Malik Asim Mansur, 2008 CGAP Photo Contest

George Haddad, 2012 CGAP Photo Contest

INCLUSION
STABILITY
INTEGRITY
CONSUMER
PROTECTION

Mohammad Gouda, 2013 CGAP Photo Contest

Highlights from the 5th Arab Policy Forum

10-11 December 2013 | Abu Dhabi, UAE

Contents

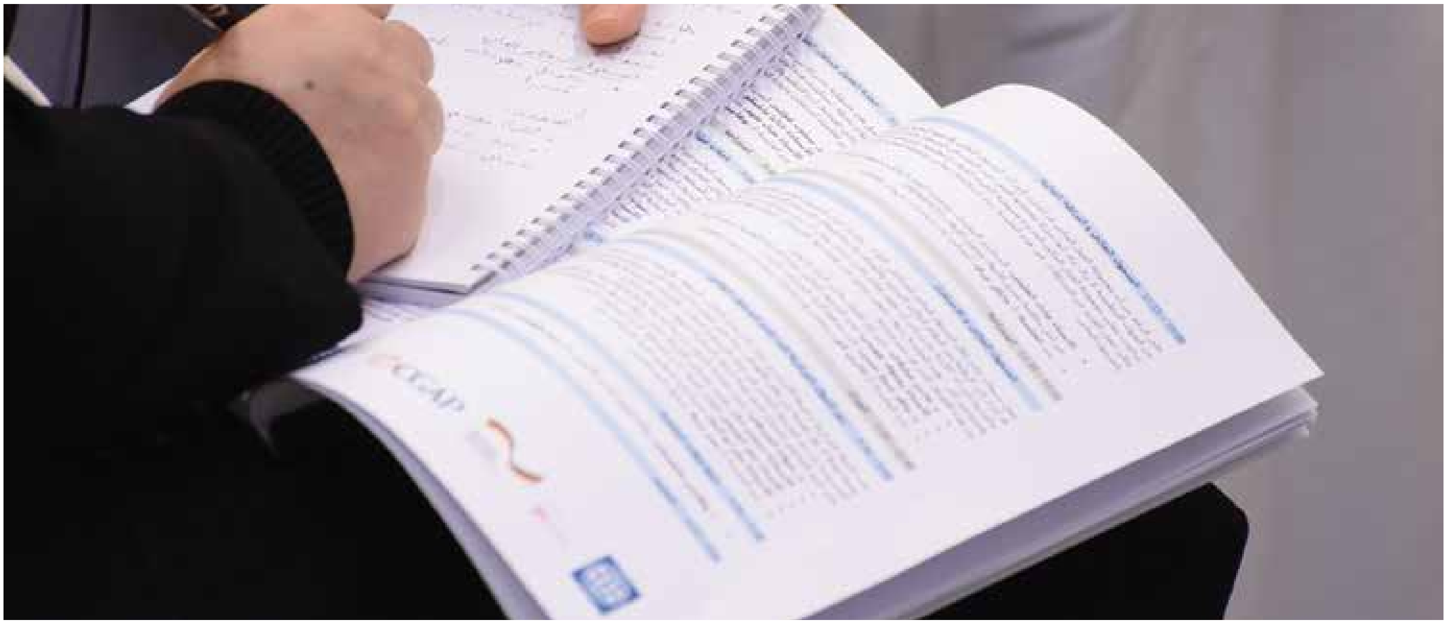


Photo: Arab Monetary Fund

Introduction

What unites the Arab World's top government leaders? Ask participants at a recent forum hosting the region's best and brightest public servants, and you will hear a consistent theme: Arab countries need to make their societies more inclusive to more of their citizens. And financial systems are no exception.

That's why more than 70 policy makers—representing central banks, ministries of finance, and financial regulatory, supervisory, and standard-setting bodies (SSBs) from the Arab World—came together at the 5th Arab Policy Forum on Financial Inclusion. The forum, held on December 10-11, 2013 in Abu Dhabi, was jointly organized by the Arab Monetary Fund, the Consultative Group to Assist the Poor (CGAP), the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH, and the World Bank.

The aim of the forum was to work toward a common vision for achieving more inclusive—and more equitable—financial systems in the region. Using the I-SIP framework developed by CGAP and others for the Global Partnership for financial inclusion (GPFI),[1] participants explored linkages between Financial Inclusion on the one hand and financial **stability**, **integrity**, and **consumer Protection** on the other.

