

## Mexico's engagement with the standard setting bodies and the implications for financial inclusion



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Suggestions made in this document do not represent the official views of any of the regulatory authorities consulted. All errors and omissions are those of the authors.



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## About this case study

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This case study highlights the experience of Mexico in implementing international standards in the financial sector and the interaction, where relevant, with the topic of financial inclusion – a topic that is of particular relevance in Mexico. It draws on a questionnaire completed by the relevant regulatory authorities, coordinated by the Secretaría de Hacienda y Crédito Público, as well as meetings with each regulatory authority.

The case study aims to tell the story of Mexico's engagement with each of the standard-setting bodies (SSBs) and to highlight areas where further engagement from the SSBs on the topic of financial inclusion will be welcomed. The Mexican authorities recognize the important role played by each SSB and would like to contribute to the dialogue process as each SSB engages with the topic of financial inclusion. However, the case study does not present the official position of any of the supervisory authorities consulted and should not be construed as making demands on the SSBs. Rather, suggestions made illustrate potential needs at the country level for SSB dialogue, information and guidance.

# 1. Financial inclusion context

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## 1.1 The financial system in Mexico

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### *The banking sector is the principal holder in the system*

In terms of total assets, the banking sector remains the principal holder in the system, while pension funds, insurance companies, non-bank banks and development banks gained importance within the system. As of June 2011, the banking sector represented 50 percent of the total financial systems' assets, including a substantial amount of foreign investment: 74.5 percent of the banking sectors' assets belong to foreign owned banks (18 of 41 banks) and 83 percent of the total assets of the sector are managed by seven banks, 23 percent by 17 medium-sized banks, while the five banks associated to retail chains hold 1.7 percent. Over the last decade, the banking sector has made significant advances in consumer credit. As of June 2010, this sector had accumulated 32 million consumer lenders, representing 95 percent of the total debtors of the banking system<sup>1</sup>.

### *The tequila crisis had a profound effect on the evolution of the Mexican banking system*

The deep financial crisis in Mexico in the mid-nineties, often referred to as the "tequila crisis" and which involved the devaluation of the Peso, has had important consequences for the current structure of the financial system in Mexico, reflected in a decline in basic indicators. For example, financial depth fell from 33 percent in 1994, its highest-ever level, to 14 percent by 1999, although by the end of June 2011 it had risen to 26 percent. In addition, by the end of June 2011, total banking credit represented just 13.3 percent of GDP while banking deposits accounted for 19.7 percent. As a result, banks have played a less important role as financial intermediaries and lagged behind in terms of technology and innovation.

### *Mexico has made significant efforts in financial inclusion.*

Mexico has made considerable progress in financial inclusion over the last few years. According to a

World Bank publication<sup>2</sup>, only 25 percent of the population in Mexico had access to a savings account in 2004 but by 2009 a survey conducted for the Ministry of Finance, showed that 60 percent of the population used at least one financial service provided by a formal financial institution. These financial services mainly included: payroll accounts (36 percent), pension funds (26 percent), savings accounts (25 percent), credit cards (17 percent) and insurance (12 percent), among others. Making the results of this survey comparable with those of the World Bank's publication, the population that had access to at least a savings account increased from 25 percent to 48 percent.

### *The "Cajas de Ahorro y Crédito"<sup>3</sup> sector is important for financial inclusion*

Mexico has a significant sector comprised of the Cajas. The Sector de Ahorro y Crédito Popular now consists of 654 institutions (595 Cajas and 59 Sociedad Financiera Popular, Sofipos<sup>4</sup>), of which 99 are regulated, and administer assets equivalent to 1.8 percent of the assets held by the banking sector. The deposits mobilized by this group represent about 3 percent of banks' deposits, and it is estimated they have over 5.5 million clients while the banking sector is estimated to have 96 million accounts opened<sup>5</sup>. Even though it is difficult to derive the number of people with banking accounts, based solely on the number of accounts (as one customer may have several accounts), it is clear that the non-banking sector has played a key role in promoting access to financial services to people excluded from the banking sector, even if it does not represent a very high proportion of the total financial system's assets and deposits.

### *The microfinance sector has grown fast*

An estimated 202 institutions offer microcredit in Mexico, including regulated Sofipos and other non-regulated institutions under different legal forms. Compartamos, a former<sup>6</sup> NGO, which has operated under a banking license since 2005, is the undisputed leader<sup>7</sup>.

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<sup>1</sup> Banco de México, Reporte del Sistema Financiero a Junio 2010. Noviembre 2010. The consumer loan portfolio was 23 percent of the total private sector loan portfolio.

<sup>2</sup> Finance for All? Policies and Pitfalls in expanding Access. A World Bank policy research report.

<sup>3</sup> The Cajas is the common name given to credit unions in Mexico. Since there are other institutions called Uniones de Credito, which is another type of financial institution established in Mexico during the 80's, in this document we will use the spanish name to assure clarity.

<sup>4</sup> The Ley de Ahorro y Credito Popular, LACP, enacted in 2002 with the main objective of providing a framework to regulate Cajas, also authorized the Sofipos, a private corporation which could be used as a vehicle for NGOs to become regulated financial institutions.

<sup>5</sup> Banco de Mexico, Ibid; CNBV, Financial Inclusion Report, September 2010.

<sup>6</sup> Since 2006 there has also been a non-regulated for-profit institution, called Sociedad Financiera de Objeto Múltiple, SOFOM, which even though is not required to become regulated (because it is not authorized to take deposits unless it becomes part of a financial conglomerate), is required to comply with regulations related to consumer protection.

<sup>7</sup> Marulanda Consultores, DAI México. Microfinanzas en México, 2010. Of the 202 institutions only 141 had public information available.

## 1.2 Different initiatives to promote financial inclusion

### *Extending the banking infrastructure enhances financial inclusion*

Based on the understanding that an extensive banking infrastructure is essential to enhance financial inclusion, Mexican authorities introduced an incentive to subsidize the establishment of point-of-sale (POS) devices. Between 2005 and 2008, under the name of FIMPE<sup>8</sup>, banks enjoyed a tax rebate for the deployment of POS devices, while a campaign with a lottery scheme also reinforced the message to the customers to promote the use of electronic payments. As a result, between 2000 and Q1 2011, POS devices increased by 403 percent: by way of comparison, the number of ATMs increased by 124.6 percent, while banks' branches increased just 63 percent. Additionally, and given the cost structure of traditional banking models, the banking agent model was introduced.

