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Branchless Banking for Inclusive Finance: Challenges & Opportunities

Denise Dias
Policy Advisory Consultant
denise@denisedias.com
1-202-731-0694

Agenda

- CGAP and CGAP Technology Program
- Branchless banking: overview
- Regulatory Diagnostics (Jan. – June 2007)
- Models of Branchless Banking
- Fostering market development

CGAP: Who we are

- Global resource center on access to finance issues
- Established 1995
- 33 members, housed at World Bank
- Incubate innovations, set standards, convene stakeholders
- G8 adopted CGAP Key Principles of Microfinance (2004)
- Four year Technology Program

Technology Program

Systematic, strategic research through large-scale experiments with financial services providers

- $26m program (over 4 years) with Gates Foundation co-funding
- Incubate new approaches through advice and support to 20-30 banks, telcos, MFIs
- 10-15 "branchless banking" policy diagnostics
- Communicate lessons learned broadly to stimulate the market

What are the factors that limit access?

- High distances / low population density
- Low income relative to cost of service
- Low education and illiteracy
- Lack of credit history
- Poor product / channel design
- Narrow range of products offered

Technology approaches may overcome these constraints

CGAP Technology Program focus areas

Regulation
- 7-country study (DFID,GSMA)
- Follow-up with local champions

Business models
- CGAP projects (Gates)
- Advising market actors

Customer adoption
- Customer demand profiling
- Client interface research

Branchless banking: what do we mean?

Use of information technology to deliver financial services to low income people beyond traditional banking channels and making use of non-bank retail agents

Bank

Sample withdrawal transaction

1. Agent balance

4. Settle accounts

Agent

2. KYC docs

3. Cash + receipt

Client

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Benefits along the value chain

Bank

- Leverage agents' infrastructure: minimize capex to expand
- Change economics of serving poorer clients, remote areas
- Enables rapid drive to high-volume required for profitable payments business

Agent

- Increase walk-in business
- Decrease cash-on hand
- Fee revenue from bank
- Differentiated service offer
- Bank brand strength rubs off

Client

- Proximity of service point: saved time and cost
- Comfort of dealing with corner merchant
- Low-income prize safety: access to services via regulated entity

Diagnostics (Jan. – June 2007)

- Joint DFID-CGAP-GSMA template
- 20 GSMA “level 1” reviews
- 7 in-country reviews: Brazil, Kenya, India, Pakistan, Philippines, Russia, South Africa
- In-country interviews with industry, MFIs, regulators, policymakers, consumer advocates
- Understand and advocate for balanced regulatory approach
- Notes on Branchless Banking
- Feedback already to regulators (Pakistan Notes & Roundtable, Kenya Banking Bill)