This eBook highlights key learning from the Arab Policy Forum through the prism of the I-SIP framework as well as provides additional resources to dig deeper into the key issues.

"World leaders have rightly elevated financial inclusion on the global development agenda. Governments and regulators should also do what they can to facilitate inclusive financial systems. A financial system that responsibly reaches all citizens, especially poorer populations, is an important driver for economic and social progress."

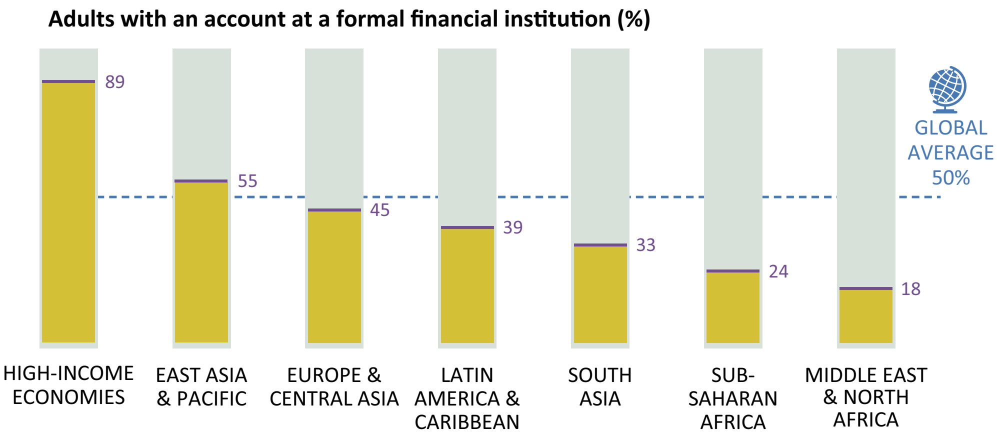
Tilman Ehrbeck
CEO, CGAP

2013 Arab Policy Forum

For more on financial inclusion topics in the Arab World, including the latest research, visit the CGAP website at www.cgap.org/countries/middle-east-and-north-africa

[1] "GPFI is an inclusive platform for all G20 countries, interested non-G20 countries and relevant stakeholders to carry forward work on financial inclusion, including implementation of the G20 Financial Inclusion Action Plan, endorsed at the G20 Summit in Seoul." (http://www.gpfi.org/).

Account Penetration



Source: Demirguc-Kunt and Klapper, Measuring Financial Inclusion, 2012.

82

Percent of the Arab World's population above 15 years without access to an account at a formal financial institution.

Why Inclusion?

It is not for lack of demand that 80 percent of the Arab World's adult population do not have access to formal financial services. Instead, the bottleneck is on the supply side, where financial service providers—who already reap profits from real estate, treasury bills, and overseas investment—have little incentive to serve the lower end of the market. This, however, is where the majority of the Arab World's population lives, and affording them greater economic opportunities is a priority of governments across the region.

Creating a more inclusive financial system makes sense on a number of levels. From a development perspective, greater financial inclusion is positively correlated with GDP growth, and financial deepening has been proven to reduce inequality. Studies demonstrate, for example, that access to microcredit increases by 50 percent the chances of hiring employees outside the household. Financial inclusion also brings down the cost of delivering public services. These services are significantly more efficient when delivered through the financial system (e.g., using plastic cards and electronic transfers for social benefits can cut costs for the government by over 80 percent) as opposed to through more paper-based mechanisms.

Although financial inclusion is not the panacea to poverty, it remains an important milestone toward more inclusive social and economic systems. This would hold especially true in the Arab World, where 90 percent of the MSMEs are informal, and where an estimated number of 8 million jobs need to be created every year for the coming decade.

The G20 has recognized and endorsed financial inclusion as a pillar of the global development agenda. Its leaders have asked global SSBs—in particular, the Basel Committee on Banking Supervision (BCBS), the Committee on Payment and Settlement Systems (CPSS), the Financial Action Task Force (FATF), the International Association of Deposit Insurers (IADI), and the International Association of Insurance Supervisors (IAIS)—to prioritize linkages between the overarching goal of financial inclusion and their distinct mandates of ensuring financial stability, integrity, and consumer protection. These four policy objectives are abbreviated as "I-SIP" (and are referred to in this e-book as the "I-SIP framework").