### *Banking agents have changed the financial inclusion landscape*

The year 2007 marked a turning point in the initiatives to promote financial inclusion in the banking sector. The proposal to introduce banking agents was passed by Congress and was finally approved in 2008 when the banks were authorized<sup>9</sup> to use third parties as banking agents. Minimum standards were set for mobile banking. Today, there are more than 9,400 points of access (retail stores) and by the end of 2011, it is estimated there will be almost 20,000 operating.

- *Competition was encouraged.* With regards to the promotion of new players, efforts to regulate credit unions continued while the creation of new banks was authorized. Between 2005 and 2008, 13 new banks were created. A good number of these were linked to large retail stores that had developed a strong credit activity. By 2008, a new concept was introduced, "Niche Banks"<sup>10</sup>, with reduced initial capital and regulatory cost for specialized operations. No Niche Bank has yet been authorized, but regulators mentioned there are a few institutions in the process of applying for a license.
- *Regulating credit unions.* Mexico has a long history of financial inclusion policies, spanning different stages and with different emphasis. The first financial inclusion initiatives occurred in

2002<sup>11</sup>, when efforts were made to regulate the credit unions after several Cajas went bankrupt and social uprisings occurred involving people who had deposited their savings in these non-regulated institutions. Specific initiatives will be discussed in section 2.2.

### *Simplification of account opening procedures drives financial inclusion*

At the same time, special attention was given to simplify AML/CFT procedures and a simplified identification and monitoring system for low-value transactions accounts was issued in 2009, which promoted the use of banking services, such as mobile banking<sup>12</sup>. During 2011 the three main Mexican financial regulatory authorities (CNBV, Banco de México and Ministry of Finance) undertook a joint exercise to simplify the AML/CFT procedures even further. They redefined the rules regarding products and channels, and came up with an innovative approach (see section 2.1).

### *Regulatory reforms promote better conditions and lower interest rates*

Regarding credit regulation, and under the assumption that the non-banking institutions were the ones mostly oriented towards the micro-entrepreneurial sector, a new classification for commercial loans was issued. This included a specific classification for micro-credits for non-bank institutions, and a simplified set of rules for the origination and credit monitoring process, which was authorized for both banks and non-banks. This reform seeks to end credit rationing for some sectors of the population and reduce regulatory costs in order to promote better conditions and lower interest rates.

### *Demand-side initiatives have also been undertaken*

With regards to demand-side initiatives, the Transparency Law of 2007<sup>13</sup> was approved and includes a provision to promote access to savings accounts by making it mandatory for banks to offer a fee-less basic deposit product, including a fee-less pay roll product. On the other hand, the Federal Government has started to implement mechanisms to pay subsidies through electronic transfers, and has established that by 2012, all the subsidies related to social programs such as Oportunidades and paid by the government will have to be made through electronic transfers. This could impact approximately 5 million beneficiaries.

<sup>8</sup> FIMPE - Fideicomiso para Extender a la Sociedad los Beneficios del Acceso a la Infraestructura de Medios de Pago Electrónicos. (<http://www.fimpe.org.mx/index.html>)

<sup>9</sup> Ley de Instituciones de Crédito; Art. 46 Bis 1, 2009.

<sup>10</sup> Ley de Instituciones de Crédito; Art. 10, 19, 50, 2009.

<sup>11</sup> Ley de Ahorro y Crédito Popular, normally referred to as LACP.

<sup>12</sup> Ley de Instituciones de Crédito; Art. 115.

<sup>13</sup> (Ley de Instituciones de Crédito; Art. 48 Bis 2), 2009.

### *Transparency, consumer protection and infrastructure has been a priority*

The Mexican Government has been pushing ahead other policies and legal reforms to promote and improve financial inclusion, increase transparency, strengthen consumer protection and enhance financial literacy. This included a decision to allow the entry of new players in order to increase and complement banking infrastructure and to promote basic financial products. By 2007, within a new law to reform the Transparency Law, Banco de México received the mandate to regulate commissions and exchange fees charged by financial institutions in addition to its obligation to regulate and supervise the payment system.

### *Information is necessary to design effective public policy*

Authorities are also working to develop indicators and methodologies to measure financial inclusion, in order to evaluate the access and use of different financial products. In this regard, in 2011 the Mexican government will be conducting the National Survey for Financial Inclusion through the National Institute of Statistics and Geography. This survey will subsequently be conducted every three years. It draws on the findings and approaches of two earlier surveys carried out by the Ministry of Finance in 2007 and 2009 (Survey of Use of Financial Services).

In addition, the CNBV assumed the task of creating indicators to guide and follow up the Financial Inclusion Strategy and periodically publishes reports that include statistics on the financial system in terms of access to products and financial inclusion. These reports highlight possibilities for expanding the financial infrastructure and provide input to policy design. So far, three reports have been published, with useful information regarding access and usage indicators.

## 1.3 Regulatory Framework

*The Mexican regulatory landscape is a complex one with many organizations involved*

The financial system in Mexico is overseen by multiple regulators. Therefore the information included in this report reflects the contributions made by different agencies<sup>14</sup>.

- The Ministry of Finance (Secretaría de Hacienda y Crédito Público (SHCP) is responsible for the overall design of the policy framework for the development and operation of the financial system, and for setting the standards related to the AML/CFT regulations.
- The Comisión Nacional Bancaria y de Valores (CNBV) establishes prudential regulation and supervises banks and other non bank deposit taking institutions, as well as the securities' markets. Since reforms in 2008, it also has the licensing authority for banking institutions, taking into account the minimum capital requirements set by law.
- Banco de Mexico regulates matters regarding money, foreign exchange, and derivatives markets, and also regulates the payment systems and authorizes financial operations and product characteristics for the banking sector.
- *The Comisión Nacional de Seguros y Fianzas (CNSF)* oversees insurance and surety companies and verifies that its operations are in accordance with applicable regulations.
- *The Instituto Nacional para la Protección del Ahorro Bancario (IPAB)* acts as the bank resolution and deposit insurance agency, and for the non-bank sector (Cajas and Sofipos), a private Deposit Insurance Fund also exists.
- Finally, following the issuance of the Transparency and Financial Services Arrangement Law, the *Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros* (CONDUSEF), an independent public institution dependant of the Ministry of Finance, was established. Although the Banco de México is in charge of promoting transparency and competition and regulates commissions and exchange fees charged by financial institutions, CONDUSEF, a decentralized agency, has responsibility for regulating and supervising financial institutions in matters related to the protection of the consumers<sup>15</sup> giving it the authority to impose sanctions.

