields.

[99] The only exception is MF-CIB, which is treated in this report as an *ex ante* case given it has not been in place long enough for its effects on the I-SIP objectives to be observed.

mention that SBP has not only relaxed provisions over time, but it has also appropriately strengthened some of them (e.g., the minimum capital requirements in response to a maturing sector).[100]

[100] SBP also has current plans to strengthen consumer protection rules for BB and MFBs and to monitor the agent channel of BB more closely.

Annex 1: List of interviews

Organization	Date
SBP: Agricultural Credit & Microfinance Department	25 March 2013
SBP: Payment System, Banking Policy & Regulation, Supervision & Inspection, and Consumer Protection Departments	26 March 2013
Financial Monitoring Unit	
Tameer Microfinance Bank	27 March 2013
United Bank	
Monet	
Khushhali Bank	28 March 2013
Pakistan Telecommunication Authority	
Waseela MFB	
Mobilink	
Telenor	
SBP: Agricultural Credit & Microfinance Department	29 March 2013
SBP: Agricultural Credit & Microfinance and Islamic Banking Departments	15 July 2013
Tameer MFB	16 July 2013
MCB Bank	
Standard Chartered Bank	
DataCheck	
Pakistan Microfinance Network	
Habib Bank	17 July 2013
United Bank	
JS Bank	
SBP: Consumer Protection, Banking Inspection and Legal Services Departments	
Kashf Foundation	18 July 2013
Kashf MFB	
DAMEN	19 July 2013
Community Support Concern	
Ministry of Finance	22 July 2013
Khushhali Bank	
NADRA	
First MFB	
Pakistan Poverty Alleviation Fund	23 July 2013
BRAC Pakistan	
DFID Pakistan	
Pakistan Microfinance Network	
NRSP MFB	24 July 2013

Annex 2: Linkage hypotheses for introducing a new microfinance law

The following table provides an example of the visualization of linkage hypotheses for the case of introducing a special law for deposit-taking MFIs.[101] The bolded cells show the direct effects of the policy (in this case the only direct effect is on inclusion), while the other cells show positive (upper right part) or negative (lower left part) linkages among I-SIP objectives. It does not mean that each of the linkages has actually materialized in Pakistan, but only that these linkages can potentially occur when introducing a special legal framework for MFBs and permitting MFBs to get direct access to the clearinghouse.

	Inclusion	***Stability***	***Integrity***	***Protection***	
Inclusion	- New retail financial service providers - Savings as new product - Savings as a new source of funding	- New type of deposit-taking institutions subject to lower regulatory requirements in some areas increases stability risks - Nondeposit-taking MFIs remain unregulated and can create spillover effects to deposit-taking MFIs - Direct access to the clearinghouse increases settlement risk	- Identification requirements and other AML/CFT compliance costs curtail client access	- Consumer protection standards drive up costs	**Potential tradeoffs**
Stability	- Transformation of existing MFIs into regulated institutions improve their soundness through new regulatory standards. - Retail deposit-taking as a new stable source of funding				
Integrity	- Clients are brought into the formal sector thereby increasing traceability of transactions				
Protection	- Clients of regulated MFIs benefit from higher consumer protection standards than in the informal sector	- Increased stability of MFIs protects clients against loss of funds	- Integrity standards protect clients against fraud		
	Potential synergies				

[101] Table adapted from Genesis Analytics (2004).

Annex 3: I-SIP Guidance Statements from South Africa

1. A proportionate approach first requires inter-agency collaboration to identify the linkages between a proposed policy and I-SIP objectives, as well as with national objectives beyond I-SIP.
2. A linkage framework is a structured approach to identify and assess the potential risks and benefits of defined policy objectives that arise in the implementation of a specific measure. A linkage framework enables linkages to be optimized, helping to avoid false or unnecessary tradeoffs between objectives and to maximize synergies among them.
3. A clear definitional framework for financial inclusion that includes definitions at the national, policy and product levels is needed to establish priorities, to avoid both irresponsible and misguided inclusion, and to measure progress.
4. Segmenting the market according to whether clients are currently served with formal financial services, within reach of but not using formal financial services, outside the current reach of formal financial services, or 'self-excluded' improves the understanding and calibration of the I-SIP linkages.
5. Policy relevant data should be collected on a regular basis to calibrate linkages *ex ante* and then monitor them in practice.
6. Structured consultation with providers in proportion to the scale of the proposed changes helps to identify and understand linkages.
7. Optimization of I-SIP linkages requires a commitment by policy makers to adapt policy and regulation over time in light of the evidence collected and outcomes observed

Source: CGAP (2012)

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