Global Standard-Setting Bodies and Financial Inclusion for the Poor

Toward Proportionate Standards and Guidance

A White Paper Prepared by CGAP on Behalf of the G-20's Global Partnership for Financial Inclusion

GPFI Global Partnership for Financial Inclusion

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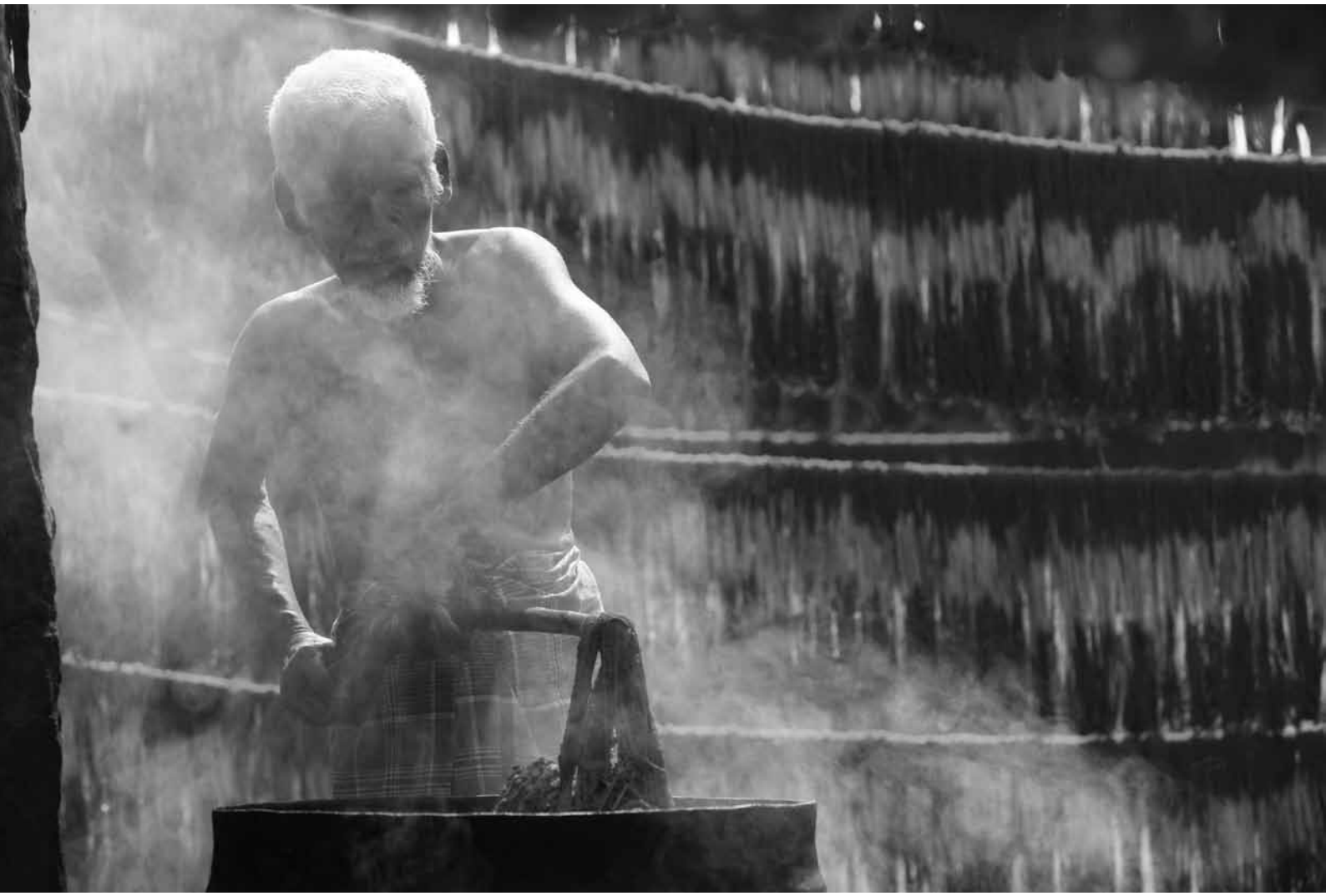
CONTENTS