## 2. Key SSB engagement stories

Mexico has been a member of IAIS since 1994, and of IADI since 2002, joining BCBS<sup>16</sup> and CPSS in 2009. It is actively involved in various Committees within each of the SSBs of which it is member.

In FATF, Mexico has been a member since 2000 and is also part of the Financial Action Task Force on Money Laundering in South America (GAFISUD). Its role within FATF was even more important when

<sup>14</sup> Special thanks to those interviewed for their time and their insights. Their names and positions within each institution are presented in Annex 1.

<sup>15</sup> Specifically in matters related to account statements, contracts of adhesion and advertising by financial institutions.

<sup>16</sup> Before 2009, Mexico participated in the Consultative Groups of BCBS.



in 2009, Luis Urrutia, former head of the Financial Intelligence Unit of Mexico, and in that capacity head of the Mexican delegation in FATF since 2007, assumed the position of Vice-President of FATF in July 2009 and the position of President in July 2010.

### *Mexico's main concerns have been regulatory issues related to FATF*

According to the different interviews, the greatest difficulties faced by the Mexican regulatory authorities pertain to FATF principles. The authorities generally consider that the other SSBs give enough flexibility or guidelines to regulate necessary issues around financial inclusion, within the specific context of the country. However, some mentioned that the relationship between the sets of core principles and financial inclusion was not evident for them.

Nevertheless when considering specific aspects of each of the SSBs' principles, it became evident that many of the restrictions identified by some authors, and in other countries, have not been faced in Mexico, mainly because the regulatory agenda had not yet dealt with them. This is either because the issues have not yet been considered a priority within the policy, or because other issues have taken precedence. In the next sections specific examples will be given.

It is worth highlighting that in many cases guidance from SSBs on different topics was mentioned as useful, specifically on those challenges that have arisen either as the financial inclusion agenda evolves, or as the financial system develops. In each of the sections below, the specific recommendations are mentioned.

## 2.1 Financial Action Task Force (FATF)<sup>17</sup>

### *Mexico has promoted financial inclusion while striving for FATF compliance*

Mexico has placed great importance on complying with the AML/CFT principles, a fact recognized in the FATF and GAFISUD evaluation in 2008<sup>18</sup>, which also recognizes Mexico's effort in fighting drug cartels and drug trafficking. Even so, regulators have been able to manage and design, within a risk-based approach, mechanisms that comply with the principles and promote financial inclusion. Efforts have been manifold and evolved over time.

### *"Corresponsales" are considered to be an extension of the bank*

A pivotal step towards inclusion was taken when financial authorities submitted to Congress a reform allowing banks to provide financial services through agents or "corresponsales". Formerly, banks were only allowed to provide complete financial services using branches served by the banks' employees. The reform was approved by Congress in 2008 and a new set of regulations were introduced. These were very specific in defining the operational requirements for agents in order to guarantee transaction security and reliability, making it also clear that agents are not considered to be an outsourcing service but rather an extension of the bank, since the bank remains fully responsible for the transactions and operations made by the customers through the agent.

### *The creation of Low Transaction Accounts and Low Risk Accounts has proved vital*

Mexican regulators also understood clearly that reducing the cost of delivery channels would not produce real results in terms of financial inclusion unless the account opening processes were simplified. Regulators had to face the challenge of how to comply with FATF principles, while simplifying opening procedures. The initial approach approved in 2009 was to establish two different products: the Low Transaction (amount) Account and the Low Risk Account, with different amount limits and requirements in terms of 'know your customer' (KYC). Low Transaction Accounts placed specific limits on the value of transactions that can be made per month and the maximum balance that can be held (US\$700<sup>19</sup>). To open one, a client need only give their name, date of birth and address and the bank would not need to keep physical records. Low Risk Accounts allowed banks to establish limits and characteristics within their own client risk models to identify "low risk" customers and then apply the set of simplified procedures. Both of these accounts could be opened through the banking agents. The same simplified procedures were approved for an additional product that was created at the same time: "mobile money accounts", which could be either of the above, but had to be linked to a cell phone number. This created a degree of confusion within the private sector because simplified procedures could be applied to accounts linked to a mobile device.

### *A new tiered approach to AML/CFT procedures was introduced*

During 2009, authorities from the Ministry of Finance, the CNBV and Banco de México continued discussions in order to simplify the rules relating to AML/CFT, taking into account issues related to the channels

<sup>17</sup> The anti-money laundering provisions are contained in the Federal Criminal Code, Article 400-Bis, and were complemented by provisions in the Federal Law against Organized Crime. In 2007 terrorist financing was also criminalized by an amendment to the Criminal Code.

<sup>18</sup> FATF-GAFISUD, "Mutual Evaluation Report Anti-Money Laundering and Combating the Financing of Terrorism", Mexico October 2008.

<sup>19</sup> The maximum is expressed in 2,000 UDIs.



in which the account could be opened and features of debit transactions that could be undertaken. This resulted in a new proposal that established a tiered approach to the AML/CFT procedures, to be applied to any type of account, with varying requirements in terms of the customer identification and deposit and balance amount thresholds. The types of payments and operations allowed with each type of account were clearly specified.

The first three account levels, although varied, are considered “low risk value accounts” and therefore simplified procedures can be applied. At the fourth level, standard opening requirements for accounts must be followed. A summary of the level structure can be found in Annex 2.

The approach includes at level 1 a prepaid product<sup>20</sup> that requires no identification from the client, and

introduces at level 2 the option of authorizing account opening without face-to-face proof of identity. It allows the integration of electronic files with basic customer information obtained, in all low risk value accounts cases, from official electronic databases. This new regulation, which came in force on August 15 of 2011, was used as one of the examples by FATF in its recently published Guidelines “Anti-money laundering and terrorism financing measures and Financial Inclusion”.