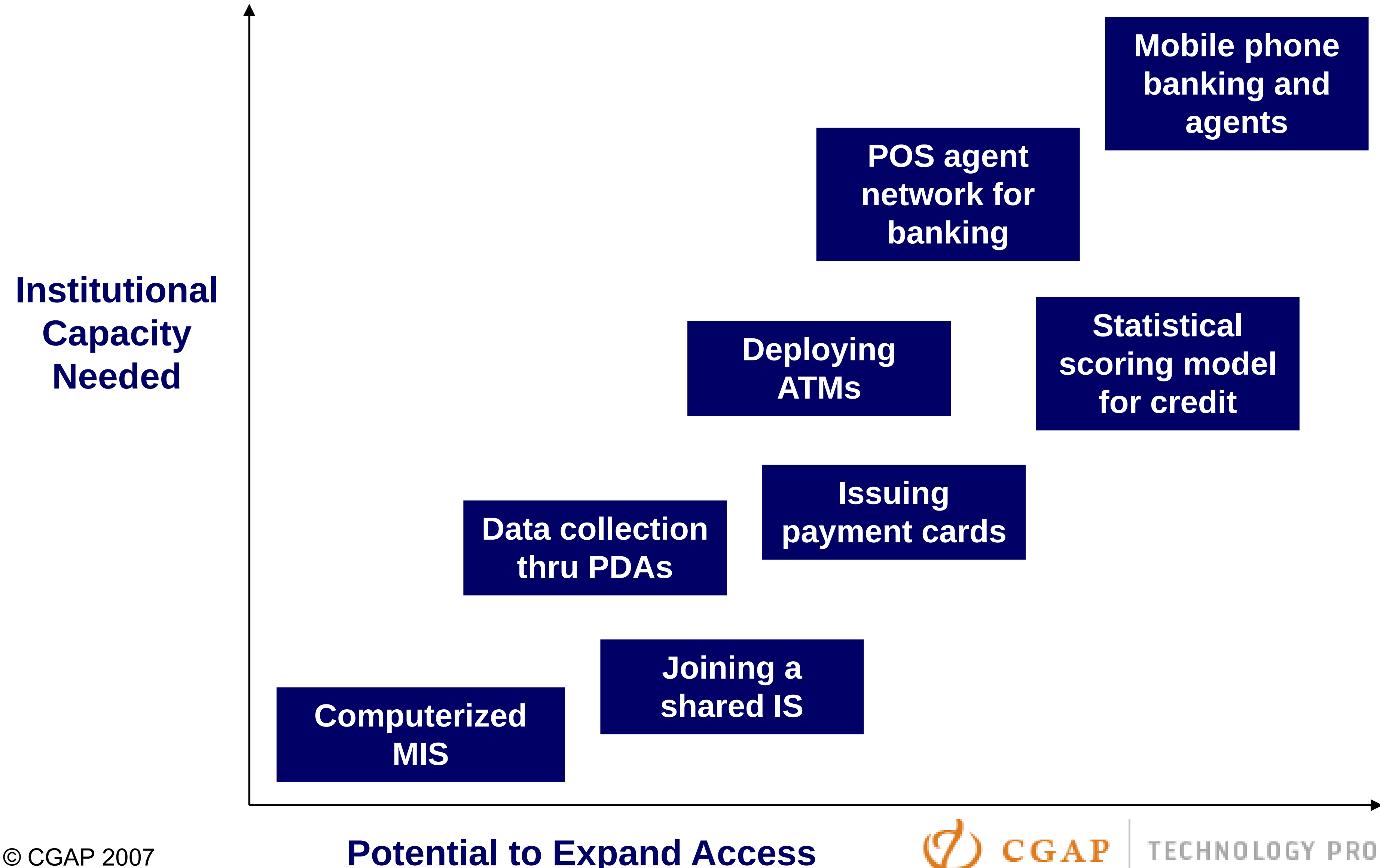
Questions to date

- Which approach(es) will endure? → Business models
- Which have potential for A2F? → Client uptake
- How should regulators respond? → Regulation

Diagnostics aimed at three questions:

How are regulators responding?
Are these responses effective?
What can we recommend?

Which technology approaches?



Branchless Banking for the Poor

Bank-based

- Leveraging agents
- Account opening

Nonbank-based

- Leveraging agents
- Account opening

and…

- E-money
- Payment systems

Other issues: Consumer protection, Data security, Competition, Taxation, FX controls, Telco regulation

Transformative vs. additive models

Thumbnail sketch - Brazil

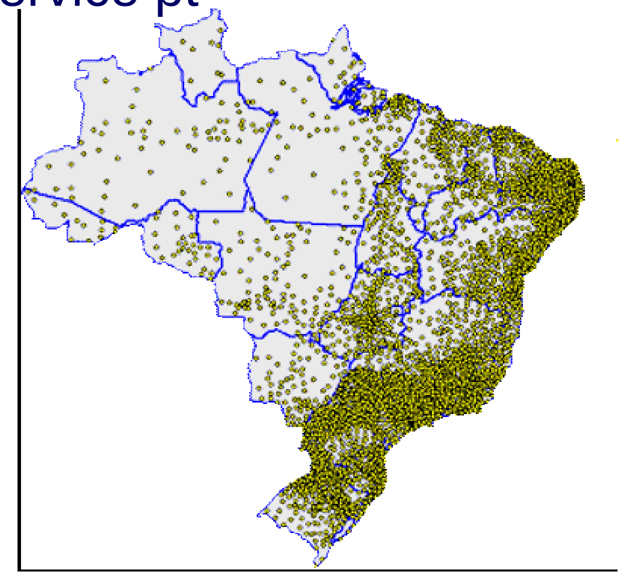
- Bank-based model
- Banking regulations amended (over time) to permit contracts with virtually *any* kind of retail agent
- Wide range of activities to be outsourced: Cash-in/out, KYC, even loan underwriting
- Customers protected because bank is liable for its agents' actions
- Supervisor has authority to inspect agents (in theory)