LIST OF ACRONYMS

AFI	Alliance for Financial Inclusion
A2II	Access to Insurance Initiative
AML/CFT	Anti-money laundering and combating financing of terrorism
BCBS	Basel Committee on Banking Supervision
BCPs	Basel Core Principles for Effective Banking Supervision
BIS	Bank for International Settlements
CDD	Customer due diligence
CGAP	Consultative Group to Assist the Poor
CPSS	Committee on Payment and Settlement Systems
FATF	Financial Action Task Force
FDIC	Federal Deposit Insurance Corporation (U.S.)
FIEG	G-20 Financial Inclusion Experts Group
FIIS	Financial Inclusion and Innovation Sub-committee, IADI Research and Guidance Committee
FIU	Financial Intelligence Unit
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSRBs	FATF-Style Regional Bodies
GPFI	G-20 Global Partnership for Financial Inclusion
GRWG	Global Remittances Working Group
G2P	Government to person
G-20	Group of Twenty
IADI	International Association of Deposit Insurers
IAIS	International Association of Insurance Supervisors
ICPs	Insurance Core Principles
IFC	International Finance Corporation
ILO	International Labour Organisation
IMF	International Monetary Fund
IOPS	International Organization of Pension Supervisors
IOSCO	International Organization of Securities Commissions
MFI	Microfinance institution
MNO	Mobile network operator
NAIC	National Association of Insurance Commissioners (U.S.)
NPMs	New payment methods
OECD	Organization for Economic Cooperation and Development
POS	Point-of-sale
ROSCs	Reports on the Observance of Standards and Codes
SSB	Standard-setting body
UNSGSA	United Nations Secretary General's Special Advocate for Inclusive Finance Her Royal Highness Princess Máxima of the Netherlands



PREFACE

The multi-year Financial Inclusion Action Plan approved by G-20 leaders at the November 2010 Seoul Summit recognizes the commitments of the global financial sector standards-setting bodies (SSBs) to "support financial inclusion" and encourages SSBs "to further explore . . . complementarities between financial inclusion and their own mandates." This call culminates a period of rapid development in global recognition of the importance of access to formal financial services for the billions of people around the world who currently lack adequate access—and a period of growing recognition of the critical role the relevant SSBs can play in closing the financial access gap. To support SSBs on this important subject, and to implement the Financial Inclusion Action Plan more generally, the G-20 launched the Global Partnership for Financial Inclusion (GPFI), an inclusive platform for G-20 and non-G-20 countries as well as other relevant stakeholders committed to peer learning, knowledge sharing, policy advocacy, and coordination on financial inclusion.

In its first year, two projects have been undertaken on behalf of GPFI pursuant to the G-20 leaders' call for engagement with SSBs: Five country case studies, prepared under the leadership of GPFI Implementing Partner the Alliance for Financial Inclusion (AFI), explore the application of SSBs' standards and guidance at the country level in countries at the forefront of pursuing a financial inclusion policy agenda (Brazil, Kenya, Mexico, the Philippines, and South Africa) and a white paper, "Global Standard-Setting Bodies and Financial Inclusion for the Poor—Toward Proportionate Standards and Guidance," prepared under the leadership of GPFI Implementing Partner the Consultative Group to Assist the Poor (CGAP), raises awareness and frames issues to inform ongoing work by the five SSBs to integrate financial inclusion into standards and guidance that can be effectively applied at the country level.

Both the country case studies and the white paper take stock of the accomplishments of SSBs to date and further steps SSBs are taking to foster a more enabling environment for financial inclusion. They also suggest further work related to the standards and guidance of SSBs—by SSBs, but also by GPFI and its stakeholders, and others—that can advance this shared objective.