According to the CNBV, “Risk measurements, limit definitions, controls and all arguments backing the approach were built around the shared perspective that greater financial inclusion works in hand with reducing informality, strengthening transaction traceability, and thus fighting money laundering and terrorism financing through the financial system”<sup>21</sup>.

## FATF: MAIN ISSUES

The Mexican authorities are convinced that financial inclusion will work in favor of AML/CFT, since the biggest enemy in the fight against crime and terrorism is cash transactions. When balancing FATF principles with the financial inclusion agenda, three main topics have particular relevance:

- 1) how to avoid the misuse of new and developing technologies
- 2) how to establish correct CDD and record-keeping obligations which can enable efficient parameters for financial institutions, and
- 3) how to adopt a flexible risk-based approach (RBA) that allocates resources effectively to deal with the most pressing money laundering and terrorism financing risks.

The main challenges they have faced in the process of designing simplified CDD procedures were around defining what constitutes “low risk”. The new approach designed over the last year reflects a desire to establish a methodology or an adequate framework to mitigate AML/CFT, which is not only based on the transactions’ value:

1. **Determine the additional controls** that would reduce the risk of money laundering operations and financing terrorism. To this end, restrictions have been incorporated into the full range of products available, which vary according to the CCD procedure that has been used. For example, in the case of level 1, where the identification of the customer is not required and therefore is anonymous, accounts cannot be linked to a mobile phone or other electronic device, are valid only in Mexico, and can only be used for products or services payments. In this respect, after thorough research, financial authorities in Mexico identified a significant number of cases where prepaid cards bought anonymously in Mexico were sent for their use abroad avoiding cash customs’ detection. Furthermore, they identified wire transfers to accounts related to drug cartels. Therefore the limitation in the operations is designed to address precisely this risk.
2. **Specify the independent and reliable sources and databases which can be used to verify the customer’s identity.** The use of the National Population Registry was considered sufficient to validate the data in the non face-to-face opening process (i.e. for level 2 accounts), while the regulation builds in the possibility for the CNBV with opinion of the Ministry of Finance to allow other validation processes. For example, in the case of accounts linked to mobile phones, regulators are confident that the national registry of cellphone numbers where the owner’s identity is registered can be used as a mandatory verification mechanism, in addition to the National Population Registry verification procedure.

<sup>20</sup> Recognizing it as a bank deposit.

<sup>21</sup> Interview with Xavier Faz and Denise Diaz. “A Bold Move Towards Simplifying AML/CFT: Lessons from Mexico”. Blog in CGAPs web page.

**3. Determine an appropriate threshold to reduce the risk of AML/CFT, while allowing the financial products to be functional. A range of different sources have been used** to define the limits, such as household income levels, value of subsidies paid by government, and an analysis of the transactions which had been identified by authorities as being used by drug cartels, compared also to international standards. Mexican authorities consider that the resulting thresholds, defined by the maximum monthly deposits at US\$280 (750 Udis and an additional non-cumulative balance of 1,000 Udis) for level 1, US\$1,114 for level 2 (3,000 Udis) and US\$3,715 (10,000 Udis) for level 3, will meet low-income households' basic transactional needs.\*

In the process, Mexican authorities have understood that “low risk” cannot be simply defined in terms of transaction value or account balances but should also take into account the characteristics of the product and the channels through which it is available – as well as the particular characteristics of each country. They are also conscious that the process will require ongoing monitoring, evaluation and adaptation.

With regard to the 40+9 recommendations, the Mexican authorities recognize the efforts made by FATF to take into account financial inclusion on its agenda and its commitment to examine potential challenges posed by AML/CFT requirements to achieving financial inclusion. In that respect, the initiative of the new guidance, launched under the FATF Presidency of Mexico, will be valuable. They expressed that greater consideration and guidelines regarding low risk products would be very helpful, as well as special attention to simplifying procedures for those that will become first time customers of the financial system.

\* Approximated amounts in US Dollars. The limits are expressed in UDIS, which are indexed to inflation. UDI 1 = MXP 4.58, USD 1 = MXP 12.34.

## 2.2 Basel Committee on Banking Supervision (BCBS)

### *A risk-based approach has been taken to BCBS*

Mexico has adopted all of the principles of BCBS for its banking sector all its recommendations and is in the process of introducing Basel III recommendations, while taking into account the different nature of the financial institutions under CNBV supervision. While updating or introducing a new set of rules, CNBV regulatory teams have aimed to balance regulatory concerns on the one hand, and institutions' inherent risk profiles and institutional strengthening for the benefit of their clients, on the other. In this sense, although reliant upon banking standards, regulatory measures have been developed to meet each group of institutions' standards and needs.

### *Regulating the Cajas prompted a special challenge*

As was mentioned in section 1.2, Mexican regulators have dedicated great effort since 2001 to bring Cajas under an adequate framework which also covers operations undertaken by Sofipos. When the first law was issued to place Cajas under regulation and supervision of the CNBV<sup>22</sup>, they faced a special challenge when defining the supervisory approach

to be adopted for the 400+ institutions that would come under supervision. The decision was taken to use an “auxiliary supervision scheme”, under which CNBV would carry out its own supervisory tasks, while at the same time relying on federations which would have special “Supervision Committees”. Even so, within the CNBV a special division was created to regulate and supervise this sector, given that responsibility for their supervision rested fully on CNBV.

The law included a transition period in which the Cajas would have to comply gradually with the new requirements. The government supported this effort by providing assistance through international renowned experts such as Desjardins<sup>23</sup>, Woccu and DGRV which were hired by BANSEFI (a public development bank) to make a diagnosis of these institutions, design an institutional strengthening program and guide them in its implementation. Even so, deadlines defined to meet the requirements had to be extended twice, while resistance remained in a large number of Cajas.

In 2009, several modifications to the law were introduced<sup>24</sup>. In the first place it was decided to split the regulation and supervision responsibilities: CNBV would continue to regulate and supervise only the institutions with assets over US\$700,000, under the same auxiliary scheme. Smaller institutions however

<sup>22</sup> Ley de Ahorro y Credito Popular- LACP, 2001.