Business model Brazil: Bank-based

CAIXA

Market impact of BCs

- Reach all 5561 municipalities
- 12 mil accounts opened ’02-’05
- US$ 90 billion in transactions
- 1.5 billion transactions
- Replaced branches as #1 service pt



Regulatory concerns when using agents

- New risk structure:
  - Credit risk
  - Operational risk
  - Liquidity risk
  - Legal risk
  - Reputational risk

- Consumer protection against losses caused by retail agent structure (e.g., fraud, negligence, bankruptcy)
- Anti-money laundering and combating of financing of terrorism
- Supervision of banking agents

Business models Philippines: Bank-based and nonbank-based

Smart Money

- Launch Dec. 2000, ~ 4 mil clients
- Facilitator, not competitor, to banks
- Mastercard debit card + mobile
- 2800 “fulfillment centers” + MC merchants and ATMs
- GMT pilot with mobile remittances

GCash

- Nonbank-based, with e-wallet and pooled deposits
- Launch 2004, ~ 1 mil clients
- GXI regulated as remittance provider and via letters w/ BSP
- 6000 cash-in/out merchants regulated as remittance agents
- Partnership with rural banks

Source: interviews with GXI, Smart, April 2007

Regulation: Philippines

Regulator engaged, but flexible → GXI: remittance agent; Smart: broad outsourcing

But don’t deal w/ e-money → 1:1 match, funds use

KYC a potential bottleneck → <1% of potential agents

Business model Kenya: Nonbank-based

M-PESA
easy.fast.safe

- 250.000 clients, 400 agents, >500m deposit/withdrawals after four months of operations
- ½ the cost of Western Union
- CBK didn't raise objections
- Largely unregulated as
  - not regarded as banking business
  - no payments law
  - no AML/CFT law covering non-banks