ACKNOWLEDGMENTS

This publication has been prepared on behalf of the G-20's Global Partnership for Financial Inclusion (GPFI) under the leadership of CGAP in its capacity as an Implementing Partner of GPFI. The consultative process by which it was developed included informal input at the outline and drafting stages from personnel associated with the five Standard Setting Body (SSB) secretariats, peer reviewers from three member countries of GPFI Implementing Partner Alliance for Financial Inclusion (AFI) (financial regulators from Kenya, Mexico, and the Philippines), staff of six relevant World Bank technical units, four co-chairs of the GPFI Sub-group on the G-20 Principles for Innovative Financial Inclusion and Engagement with SSBs (Indonesia, Kenya, Korea, and the Philippines), staff of GPFI Implementing Partner International Finance Corporation (IFC), staff of the UN Secretary General's Special Advocate for Inclusive Finance Her Royal Highness Princess Máxima of the Netherlands, and staff of the Bill & Melinda Gates Foundation. This white paper was developed by experts from CGAP and the World Bank led by Timothy Lyman of CGAP. These experts include Louis de Koker, Denise Dias, Kathryn Imboden, Kate Lauer, Kate McKee, Rafael Mazer, and Michael Tarazi (all from CGAP) and Pierre-Laurent Chatain, André Corterier, Claire McGuire, Rafael Pardo, Ceu Pereira, Sue Rutledge, Craig Thorburn, and Emiko Todoroki (all from the World Bank). Valuable guidance was provided by Tilman Ehrbeck and Greg Chen (both from CGAP) and Massimo Cirasino, Mario Guadamillas, Eric Haythorne, Jean Pesme, and David Scott (all from the World Bank).

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

EXECUTIVE SUMMARY

Introduction

Together, the normative standards and advisory guidance of 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) have significant influence on *how many poor households* get access to *what range* and *quality* of formal financial services and *at what cost*. While these five standard-setting bodies (SSBs) have varying relevance and importance to financial inclusion, all matter and all are increasingly engaged on the subject. This white paper aims to raise awareness and frame issues to inform ongoing work by the five SSBs to integrate financial inclusion into standards and guidance that can be effectively applied at the country level.

For the SSBs, embracing the goal of full financial inclusion represents a potentially significant shift of focus and requires a commensurate evolution in thinking, and the SSBs are at different stages in this evolution. Some of the issues to be considered are specific to the mandate of each SSB, while others are jointly relevant to multiple SSBs. On both types of issues, joint engagement offers the SSBs the opportunity to understand each other's perspective and to learn from each other. It also holds the promise of SSB standards and guidance that help country-level policy makers balance priorities as they pursue a broad financial inclusion agenda.

Background: Three Themes and Proportionality

"Financial inclusion", as the term is used in this white paper, refers to a state in which all working age adults have effective access to credit, savings, payments, and insurance from formal service providers. "Effective access" involves convenient and responsible service delivery, at a cost affordable to the customer and sustainable for the provider, with the result that financially excluded customers use formal financial services rather than existing informal options.

Working toward full financial inclusion is an ongoing and dynamic process. The reality for many financially excluded households is that informal options may be the best they have available for years to come for at least some of their financial service needs. This white paper introduces three linked themes for the SSBs to consider in relation to this process.

First, *financial exclusion carries risks* within the SSBs' spheres of interest (those of FATF, IAIS, and BCBS, in particular). These include threats to financial integrity and international security (e.g., the money-laundering and terrorist financing risks of cash transactions, often across borders, through informal providers), social and political stability, and even potentially financial stability (e.g., political

unrest touched off by pyramid schemes organized as informal savings and investment opportunities that trigger lack of confidence in the banking system). Though FATF has recently explicitly acknowledged financial exclusion as an important risk (FATF 2011), the subject has not yet been systematically studied with respect to any of the SSBs.

Second, the processes of *increasing financial inclusion* will *change the nature* (and sometimes also the level) of risks. These changes result from a variety of factors, including the characteristics of currently financially excluded customers (which differ from the "already served" with which the SSBs are most familiar), as well as the nature of the products, services, and providers capable of reaching them, and especially the innovative approaches needed to accomplish significant increases in financial inclusion. The *benefits of financial inclusion,* such as economic growth, efficiency, and increased welfare, both offset these changing risks and mitigate the risks of financial exclusion.

Third, the *country context* in which SSB standards and guidance are being applied matters. Two parameters, in particular, merit reflection: the current nature and level of financial exclusion in the country in question and the capacity of policy makers, regulators, and supervisors to implement SSB standards and guidance. For some, particularly lower income, countries with high current levels of financially excluded households, full compliance with existing SSB standards and guidance may be a long-term goal. Thus, while SSBs' normative standards of relevance to increasing financial inclusion may be designed to be applied flexibly in all country contexts, advisory guidance that considers the implementation challenges encountered in varying country contexts may be needed.