<sup>23</sup> The Développement International Desjardins, from Canada, World Council of Credit Unions, WOCCU, from USA, and the Deutscher Genossenschafts und Raiffeisenverband, DGRV, from Germany are international recognized experts in the institutional strengthening of credit unions

<sup>24</sup> Ley para Regular las Actividades de las Sociedades Cooperativas de Ahorro y Crédito-LRASCAP, 2009.

would be only required to register and provide periodical information. Organizations under supervision would have a private Deposit Insurance Fund, which could be partially funded from government resources, but mainly through contributions by the Cajas. The rest would not have any deposit insurance.

The auxiliary supervision role was established under the Deposit Insurance Fund; any Caja that wants this protection must be affiliated to the Fund and regulated. Also, by putting the supervisory activities under the same authority managing the deposit insurance fund, CNBV hopes to better align the interests of all the stakeholders. This still represents a formidable challenge: of the 595 Cajas that exist in Mexico (according to CNBV's figures as of June 2010), just 57, accounting for 57 percent of the total assets held by Cajas and with 3.2 million members, had been fully authorized and complied with the regulation. The remaining share, with 2.5 million members, had yet to undergo either the registration process or comply with the regulatory requirements according to assets size. The situation of the Sofipos is much clearer: 58 are registered and 38 of these hold 95 percent of assets and clients <sup>25</sup>.

#### *Adapting Basel recommendations for the Mexican context: the use of the tiered approach*

In terms of prudential regulation for Cajas and Sofipos, a tiered approach was developed to distinguish between entities according to asset size: the smallest and least complex entities have a much simpler regulatory burden, consistent with their risk profile. A summary of the main differences between tiers is shown in Annex 3. With regards to prudential regulation, the CNBV considered that it would be very difficult and onerous to apply Basel II requirements to the non-bank institutions (not to mention unnecessary, due to their risk profiles and scope of activities), and therefore has followed Basel I, adapting the requirements slightly for those institutions at the first level of supervision. For example, there are variations in the requirements for the "risk and credit management process" between the four levels, and requirements for governance bodies to verify AML/CFT compliance at level 1 are much simpler, increasing as the operations become more complex.

With respect to the capital adequacy standards, the only provision taken is that when a Caja reaches its limit, which is the same for banks and non banks (8 percent), the associates will not be able to withdraw any more of their contributions. This takes into account the volatile structure of capital contributions made by Cajas associates. Regulators are considering establishing a new early warning system with permanent monitoring on capital adequacy levels. Higher levels of capital would be required before

entering a preventive supervision process, where the freezing of contributions would take place. They are aware of the risks this still involves, and are taking into account the difficulty of raising new sources of capital for Cajas in distress. Currently, this higher level is set at 10 percent for banks and would be 12 percent for the Cajas and the Sofipos.

A similar tiered approach was adopted by the authorities in 2008, when niche banks were legally authorized. In this instance, the minimum capital and operations are clearly differentiated, allowing at one extreme an institution with a minimum capital of 36 million UDIs to undertake only those operations related to issuing payment instruments without making loans, while a minimum capital requirement of 90 million UDIs – the normal level required to create a universal bank – is needed for organizations which plan to can undertake all operations (See Annex 4).

The CNBV understands that the present regulatory framework could create a continuum whereby the microfinance<sup>26</sup> institution (with their different regulatory and asset levels) represent the first level in the regulated financial market, and the universal banks represent the most regulated level of firm which can offer the full array of financial services. The CNBV considers there to be a place for every financial intermediary according to their size, market niche and long-term objectives. Likewise, there are clear possibilities to graduate to a "higher" level or transform into another type of entity better suited to their needs and objectives.

#### *An unbalanced scenario persists for addressing microcredit type activities*

Even though all the regulations recommended by Basel II have been implemented for the banking sector, during 2007 regulations were adjusted to simplify the verification of credit history, particularly for low loan amounts. The category of microcredit has not yet been introduced for banks, even though it has been applicable to Cajas and Sofipos since 2009. In this respect, authorities recognize that they now have an unbalanced scenario in which the same loan would be subject to different requirements depending on where it is made. For example, a loan from Banco Compartamos<sup>27</sup> would not be classified as microcredit in the bank and would thus have different reserve requirements and verification procedures for supporting information to a loan for the same person being offered by a Sofipo like Fincomun, where the microcredit classification does apply. This is currently under review.

Since reserve requirements for the non-bank sector are still based on the maturity of overdue loans, and taking into consideration that the main channel for

<sup>25</sup> CNBV, José Ricardo Álvarez Juárez. "Tendencias en Regulación y Supervisión de CAC: El Caso de México". Dirección General de Supervisión de Cooperativas de Ahorro y Crédito, Seminario internacional "Regulación y Supervisión de Cooperativas de Ahorro y Crédito", septiembre de 2010.

<sup>26</sup> While there is not a formal definition of microcredit, by quantity it is defined from the point of view of file integration and credit granting process.

<sup>27</sup> The biggest microfinance institution in Mexico which operates under a bank license.

microcredit in Mexico is village banking (with weekly payments and three or four-month terms), regulators are also considering the possibility of setting rules

according to the number of payments overdue, regardless of the days.

## BCBS: MAIN ISSUES

Undoubtedly, Mexico's regulatory framework, even though very complex, has successfully adopted a risk-based approach to regulating and supervising banks and non banks. They have not faced any major restrictions or limitations arising from Basel Principles, which has, according to the regulators, allowed an ample framework to develop which incorporates a proportionate approach depending on the institutions' risk profile. However, regulators consider that Basel II will be too burdensome on small MFIs and Cajas and so have put into place a tiered approach in terms of minimum capital, and risk management processes focused mainly on credit risk, all of which offer enough flexibility to deal with the peculiarities of the institutions and the segments they cater to.

To simplify the supervisory challenge for the CNBV, Mexican regulators decided to construct an auxiliary supervision scheme that takes into account the CNBV's capacity and provides a cost-effective structure. They took into account not only the number of additional institutions to supervise but also their geographical distribution in areas where CNBV has no physical presence. The system has had to be reformed further during the past decade and special attention has been placed on aligning the interests of the CNBV, as the ultimate supervisory entity, and those in charge of auxiliary supervision. In both areas, regulators state that more guidance from BCBS would be very useful, especially in outlining the specific risks around Cajas. These include corporate governance structure, capital composition, ways to strengthen capital in crises and supervisory approaches, for which guidance and an exchange of views and information between regulators and supervisors would be beneficial. In this respect, although they have taken into account the document on microfinance published by the BCBS in 2010, they would also welcome a deeper discussion on topics relevant to Cajas.