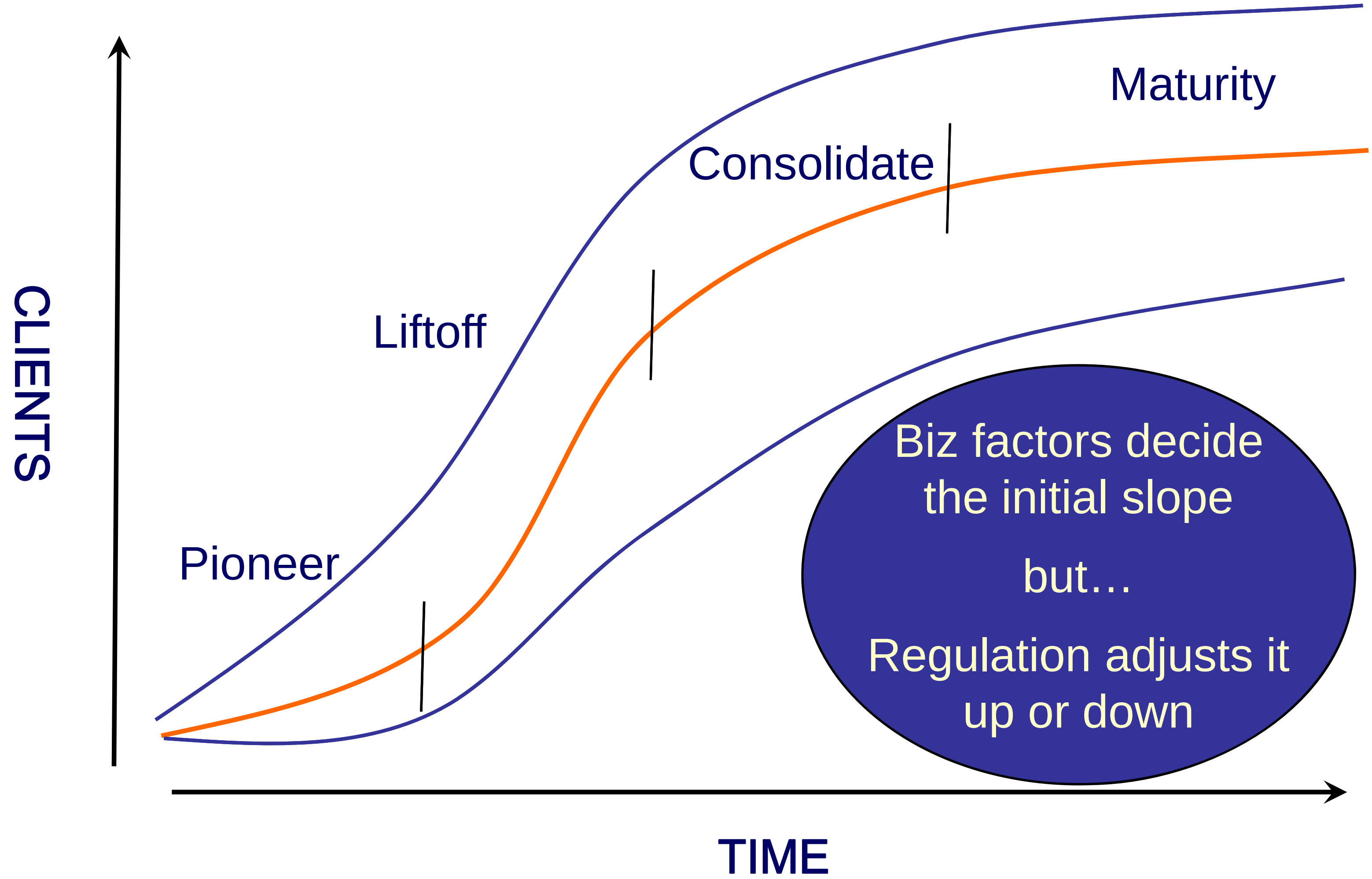
Fostering market development

- Balance openness to innovation with adequate protections for consumers and financial system
- Engage providers, understand risks and how provider proposes to mitigate them
- Avoid prescribing a particular model, rather analyze models presented from the market

Fostering market development

- Competition in retail payment systems
- Pricing structure can affect expansion of network and access
- Lack of interoperability hinders expansion

Market development: what decides the future?