This white paper advocates application of the *proportionality principle*—the balancing of risks and benefits against costs of regulation and supervision—as an essential means for addressing these themes, both in the standards and guidance of the SSBs and in their country-level implementation. Risks and benefits are often perceived and measured differently by different stakeholders, and the complexity of the risk and benefit assessment multiplies when the varied regulatory and supervisory standards of the SSBs are applied across the different products, services, and providers that a broad financial inclusion agenda involves. Also, the proportionality calculus requires attention, not just to the risks of financial exclusion, but also to the benefits of financial inclusion beyond the mitigation of financial exclusion risks, such as economic growth, efficiency, and increased welfare. While these benefits may be only indirectly related to the core mandate of a particular SSB, they can feature significantly among the SSBs' motivation to incorporate consideration of financial inclusion issues into their work and are priorities for many country-level policy makers seeking to apply the SSBs' standards and guidance.

SSB-specific topics

Basel Committee on Banking Supervision. BCBS sets standards and issues guidance that are applied by many countries in the regulation and supervision of both banks and other deposit-taking institutions. The 2010 BCBS report "Microfinance activities and the Core Principles on Effective Banking Supervision" offers a useful starting point for considering proportionate application of the Basel Core Principles (BCPs) to enable a broader financial inclusion agenda. Additional issues to consider include, among others, differentiated guidance on various types

of nonbank deposit-taking institutions that today serve large numbers of poor households, often without effective regulation and supervision, and proportionate approaches to regulation and supervision of financial inclusion innovations, such as branchless banking (including nonbank e-money and the use of agents). The revision of the BCPs currently in process provides an opportunity to examine the relevance of the BCPs with regard to financial inclusion—in particular, the links among financial inclusion, prudential oversight, and financial consumer protection. While the existing BCP framework is considered adequate for microfinance (BCBS 2010), the revision process also offers a chance to reconsider the BCPs' implications for financial inclusion broadly, and to assess which aspects of financial inclusion are appropriately addressed in the BCPs (because of linkages to banks and the banking sector) and which may be more effectively dealt with in subsidiary guidance.

Committee on Payment and Settlement Systems. CPSS has historically focused on large-value payments and systemically important payment systems, though in recent years, it has expanded its involvement with the issues of safe and efficient retail payment systems and payment instruments. In principle, all the work of CPSS is potentially positively correlated with the goal of financial inclusion to the extent that implementation of relevant CPSS standards and guidance leads to a larger share of the population benefiting from better quality payment services at a lower cost. Current CPSS standards permit this goal to be pursued while also allowing space for innovative payment platforms and instruments (such as e-money) that provide new ways of reaching financially excluded customers and are gaining transaction volume, particularly in the emerging market and developing economy countries, where a majority of financially excluded people live. The CPSS Working Group on innovative retail payments offers a forum for considering and developing further guidance to position country-level authorities to enable such innovation through proportionate regulatory and supervisory treatment.

Financial Action Task Force. FATF sets standards for national regimes on anti-money laundering and combating the financing of terrorism (AML/CFT). Financial exclusion poses a profound challenge for FATF's financial integrity mandate. Because financial inclusion brings more customers and transactions from the untraceable world of cash into the traceable world of formal financial services, it bears a highly complementary relationship to FATF's core objective of combating money laundering and terrorist financing, as recognized in FATF's groundbreaking 2011 guidance paper "Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion"—the first instance of an SSB explicitly addressing financial exclusion risks in its guidance. Yet, despite the potential complementarity of financial inclusion and AML/CFT as policy objectives, national AML/CFT requirements aimed at implementing FATF's Recommendations in some countries perpetuate or increase financial exclusion by imposing unnecessary costs and regulatory hurdles for service providers trying to reach financially excluded customers and by setting customer due diligence (CDD) identification and verification requirements that many low-income persons are unable to meet. Following a "risk-based" (i.e., proportionate) approach to AML/CFT, as permitted by the FATF Recommendations, could permit countries to exempt financial services rendered on very limited bases from most AML/CFT controls and allow simplified CDD measures on "low risk" financial services. Ongoing review of the FATF Recommendations and upcoming revisions to the FATF guidance papers on the

risk-based approach, as well as future work on the methodology for mutual evaluations and training of evaluators, offer potential opportunities to clarify acceptable risk-based approaches, and take into account the links between money laundering and terrorist finance risk and financial exclusion.