"In order to successfully promote Financial Inclusion in the Arab World, one major task will be to further enhance an enabling policy environment as well as conducive legal framework conditions. It is fundamental that it will be permitted for a broad set of financial institutions to offer a variety of financial services to the poor in a sustainable and responsible manner."

Wolfgang Buecker, Head of Financial Systems Development, GIZ

2013 Arab Policy Forum

There is ample evidence that pursuing these linkages is actually an imperative for governments. IAIS, for example, in its October 2012 "Application Paper on Regulation and Supervision Supporting Inclusive Insurance Markets" states that anything "less than fully effective inclusion can, and

Dig Deeper

10 Useful Data Sources for Measuring Financial Inclusion (CGAP)

has, led to financial sector instability." But although there is broad agreement about the interconnections between the four policy objectives, at the policy level, the perceived tradeoffs between inclusion, on the one hand, and stability, integrity, and consumer protection, on the other, can hinder policy makers' ability to optimize I- SIP linkages for the greater benefit of the country. A CGAP working paper, "Financial Inclusion and the Linkages to Stability, Integrity and Protection: Insights from the South African Experience," outlines the need to look holistically at the I-SIP objectives, rather than at each one alone, and to apply the principle of proportionality to financial inclusion measures (i.e., balancing risks and benefits against costs of regulation and supervision) to optimize I-SIP linkages. It also calls for policy makers' commitment to regularly update policies based on actual experience and outcomes.

BOX 1. Putting in Place Financial Inclusion Strategies: 5 Key Attributes

Any financial inclusion strategy has five key attributes of success: (1) political will or high-level commitment; (2) a lead institution, usually the financial regulator, with a specialized and motivated financial inclusion team; (3) coordination among all stakeholders from governmental institutions and the private sector; (4) a pragmatic action plan; and (5) accountability.

The Role of Financial Service Providers

Ideally, commercial banks would serve poorer customers and small businesses as effectively as they do their wealthier clients and large corporations. In reality, practical examples of extending financial services for the unbanked at a significant scale involve either postal banks or microfinance institutions (MFIs) that have transformed into deposit-taking, regulated financial institutions.

Thanks to their extensive branch outreach, exclusive technologies (e.g., for money transfers), and their geographic proximity to clients, postal banks can rapidly expand financial access and offer financial services both at scale and at much lower costs for low-income clients.

BOX 2. Postal Banks: Al Barid Bank, Morocco

Al Barid Bank is an impressive example of a postal bank massively increasing financial access: It opens 500,000 new accounts every year and has contributed to increasing financial inclusion in the country from 34 percent to 54 percent in just two years—with 70 percent financial access projected by the year 2015.

Learn more about postal banks in the Arab World:
http://www.cgap.org/sites/default/files/CGAP-Brief-Can-Postal-Networks-Advance-Financial-Inclusion-in-the-Arab-World-May-2012.pdf

For their part, MFIs are also primed to scale up their services because of their established reputations among poorer and harder-to-reach clients as well as their mechanisms (such as loan officers and rural branches) for reaching these clients. What these MFIs need is the ability to raise their own capital, through deposit-taking as well as external investment—both of which require their respective governments' sanction through licensing and regulation.

In all cases, scaling up the outreach to the underserved requires two critical elements: (1) engaging in a broad-based set of consultations with all public and private stakeholders, be it the central bank, ministries, commercial banks, or other nonbank financial service providers; and (2) having—or building—a national vision and accompanying goals for increased financial inclusion.

BOX 3. NGO Transformation: ACLEDA Bank, Cambodia

ACLEDA Bank began as a small project supported by international aid agencies and providing small loans after the war in Cambodia. Today, this MFI has transformed into the largest bank in the country with over $1.2 billion in assets.

Learn more about MFI transformation:
http://www.cgap.org/publications/ngo-mfi-transformations-ownership-issues

The Role of Central Banks

Central banks are key to championing and coordinating financial inclusion policies. Their staff have both the skill set and the mandate to oversee several key items related to financial inclusion: financial regulations and policies, financial infrastructure, and financial sector supervision. A World Bank analysis of 56 countries showed that central banks take the lead on financial inclusion strategies in 71 percent of the cases, especially when the central bank is the integrated financial sector supervisor. Central banks can do the following:

1. Shepherd the development of a financial inclusion strategy

2. Contribute to favorable rules and regulations by (a) encouraging the creation of specialized providers or enabling existing ones to transform into regulated institutions, allowing them to scale up by raising capital or, for those meeting specific prudential criteria, to take deposits; (b) approving alternative distribution channels for financial services, such as mobile banking and "branchless" agents

3. Improve financial infrastructure, an area the Arab Monetary Fund is actively supporting, by (a) establishing and scaling up the outreach of credit bureaus and (b) improving payment systems

4. Boost financial literacy among new entrants to the financial system

Access to finance for SMEs is often a central bank's entry point into the financial inclusion landscape. The Brazilian success story started with the aim to bring financial services to MSMEs because they account for more than 20 percent of GDP, 99 percent of formal companies, and 60 percent of jobs—figures similar to several Arab countries. Brazil broadened this scope to look at the whole financial sector's effectiveness and efficiency.

While Brazil remains an international champion of financial inclusion, several countries in the Arab World have also begun taking similar measures, led by Morocco, the first country to have pursued an active financial inclusion strategy on all fronts by specifically targeting the low-income, expanding access points (mostly through Al Barid Bank), and providing suitable and affordable savings, credit, and payment products (e.g. authorizing mobile banking, requiring banks to offer 16 basic products free of charge, and reviewing SME guarantees requirements). It has done so while catering for consumer protection through transparency measures, supervision of microcredit providers, and conflict resolution systems.

In other Arab countries, especially those with a vast rural population, such as Egypt or Yemen, mobile banking is one of the roads to financial inclusion. Others, such as Syria and Yemen, have also adopted laws and regulations allowing microfinance banks to operate.

BOX 4. The Brazil Experience

The Banco Central do Brasil has been working to increase and improve access to financial services in Brazil since the 1990s in three main ways: (i) expanding and strengthening distribution channels for financial services, (ii) developing instruments to better adapt financial services to the needs of lower-income segments of the population, and (iii) guaranteeing the quality of financial services provision. As a result, it has done the following:

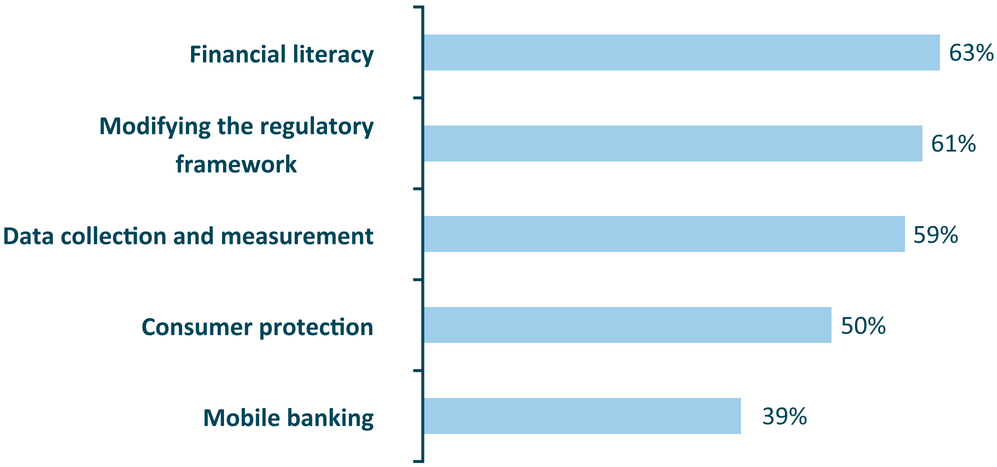
- Increased the number of agent banking outlets from 19,000 in 2000 to 150,000 in 2010

- Focused on strengthening credit cooperatives, leading to a more then three-fold increase in the number of cooperative members between 2000 and 2010—from 1.5 million to 5.1 million.

Today, all of Brazil's 5,565 municipalities have at least one access point, and the percentage of adults with an active relationship with a financial institution has reached 84 percent.

Excerpted from Banco Central do Brasil's National Partnership for Financial Inclusion document, "Action Plan to Strengthen the Institutional Environment" (May 2012).

Common Policy Areas Of National Financial Inclusion Strategies (56 Countries)



Source: World Bank, An Analysis of National Financial Inclusion Strategies, 2013.

80

Number of jobs, in millions, that the Arab World will need to create in the next 15 years.