With regard to the Core Principles they suggest that in principle 18, the text should also reflect the obligation of supervisors to ensure (through a risk-based approach) that KYC rules are not an obstacle to offer financial services for segments of the population unattended by banks. Apart from the focus upon safety and soundness, and the stability of the banking system, in principle 19 they suggest the incorporation of "inclusiveness" as another of the supervisory responsibilities. Furthermore, principle 11 should highlight the importance of "policy solutions that enhance access and usage of the formal financial system".

## 2.3 Committee on Payment and Settlement Systems

### *Steps have been taken to assure interoperability in the payment system*

As mentioned above, since the adoption of the 2002 Payment Systems Law<sup>28</sup>, Banco de México acts as regulator and supervisor to payment system operations. It operates the Electronic Interbank Payment System (Sistema de Pagos Electronicos Interbancarios, SPEI) through which the banking and non-banking sector<sup>29</sup> are interconnected. Via SPEI, funds can be transferred from any account in the financial system to another, since all banks promote and are required to assign a unique identification number, CLABE, to every

account. This guarantees full interoperability and allows any financial institution (including non-banks), to have direct access and to disburse electronic payments (of any value) to any bank account, at one of the lowest costs in the world for direct participants, which also offer the service at a very low fee to their originating customers.

### *Payment systems between Mexico and the United States have also been linked*

Apart from the SPEI, the other two systemically important payment systems in Mexico are the Banco de México's Account Holders Service System (Sistema de Atención a Cuentahabientes de Banco de México - SIAC), and the Securities Deposit, Administration, and Settlement System (DALI). Both the SPEI and SIAC are Real Time Gross Settlement (RTGS) Systems.

<sup>28</sup> Ley de Sistemas de Pagos, Diciembre 2002.

<sup>29</sup> Reglas del SPEI (Circular 17/2010).

Another innovation is the interconnection between the Mexican payment system and that of the United States<sup>30</sup>. This connection, Directo a México, resulted in an efficient interbank mechanism to process cross-border payments between both countries. It is available to all financial institutions in both countries. On the Mexican side, the connection has been with the RTGS, allowing all banks and non-bank institutions that participate in SPEI to use it. Directo a México has helped significantly reduce costs in sending cross-border payments and in foreign exchange operations.

Due to the success of the SPEI, this Real Time Gross Settlement System was opened not only for banking institutions but also for other non-banking participants approved by the Central Bank, enabling proportionate standards in this field to be met.

### *Payment switches have promoted competition and strengthened the payment architecture*

In terms of card payment systems, there are two payment switches (card clearing house) that operate in Mexico: Prosa and E Global, both co-owned by the banks (though not all the existing banks). The most recent amendments to the Transparency Law, aimed at promoting competition in the payments processing market and reducing entry barriers, requires payment clearing houses to interconnect and allow access to any new entrant, without charging any interconnection and per transaction processing fees. The regulation that establishes the detailed requirements is in process of being enacted by the central bank. Special consideration is being given to the methodology used to calculate the interchange fees to be charged between the operators by Banco de México.

### *Remittance services are not regulated*

Given the importance of remittances in the Mexican economy and in particular for the lower income population (the average remittance is US\$317), it is noteworthy that remittances, both international and national, are considered a “money transmission” service. They are differentiated by the fact that the amount that is sent has to be claimed fully by the beneficiary. “Money transmitters” until very recently could voluntarily register at the Tax Administration Office (Servicio de Administración Tributaria – SAT). This registration process became mandatory on 3 August 2011 and will come into force 90 days after this date. It further requires that they be structured as legal entities, with a physical fixed address. In eight months’ time, they will be supervised for AML/CFT purposes (duty carried out by the SAT up to that date), which are now being discussed in terms of the transaction threshold that will require full disclosure. Since 2009, the threshold for the Cajas and Sofipos has been US\$3,000 and for banks has been US\$1,000, but authorities are in the process of standardizing these limits across all operators of remittances to prevent regulatory arbitrage.

### *A legal framework for e-money has not yet been considered*

In Mexico there is no regulation yet applicable to e-money services. Some of those interviewed mention that the “Niche bank” regulation already provides a framework whereby institutions specializing in payment services could operate with a lower capital requirement. Nevertheless, other authorities mentioned that they are currently discussing the elements of draft regulation that will consider a legal framework for these services.

## **CPSS: MAIN ISSUES**

CPSS principles in the case of Mexico are regarded as especially relevant for the systemically important payment systems and therefore no limitations or restrictions have been identified in relation to financial inclusion.

Banco de Mexico has assumed an active role not only as regulator but rather as the operator of SPEI, the RTGS system which allows any financial institution linked to it to disburse electronic payments, of any amount, to any banking account in the financial system. In doing so, it has guaranteed interoperability and encouraged access and competition in the payment market. Nevertheless, the recent law that establishes interconnection obligation between switches, without charging fees, could have profound effects in the payment infrastructure of the country. Since they are in the process of issuing the specific regulation, regulators would consider it very important to discuss different alternatives that guarantee competition and interoperability, including the mobile networks, which do not stifle innovation and the development of new business models.

In terms of proposals to the CPSS, Banco de Mexico would value more guidance related to Card Payments Systems, particularly in terms of regulation for the card processing market, interchange fees and merchant acquiring services. Specifically, methodologies to increase the transparency of the interchange fee structure would be very useful.

<sup>30</sup> This originated as a response to the Partnership for Prosperity “Action Plan” between Mexico and the United States, when the central banks of both countries agreed to link their payments systems.



## 2.4 International Association of Deposit Insurers (IADI)

### *Greater public awareness of deposit insurance in Mexico is being fostered*

The Deposit Insurance Institute (Instituto de Protección del Ahorro Bancario- IPAB) understands its main responsibility regarding financial inclusion is to foster confidence in banks, by offering savers the certainty that their deposits are guaranteed up to the coverage limit and so providing an incentive for people to deposit their savings. This contributes to the soundness of the banking system.