International Association of Deposit Insurers. IADI provides a forum for international cooperation among deposit insurers, central banks, and international organizations on issues related to financial stability, deposit insurance, and resolution activities. IADI's Core Principles were developed and approved jointly with BCBS in June 2009, reflecting the fact that deposit insurance is part of an effective financial "safety net" that also includes robust prudential regulation and oversight. Public awareness in countries that have explicit deposit insurance systems can play a significant role in ensuring that low-income depositors are informed about safe methods of storing their money. Effective systems of deposit insurance can also potentially increase public trust in institutions holding insured deposits, spurring greater participation by financially excluded poor households in the mainstream banking system. In 2010, IADI formed the Financial Inclusion and Innovation Subcommittee (FIIS) to study issues related to financial inclusion and deposit insurance. FIIS is currently conducting a survey of IADI members to identify the range of practices among its members on issues related to financial inclusion and deposit insurance. While it is premature to anticipate the future work streams that FIIS may pursue, some countries may be giving thought to the challenges of extending deposit insurance coverage to nonbank deposit-taking institutions and "deposit-like" products, such as e-money, that have demonstrated potential to reach financially excluded customers. However, the first challenge for emerging market and developing economy countries interested in expanding deposit insurance to nonbank deposit-taking institutions will be establishing the strong and independent supervision of those institutions, a precondition for inclusion in effective deposit insurance systems.

International Association of Insurance Supervisors. IAIS's insurance market development mandate and very broad membership (including many jurisdictions with high levels of financial exclusion) make financial inclusion a fundamental priority for IAIS, intertwined with its prudential and consumer protection objectives. Since the inception of its work in the area of microinsurance (which has become synonymous with the concept of inclusive insurance markets), IAIS has recognized two distinct classes of relevant issues: *(i)* those applicable to extending conventional insurance to reach excluded customers and *(ii)* those applicable to bringing existing informal providers of insurance products into compliance with the Insurance Core Principles (ICPs) and ultimately under supervision. Revised ICPs that strengthen the proportionality principle are to be adopted in fall 2011, and are anticipated to be followed by approval of IAIS guidance on implementation of ICPs in the context of inclusive insurance markets, which marks the culmination of IAIS's pathbreaking work begun in 2005. Following adoption of the guidance paper, the opportunity will arise to shift focus to developing tools and capacity for implementation at the country level.

Topics of Joint Relevance

This white paper considers three topics that are each of essential importance to the goal of financial inclusion, and also highly relevant to the core mandates of multiple SSBs—in some cases all five: *formalization of informal providers, financial consumer protection,* and *branchless banking (including e-money, agents, and similar innovations)*. On some aspects of each topic, financial inclusion will be advanced by SSBs arriving at common positions; on others all that will be required is an understanding of each other's differing concerns and perspectives.

Formalization of informal providers is a critical topic to financial inclusion given the large (and, in many countries, growing) numbers of such providers that already serve poor households. Proportionality and formalization are intertwined concepts, as proportionate regulation can be critical to formalization. Where regulatory and supervisory approaches are not proportionate, informal institutions may not be able to formalize. Formalization, however, is also a complicated topic to consider across the standards and guidance of the five SSBs because it has varying meaning and importance depending on the SSB and the type of service provider in question. Moreover, in many situations, closing off access to informal financial services because the providers cannot or do not want to meet the requirements of formalization runs counter to the overall objective of financial inclusion to improve the well-being of poor households. Indeed, there is strong justification for permitting certain small institutions (such as small financial cooperatives that pose no systemic threat) to operate informally if their members have no access to safer options.

Effective financial consumer protection is an essential element of "financial inclusion" as defined in this white paper, as the concept of "responsible delivery" presupposes both responsible market conduct by providers and effective financial consumer protection oversight. It is also a topic of concern for four of the five SSBs (IAIS, BCBS, IADI and CPSS), although to varying degrees. The topic triggers specific considerations for financially excluded customers and for low-income countries with high levels of financial exclusion and low levels of capacity among regulators and supervisors. The specific characteristics of excluded consumers have significant implications for effective consumer protection regulation and supervision and, therefore, also for SSB standards and guidance aimed at enabling financial inclusion. Relevant characteristics are likely to include limited experience with, and sometimes distrust in, formal financial service providers; lower levels of education and financial literacy and capability; few formal providers to choose from, if any; and remote locations. Consumer research provides a useful tool for policy makers seeking to understand the behavior of excluded consumers joining the formal financial system and to design and prioritize effective and proportionate measures to protect them.