Stability

There are at least three ways in which inclusion can foster greater stability in a financial system:

- An inclusive financial sector will have a more diversified, stable deposit base that should increase systemic stability. Similarly, inclusion may improve the diversification of lenders' portfolios away from large borrowers, thereby reducing systemic risk.
- An inclusive financial sector is likely to have greater political legitimacy and thereby decrease the risk of political and social instability.
- An inclusive financial sector has the potential to enhance economic stability, which is an essential component of financial stability.

Recent research from the World Bank has indeed shown that countries with more inclusive financial systems are more resilient to political crisis and instability. Most conclusively, this research has shown that countries with more inclusive financial systems attract a broader base of deposits, which in turn help them weather financial shocks better than countries with a preponderance of large depositors. In part, this is because large depositors, according to the research, are usually the first to "run on banks and withdraw their deposits"—a risk that "could be mitigated if bank deposits are more diversified."

In South Africa, for example, only 30 percent of the population participated in the formal financial system in 1994, according to Roelof Goosen of the South African National Treasury. By 2005, that number had increased to 55 percent; and by 2013, it had risen again to 79 percent, according to FinScope. Evidence suggests that this increase in inclusion has positive effects on macroeconomic stability.

World Bank research shows that "a 10 percent increase in the share of people that have access to bank deposits can mitigate…deposit withdrawal rates by about three to eight percentage points."

Institutionalizing such stability system-wide is a key priority of Arab governments. In Jordan, for example, the Central Bank has prioritized financial inclusion as a means toward greater systemic stability. Deputy Governor Maher Hasan explained that part of this priority is to attract a broader deposit base to "include all segments of society"—a move that would "reduce risk exposure" to institutions and, hence, the entire financial system. To this end, in 2013, the Central Bank established a specialized department tasked with ensuring the stability of the financial system by, in part, encouraging greater inclusion.

"Financial inclusion is increasingly becoming a high priority for policymakers in the Arab World, especially in the current context of socio-economic uncertainty, where many countries in the region are facing various challenges and need to foster homegrown sources of employment and income generation, particularly by promoting entrepreneurship and SME development, but at the same time ensure a strong financial stability."

Jassim Al-Mannai, Director-General and Chairman of the Board of the Arab Monetary Fund

2013 Arab Policy Forum

This new empirical evidence confirms what many had thought intuitively, that by encouraging more inclusive products, policy makers help institutions become more resilient by attracting a broader base of customers—which in turn benefits the financial system as a whole.

Dig Deeper

Financial Inclusion and Stability: What Does Research Show? (CGAP)

Hasan Amin, 2012 CGAP Photo Contest

1

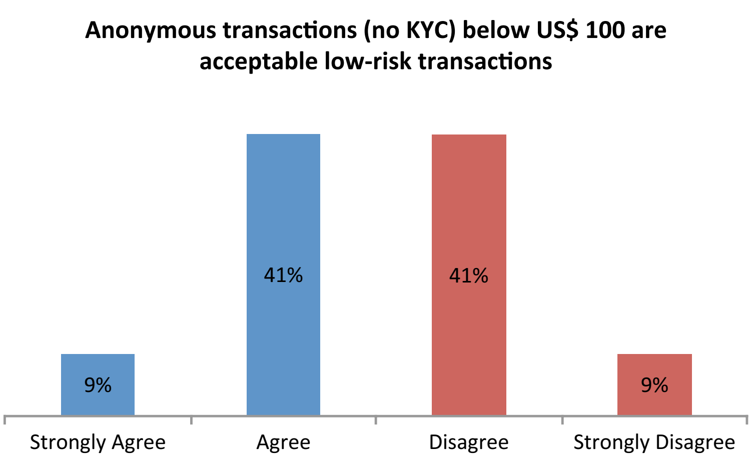
Rank of "suspicious transaction monitoring" as the greatest AML/CFT challenge in their countries, according to participants in the Arab Policy Forum.

Integrity

A financial system's integrity is gauged not only by an individual country's measures to maintain it, but by a set of internationally agreed on recommendations designed to curb the global financial system's misuse, including through money laundering or the financing of terrorism.

Issued by FATF, these anti-money laundering and countering the financing of terrorism (AML/CFT) recommendations can seem burdensome to government agencies focused on their country's domestic financial system. Not surprisingly, policy makers differ on what their AML/CFT priorities should be: Participants in the Arab Policy Forum were evenly split on whether anonymous transactions below US$100 constitute an acceptable risk to their financial systems' integrity.