### *The rigor of regulation reflects the level of deposit insurance*

IPAB underscores the importance of its role within the “National Strategy of Financial Literacy” where it has carried out outreach programs to raise public awareness of the benefits and scope of the deposit insurance system, as well as to encourage the use of formal savings mechanisms. The limited financial resources it has to develop these activities pose a challenge when promoting savings nationwide. IPAB has a legal mandate to manage the deposit insurance system in Mexico for the benefit of depositors in

banking institutions. As explained in section 2.2, the Law enacted in 2009 to enforce regulation for the non-bank sector (Cajas and Sofipos), created a separate private deposit insurance scheme, administered under a fiduciary arrangement by BANSEFI, a state owned development bank. Both IPAB and FPD differ in their coverage. IPAB offers insurance with a limit of US\$108,000, covering almost 99 percent of bank deposits while the Fondo de Protección de Depósitos of the non-bank sector covers deposits up to US\$6,750 held in regulated organizations. This amount, according to the analysis of the deposits held in non-banks, represents an important portion of the savings accounts in those institutions. According to the authorities interviewed, this is an effort to correctly align incentives with the level of supervision and regulatory requirements, and to provide an incentive for the non-regulated institutions to increase their operational standards and the services for their clients.

### *Marketing has helped to promote deposit insurance in the public space*

The IPAB has undertaken different marketing activities such as advertising, brochures, and information on the websites of banking institutions to spread the benefits of deposit insurance to the general population.

#### IADI: MAIN ISSUES

The main priority of IPAB is to assure confidence in the banking sector. It regards the IADI principles as extremely relevant and applicable. For IPAB, providing a broad coverage of a deposit scheme is made possible by covering banks’ deposits, which they regard as the ultimate goal of a financial inclusion agenda. They stimulate the usage of financial services provided by the most regulated and supervised financial institutions (banks) and in this sense feel they comply with IADI principles in terms of “awareness”, “coverage”, and “membership”. Similar to IADI, strengthening cooperation and coordination mechanisms with organisms and associations is of paramount importance. They also promote international forums regarding financial inclusion topics pertinent to deposit insurance.

The latest initiative with regards to the legal framework supports efforts to regulate Cajas and has established a private deposit insurance scheme for them and Sofipos, using this as an incentive to invite them to come under regulation.

## 2.5 International Association of Insurance Supervisors (IAIS)<sup>31</sup>

### *Regulatory simplification contributes to an expansion of micro-insurance*

As the insurance companies’ supervisor, CNSF has in its mandate not only the supervision of the insurance

and surety industries to ensure their solvency and financial stability, but also a role in increasing their outreach.

Insurance regulation in Mexico covers the concept of micro-insurance<sup>32</sup>, defined as low price insurance product targeting the low-income population. Special attention has been given to simplifying the distribution process, whereby for example there is no requirement for agents to be certified by the

<sup>31</sup> Mexico is a member since 1994.

<sup>32</sup> Capítulo Título 5, Capítulo 5, inciso 5.1.2 e inciso 5.1.23. de la Circular Única de Seguros, CNSF.

Commission<sup>33</sup>. In terms of coverage, regulation sets limits as well as specific clauses which the policies should incorporate in order to simplify the product and make it comprehensible for potential clients. Some features of micro-insurance regulation are:

- Insurance agents that sell or promote micro-insurance products do not have to be evaluated and consumer protection is certified by the CNSF, as long as they have received the appropriate training provided by the respective insurer.
- Limits are established: For personal insurance (life and accidents & health) the insured amount must not exceed four times the minimum wage (SMG)<sup>34</sup>, annualized; for collective insurance (life and accidents & health) the insured amount for each member of the group must not exceed four times the SMG, annualized; and for Property and Casualty, insurance must not have a monthly premium above 1.5 SMG.
- Insurance contracts have to be filed at CNSF for registration before a new product is launched. Contracts must be written clearly, precisely and in a simple manner; if any exclusions are applied, they have to be general and not related to the individual risk. Claim and indemnity payments

must follow a simplified procedure, which has to take place within five days after the claim.

Regulators consider they have made great progress since the number of people with micro-insurance has increased from 608,097 in 2006 to 3,305,317 in 2010.

Regulations for insurance companies offering a proportionate approach have not been issued, since CNSF considers there are no informal providers of insurance products. What is very common in the country is the “prepayment” of funeral services. However such products are not considered an insurance product and so authorities do not consider it necessary to regulate that market. Concerning “market conduct”, existing regulation considers requirements in terms of disclosure and transparency of relevant information. Companies are required to publish all the relevant information pertaining to their financial situation, risk level, and solvency.

The aspects related to consumer protection are the responsibility of CONDUSEF, as will be explained later, but the authorities propose that micro-insurance product simplification allows potential clients to understand it easily, with the claim process undertaken without great difficulty.

#### IAIS: MAIN ISSUES

The CNSF, which is an active member of IAS, has found no impediment or difficulty in applying the principles in regulations related to micro-insurance (the best suited product for financial inclusion). Nevertheless, authorities are still analyzing how to reconcile the need to have more flexible rules for new delivery channels with FATF requirements and principles. Specifically this applies to requiring insurance agents to be integrated within a system that complies with AML/CFT requirements.

## 3. Cross-cutting challenges

### 3.1 Proportionality

#### *Enabling a positive environment for financial inclusion while applying principles of proportionality*

Mexican regulation includes diverse examples that apply principles of proportionality, and authorities state they have been able to adjust regulatory requirements based on an assessment of the risks that are implicit in different circumstances.

This is most evident in the way that FATF and BCBS principles have been adopted. The example of the new regulation that distinguishes between different levels of requirements for accounts according to amount limits reflects a conscious effort to regulate while having a low-cost environment to promote financial inclusion, within a risk based approach. This has required “fine tuning” since the first efforts in 2009; thresholds, operations and means of payment have all been revised, to come up with a combined approach that authorities now feel will enable a positive environment for inclusion while preserving adequate controls for AML/CFT.

<sup>33</sup> With regard to agents, the CNSF and the Ministry of Finance are discussing with the UIF how to develop a framework to adequately conduct AML/CFT procedures without hindering the financial inclusion objectives.