Branchless banking (including e-money, agents, and similar innovations) is relevant due to its unique potential to increase financial inclusion. In addition, it raises several issues that would benefit from coordinated attention by two or more SSBs. As with other innovations in financial service delivery on which the SSBs have worked jointly, the better each SSB understands the risks and benefits of branchless banking as perceived by the others, the more likely that SSB engagement will reflect a proportionate approach to regulation and supervision of the relevant actors and products. For policy makers, regulators, and supervisors at the country level and for the SSBs, branchless banking, e-money, and agents present challenges because they implicate new actors and new relationships among actors. In

addition, the pace of innovation is challenging, with new models evolving rapidly. SSB guidance needs to recognize that the various emerging models place the different elements of the financial services value chain in different hands. This calls for unbundling the value chain and taking a "service-based" approach, regulating to the extent feasible based on the activity and the risks it involves, while taking due account of the risk profile of the party executing the activity in question.

Observations and Recommendations

This white paper concludes with general observations and specific recommendations for further engagement on financial inclusion with respect to the standards and guidance of each of the SSBs. Although the SSBs (including their members and observers and their secretariats) are the primary audience, the observations and the recommendations are also relevant for a broader audience given the limited resources of the SSBs and the fact that others may be well-positioned to undertake the recommended activities on their own or in partnership with the SSBs. The observations and recommendations are informed by the varying relevance of financial inclusion to the each of the SSB's core mandate and the varying length and nature of each SSB's engagement on the subject. These factors result in different levels of depth in the application of the observations across the five SSBs as well as wide variation in the level of specificity in the SSB-specific recommendations. However, for all the SSBs, pursuing the ambitious agenda inherent in the concept of "financial inclusion" proposed in this white paper will take time. This white paper is a first step toward framing the issues involved in proportionate SSB standards and guidance on financial inclusion.

Global Standard-Setting Bodies and Financial Inclusion for the Poor

Toward Proportionate Standards and Guidance

Introduction

Dalisay lives in the remote community of Barangay Papaya, on the Philippine island of Tingloy—two hours by small boat from the nearest bank branch. She has no government-issued identification and no officially recognized address. Yet, because of the interpretation of the relevant Financial Action Task Force (FATF) Recommendations adopted in Philippine regulation, she can use a letter from the village leader to open an account with G-Cash, a payments platform offered by the country's second largest mobile network operator. She can use her mobile phone to receive remittances from her relatives in Manila and to pay installments on a small loan she has taken from Bangko Kabayan, a specialized rural microfinance bank. She uses her village corner store (also a G-Cash participant) both to withdraw cash from and to deposit cash into her G-Cash account. FATF, the global standard-setting body (SSB) responsible for norms on anti-money laundering and combating financing of terrorism (AML/CFT), is not the only SSB influencing Dalisay's access to these formal financial services. In regulating and supervising both Bangko Kabayan and G-Cash, Bangko Sentral ng Pilipinas (the Philippine Central Bank) has also sought to conform its approach with the norms of at least two other SSBs, the Basel Committee on Banking Supervision (BCBS) and the Committee on Payment and Settlement Systems (CPSS).

Together, the interpretation of normative standards and advisory guidance[1] of FATF, BCBS, CPSS, and two other SSBs—the International Association of Insurance Supervisors (IAIS) and the International Association of Deposit Insurers (IADI)—has significant influence on *how many poor households* get access to *what range* and *quality* of formal financial services and *at what cost*.[2] The composition and current core mandates of these five SSBs vary widely, and their relevance and importance to financial inclusion also varies. Yet all five matter, and all are taking increasing interest in financial inclusion. Whereas five years ago only two had any

1. "Standards" is used in this white paper to connote the generally high-level norms that each of the five SSBs discussed has formally adopted, and which are variously referred to by the SSBs as "Principles", "Core Principles", "Recommendations", and "Special Recommendations". "Guidance" is used in this white paper to connote a wide range of subsidiary advisory, interpretative, descriptive, or analytical documents below the level of normative standards, which include methodologies, general guidance, applications, issues papers, working papers, and other similar documents.
2. Although these five are not the only SSBs, the standards and guidance of which influence financial inclusion, each was identified by the G-20 Financial Inclusion Experts Group as having significant relevance, direct or indirect, and each has current activities, processes, and forums that address financial inclusion issues (see Part II, "Topics Specific to Each SSB"). The Financial Stability Board (FSB) plays a coordination role with regard to the SSBs discussed in this white paper, particularly regarding issues pertaining to financial stability. FSB was established in 2009 (effectively replacing the Financial Stability Forum) during the financial crisis to address vulnerabilities and to develop and implement strong regulatory, supervisory, and other policies in the interest of financial stability. The work of FSB is not directly considered in this white paper, nor is the work of the International Organization of Securities Commissions (IOSCO) or the work of the International Organization of Pension Supervisors (IOPS).