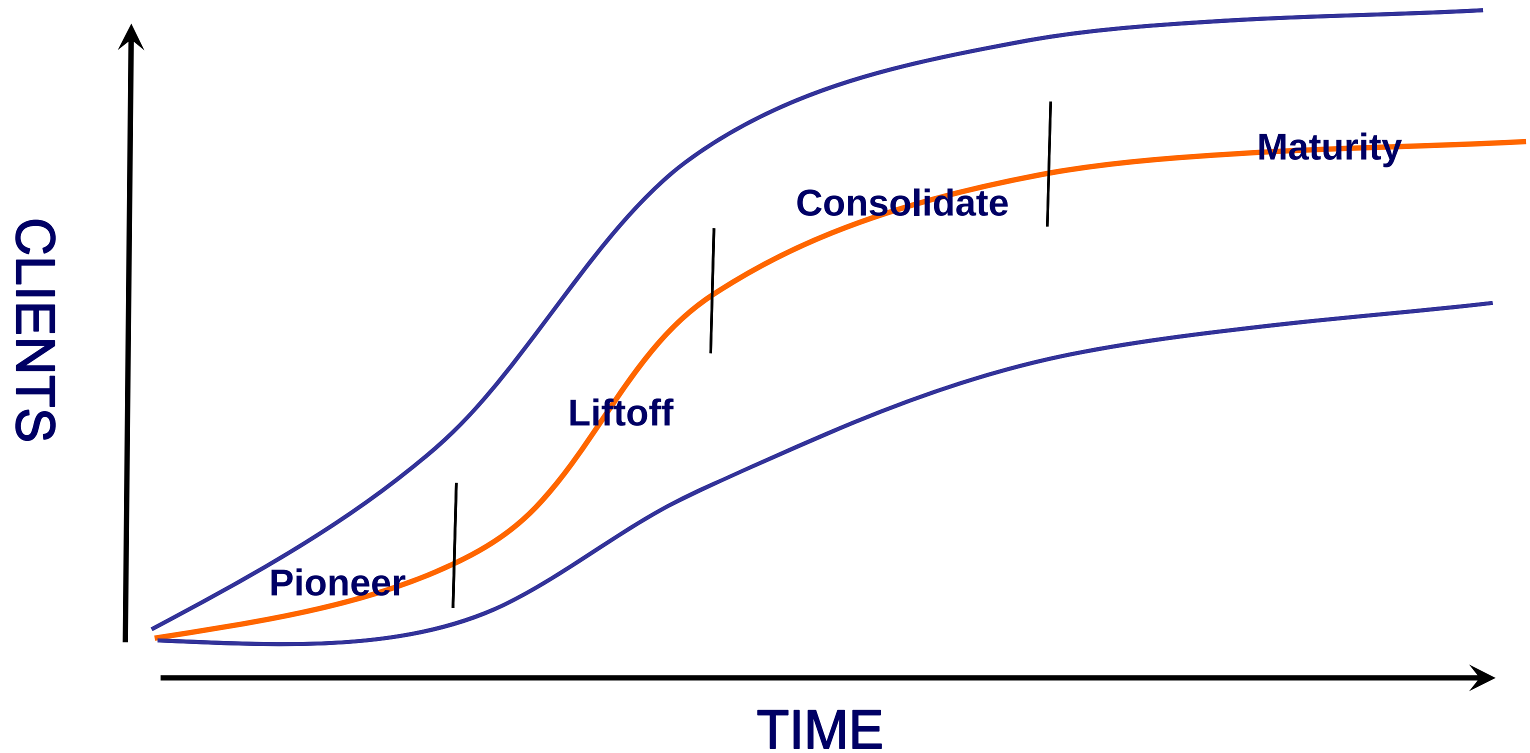


Biz factors

- Technology penetration
- Competition
- Risk profile of players
- Literacy
- Language
- Familiarity with mobile

Source: CGAP analysis

Regulation: fostering and sustaining growth



Pioneer Phase

-Who can participate?

- Transformative models possible?

Liftoff

- Clients can meet KYC requirements
- Interoperability
- Consumer protection & data privacy

Source: CGAP analysis

Some conclusions

1. Regulators have interest in BB to improve access
2. Existing regulation is over- and under-protective
3. Regulation should balance openness to innovation with adequate protections for consumers and financial system (open **and** safe)
4. Engage providers, flexible and hands-on responses

Theme 2: Existing Regimes

Existing regulation is both
over- and under-protective.

Overprotective

- Tight control over deposit taking (sometimes payments)
- Rules-based and law-enforcement orientation to AML/CFT

Underprotective

- Lack of payment system law
- Lack of e-commerce laws
- Lack of coordination mechanisms among policymakers

Theme 3: Rapid and Safe

Regulation should promote *rapid* and *safe* scaling-up of branchless banking

Rapid: Provide space for experiments to scale-up into durable offerings that shift the access frontier

Safe: Prevent avoidable disasters which damage credibility of BB with public and regulators.

PayPal? *OR* Moneta Cash?

Theme 3: Rapid

For BB to scale-up rapidly…

Understand *appetite for innovation*

- Appetite: in many markets weak among traditional banks, stronger among MNOs and banks with social dimension
- Attraction is new clients, reduced costs

Law and regulation *open* and *clear* on key features of BB:

- Use of electronic channels
- Outsourcing to agents
- Client acquisition by new avenues, using risk-based KYC
- Appropriate role for nonbanks

Theme 3: Safe

For BB to scale-up safely…

Safeguard *confidence:* the public (and regulators) must have for BB models to become trusted ways to pay and bank.

Preventing the *avoidable disaster:*

- Highly publicized loss of funds
- Large-scale breach of data privacy
- Botched prosecution due to non-recognition of e-signatures
- Low-level but systemic fraud or theft at agents

Theme 4: Hands-on but flexible response

Developing appropriate regulation likely to be iterative, learning process

- *Value of engagement with providers:* New business models come with new or heightened old risks, and new ways to manage both.
- New players, new models and new risks call for *flexible responses* moving towards *clear guidance*
- Avoid *"over-protection"* that blunts the business case

CGAP

Building Financial Systems for the Poor

Thank you!

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DGDC

1818 H Street, N.W.
Washington, DC 20433
Internet : www.cgap.org
Email: cgap@worldbank.org
Telephone: +1.202.473.9594

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