<sup>34</sup> Referred to the minimum wage established for the Distrito Federal, Mexico’s Capital.



Even though the authorities acknowledge that they have not used the “test and learn” approach, they recognize that in the efforts made to regulate and supervise Cajas, they have come to know and understand their special characteristics and peculiarities, which raises the possibility of simplifying and adjusting requirements, based on the institutions’ risk profiles.

## 3.2 Formalization of informal, semi-formal and alternative service providers

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*Consideration has been given to regulation of alternative providers of financial services*

Regulators in Mexico have been particularly concerned with the need to take a much more flexible approach to regulate deposit taking institutions and in particular alternative (informal and semi-formal) types of providers of financial services, for example “money transmitters”, which currently are subject solely to AML/CFT rules and no further regulation or supervision.

Such a balanced approach has already been demonstrated in the way that formalization incentives have been provided for Cajas. This includes the creation of a private deposit insurance scheme and also by balancing the regulatory and supervisory requirements, seeking equilibrium between the sector and the authorities. The common denominator is the wellbeing of the sector and its members.

The same case has not happened in the insurance sector because the CNSF considers that informal providers in Mexico are negligible.

## 3.3 Consumer Protection

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*Financial education and public awareness are recognized as pillars of financial inclusion*

Consumer protection in financial services has been at the forefront of policymaking in the Mexican context since the mid nineties crisis, giving way to the creation of the Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros, CONDUSEF, an independent public institution created dependant of the Ministry of Finance. Authorities consider that greater public awareness increases financial inclusion, and helps protect public confidence in the financial system.

The role played by CONDUSEF was reinforced by the 2009 reforms to the Transparency Law, which transferred from CNBV to CONDUSEF powers to regulate and supervise financial institutions in consumer protection matters, even giving it the authority to impose sanctions.

The original “Law for the protection and defense of users of financial services” (*Ley para la Defensa y Protección de los Usuarios de los Servicios Financieros (LPDUSF)*), established the protection and defense of the interests of financial services’ customers and considered CONDUSEF’s main task to be to promote, advise, protect and defend the rights and interests of such users; to arbitrate their differences in an impartial way, and to contribute to a fair relationship between the users and financial institutions.

Recently, the government has been also working in other areas including transparency, by establishing precise standards regarding fees charged by financial institutions, disclosure statement principles and the obligation for banks to offer basic savings products. The Ministry of Finance has also been working to develop a financial literacy agenda in order to implement a national financial education strategy aimed at enhancing financial literacy in all segments of the population.

## ANNEX 1 – Features of Banking Accounts

	Level 1 <sup>1/</sup> (280 USD)	Level 2 <sup>2/</sup> (1,114 USD)	Level 3 (3,715 USD)	Traditional Bank Account
Customer file	No ID needed	Basic customer information <sup>3/</sup>	Complete customer information	Complete customer information
Customer documentation	Not applicable	No need to keep a hard copy		Required to keep hard copy
Face to face process	No	No (bank could decide for a face procedure)	Yes	Yes
Point of access	Bank branch / banking agent / Internet / Mobile phone / third-party call center		Bank branch / banking agent	Bank branch

1/ Additional non-cumulative balance of 370 USD.

2/ There is a one time transitional period to verify customer identification (18 months). In this period the transactional limit is 560 USD.

3/ Name, date and place of birth, gender and address.

Note: Approximated amounts in US Dollars. The limits are expressed in UDIS, which are indexed to inflation.

UDI 1 = MXP 4.58, USD 1 = MXP 12.34.

## ANNEX 2 – Non Bank Institutions - Cajas and Sofipos: Operation and Regulation Levels

OPERATIONS		ASSETS		MINIMUM CAPITAL	
		UDIS	US\$	UDIS	US\$
Basic level	Savings and time deposits from associates. Lend and transfer money from associates, borrow from financial institutions	Asset <= 2,500,000 UDIS	Assets <=927,083		
Level 1	Savings and time deposits from associates. Lend to associates, borrow from financial institutions, issue debit and prepaid cards, money transfers. Lend to other co-ops. Buy foreign exchange	Asset <= 10 mill UDIS	Asset <= US\$ 3,708,333	100,000	37,083
Level 2	Level 1 + factoring, safe deposit boxes, payrolls services	Asset > 10 mill <= 50 mill UDIS	Asset > US\$ 3,708,333 <= US\$18,541,667	500,000	185,417
Level 3	Level 2 + leasing with associates	Assets > 50 mill <= 250 mill UDIS	Asset > US\$ 18,541,668 <= US\$92,708,333	4,000,000	1,483,333
Level 4	Level 3+ acceptances & guarantees discounts, credit cards & current account to associates	Assets > 250 mill UDIS	Assets > US\$92,708,333	22,500,000	8,434,750

Source: CNBV

### ANNEX 3 – Banks: Minimum Capital Requirements

Type	Operations Allowed	MINIMUM CAPITAL	
		UDIS	US\$
1	All operations allowed	90,000,000	33,375,000
2	Only domestic operations allowed	54,000,000	20,025,000
3	Institutions Specialized in Corporate Clients	36,000,000	13,350,000
4	Institutions Specialized in Money Issuing and Payments	36,000,000	13,350,000

Source : CNBV

**GPFI**

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Global Partnership  
for Financial Inclusion

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## Global Partnership for Financial Inclusion

[www.gpfi.org](http://www.gpfi.org)

The Global Partnership for Financial Inclusion (GPFI) is the main platform for implementation of the G20 Financial Inclusion Action Plan. The group engages partners from G20 and non-G20 countries, private sector, civil society, and others. It is chaired by the G20 troika countries, currently Korea, France, and Mexico. The GPFI is supported by three implementing partners: the Alliance for Financial Inclusion (AFI), the Consultative Group to Assist the Poor (CGAP), and the International Finance Corporation (IFC).

**afi** Alliance for  
Financial Inclusion  
Bringing smart policies to life

## Alliance for Financial Inclusion (AFI)

[www.afi-global.org](http://www.afi-global.org)

AFI is a global network of central banks and other financial inclusion policymaking bodies in developing countries. AFI has been given the mandate to foster the participation of non-G20 developing countries in the G20's Global Partnership for Financial Inclusion as an implementing partner.

### Alliance for Financial Inclusion

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