Polling Participants Opinion on Anonymous Financial Transactions



Despite the range of interpretation, however, a risk-based implementation of the FATF recommendations is an essential ingredient of financial inclusion. This is especially true given the scrutiny around cross-border transfers—such as the remittances on which so many of the world's poor rely—and related record-keeping and "know your customer" due diligence requirements, especially by financial agents operating in otherwise underserved areas.

"The new FATF Recommendations provide authorities with a stronger and universal set of measures to act against threats to the international financial system.... They also strengthen the requirements for higher risk situations and allow countries to take a more targeted risk-based approach."

Giancarlo del Bufalo
FATF President

Letter to G20 Leaders, May 25, 2012

Recognizing that financial exclusion actually increases AML/CFT risks, FATF has, over the past two years, made it easier for policy makers to pursue financial inclusion goals while putting in place regulations aimed at preventing money laundering, terrorist financing, and other financial crimes. Among FATF's recent measures is a revision of its "forty recommendations" to include expanded definitions of "low-risk" and "lower-risk" transactions.

Dig Deeper

Anti-Money Laundering Regulation and Financial Inclusion

Reaza Golchin, 2012 CGAP Photo Contest

Ceasar Alwarda, 2012 CGAP Photo Contest

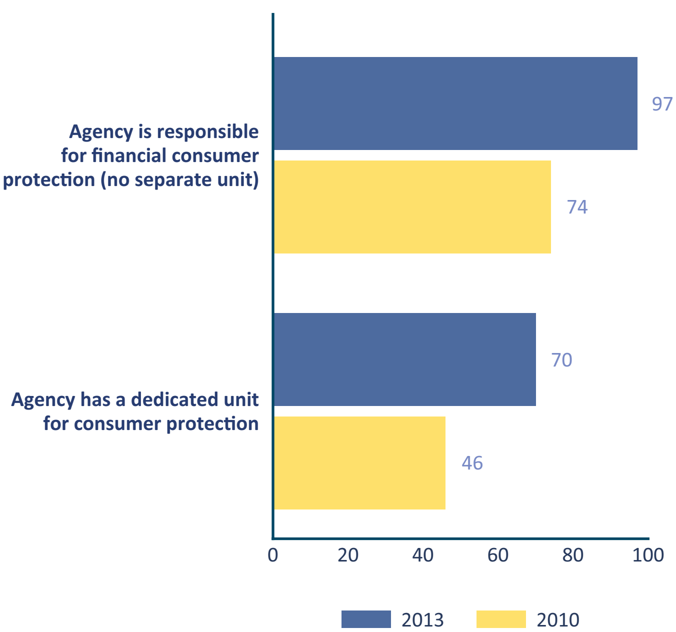
150

Number of staff members dealing with consumer complaints at the Central Bank of Brazil.

Consumer Protection

As they push for greater financial inclusion, governments must ensure that inclusion is achieved responsibly—a goal that hinges on effective consumer protection measures that take into account the financial literacy of poorer clients as well as the ways in which they access information. Densely worded legal contracts, for example, may be of little use to customers who have never before dealt with a formal financial institution. And some of the terms in those contracts—annual percentage rates, penalties, even the difference between principal and interest—may be unfamiliar to these customers. How then can policy makers adjust for these knowledge gaps while still encouraging financial inclusion?

Legal responsibility for financial consumer protection between 2010 and 2013



Note: Data for 109 countries with data for 2010 and 2013.

Source: World Bank, Global Survey on Consumer Protection and Financial Literacy, 2013.

"Over-indebtedness has been an issue for the past 4,000 years—from Mesopotamia to Rome, leading to civil unrest in the latter. But we still do not know how to deal with it."

Nataliya Mylenko
World Bank

2013 Arab Policy Forum

Research in South Africa suggests that consumer protection guidelines are best derived by first observing the financial habits of traditionally unbanked customers. Policy makers there employed hands-on research tools, such as mystery shopping and focus groups, to learn directly from these customers how they manage their financial lives and assess the gap between what they need and how existing products are modeled. The research showed that the gap is best addressed through a single government agency with the sole mandate of protecting financial consumers. World Bank research has also shown that **an integrated agency is the most predominant model, globally, for regulating financial consumer protection.**

Still, consumers need to take responsibility for their own financial choices. This underscores the importance of financial literacy programs, such as those discussed in this CGAP blog post.

Dig Deeper

Implementing Consumer Protection (Technical Guide)

Presenters

The following presenters participated in the 5th Arab Policy Forum on Financial Inclusion. Where available, links to their presentations are included below and are provided as a courtesy by the presenters.

Financial Inclusion in the Arab World Today

Ms. Nadine Chehade, MENA Representative, CGAP [EN]

Client Protection and Consumer Behaviour

Dr. Penelope Hawkins, Managing Director, Feasibility Ltd, South Africa [EN]
Ms. Nataliya Mylenko, Senior Financial Sector Specialist, World Bank [EN]
Mr. Johannes Majewski, Programme Coordinator, GIZ, Moderator [EN]

Reflections from Financial Service Providers Serving the Poor

Mr. Redouane Najm-Eddine, Chairman of the Management Board, Al Barid Bank, Morocco [EN | AR]
Mr. Kim Vada, General Director, Banking Supervision, National Bank of Cambodia [EN]
Ms. Sahar Tieby, Executive Director, Sanabel, Moderator

I-SIP Framework

Ms. Kate Lauer, Lawyer, CGAP [EN | AR]

Financial Inclusion and Financial Integrity

Mr. Adel Al Qulish, Executive Secretary, MENA FATF [EN]
Mr. Michael Tarazi, Senior Policy Specialist, CGAP, Moderator [EN]

Financial Inclusion and Stability

Mr. Martin Melecky, Senior Financial Economist, World Bank [EN | AR]
Mr. Roelof Goosen, Director for Financial Inclusion, South Africa National Treasury [EN]
H.E. Dr. Maher Sheikh Hasan, Deputy Governor, Central Bank of Jordan [EN]
Ms. Kate Lauer, Lawyer, CGAP, Moderator [EN | AR]

Role of Central Banks in Advancing Financial Inclusion

Ms. Jihan El Menzhi, Head of Banking Department, Ministry of Finance, Morocco [AR]
Ms. Denise Dias, Bank Examiner, Market Conduct Supervision, Central Bank of Brazil [EN]
Mr. Nabil Al-Montaser, Acting Deputy Governor, Central Bank of Yemen [AR]
Ms. May Abulnaga, Regulations Department Head, Central Bank of Egypt [AR]
Mr. Yisr Barnieh, Chief of the Financial Markets Division, Arab Monetary Fund, Moderator

About the Sponsors

Arab Monetary Fund

Headquartered in Abu Dhabi and founded in 1976, the Arab Monetary Fund is a Regional Arab organization dedicated to correcting and balancing the payment of its member states; removing payment restrictions between members; improving Arab monetary cooperation; encouraging the development of Arab financial markets, paving the way for a unified Arab currency; and facilitating and promoting trade between member states. Its 22 member countries include: Jordan, the United Arab Emirates, Bahrain, Tunisia, Algeria, Djibouti, Saudi Arabia, Sudan, Syria, Somalia, Iraq, Oman, Palestine, Qatar, Kuwait, Lebanon, Libya, Egypt, Morocco, Mauritania, Yemen, and Comoros. More information can be found at www.amf.org.ae.

The World Bank

Established in 1944, the World Bank Group is headquartered in Washington, D.C. The World Bank Group has set two goals for the world to achieve by 2030: End extreme poverty by decreasing the percentage of people living on less than $1.25 a day to no more than 3%; and promote shared prosperity by fostering the income growth of the bottom 40% for every country. The World Bank is a vital source of financial and technical assistance to developing countries around the world. It is not a bank in the ordinary sense but a unique partnership to reduce poverty and support development. The World Bank Group comprises five institutions managed by their member countries. More information can be found at www.worldbank.org.

CGAP

Established in 1995 and housed at the World Bank, the Consultative Group to Assist the Poor (CGAP) combines a pragmatic approach to market development with an evidence-based advocacy platform to advance poor people's access to finance. Its global network of members includes over 30 development agencies, private foundations, and national governments that share a common vision of improving the lives of poor people with better access to finance. CGAP develops innovative solutions for financial inclusion through practical research and active engagement with financial service providers, policymakers, and funders. More information can be found at www.cgap.org.

GIZ

The Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH supports the German Government in achieving its objectives in the field of international cooperation for sustainable development with the Federal Ministry of Economic Cooperation and Development (BMZ) being its main client. GIZ is also engaged in international education work around the globe. More information can be found at www.giz.de/en.