substantial work in progress explicitly addressing inclusion-related issues, now all five do, with the active encouragement of both member and nonmember governments, the G-20 Financial Inclusion Experts Group (FIEG) and its successor the Global Partnership for Financial Inclusion (GPFI), the UN Secretary General's Special Advocate for Inclusive Finance Her Royal Highness Princess Máxima of the Netherlands (UNSGSA), the World Bank Group, and many others.

This white paper builds on this important work. It aims to raise awareness and frame issues to inform ongoing work by the five SSBs to integrate financial inclusion into standards and guidance that can be effectively applied at the country level. The audiences include the SSBs (their secretariats and their members and observers); other national-level policy makers who interpret and apply the SSBs' standards and guidance; assessors and evaluators who appraise the implementation of SSB positions at the country level; and industry actors who adjust their operations to comply.

Working toward full financial inclusion is an ongoing and dynamic process. Progress will be incremental, and the goal will remain an aspiration for many countries at least for years to come. This white paper introduces three linked themes for the SSBs to consider in relation to this process.

First, *financial exclusion carries risks* within the SSBs' spheres of interest—risks that one of the SSBs, FATF, has recently explicitly recognized, but that none of the SSBs has yet considered extensively.

BOX 1

"Financial Inclusion": A Working Definition

"Financial inclusion", as the term is used in this white paper, refers to a state in which all working age adults, including those currently excluded by the financial system, have effective access to the following financial services provided by formal institutions: credit, savings (defined broadly to include current accounts), payments, and insurance.

"Effective access" involves convenient and responsible service delivery, at a cost affordable to the customer and sustainable for the provider, with the result that financially excluded customers use formal financial services rather than existing informal options.

"Financially excluded" refers to those who do not have access to or are underserved by formal financial services. An estimated 2.7 billion adults worldwide do not have a savings or credit account with a bank or other formal institution (CGAP 2010). (This figure, however, is only a rough proxy for the number of persons worldwide who are "financially excluded" as it sheds no light on factors such as the quality, affordability, sustainability, cost, or convenience of the savings and credit accounts to which others have access, and it does not measure access to payment services or insurance.)

"Responsible delivery" involves both responsible market conduct by providers and effective financial consumer protection oversight.[a] The specific characteristics of excluded consumers have significant implications for effective consumer protection regulation and supervision, and therefore also SSB standards and guidance aimed at enabling financial inclusion. Relevant characteristics are likely to include limited experience with, and sometimes distrust in, formal financial service providers; lower levels of education and financial literacy and capability; few formal providers to choose from, if any; and remote locations (see Part III B, "Financial Consumer Protection").

"Formal institution" refers to a financial service provider that has a recognized legal status and includes entities (and, in some countries, even some individuals) with widely varying regulatory attributes, subject to differing levels and types of external oversight. However, the fact that a customer's financial service provider has a recognized legal status does not mean she or he should be considered "financially included" under the definition used in this white paper: for this, all the conditions of "effective access" must be met. Moreover, formal products and providers do not in all cases offer customers a better value proposition than informal products and providers. The reality for many financially excluded households is that informal options may be the best they have available for the foreseeable future for at least some of their financial service needs (see Part III A, "Formalization").

a. Responsible market conduct by providers includes reasonable steps to ensure transparency and fair treatment, and to mitigate consumer risks.

Second, the processes of *increasing financial inclusion will change the nature* (and sometimes also *the level) of risks* within the SSBs' spheres of interest. These changes will continue as more excluded households are brought into the formal financial sector, due in part to the innovative approaches that are needed to reach these customers. Offsetting these changing risks (and mitigating the risks of financial exclusion) are the *benefits of financial inclusion,* such as economic growth, efficiency, and increased welfare, which are often difficult to quantify and go well beyond those directly relevant to the SSBs' core mandates.

Third, the SSBs should consider the *country context* in which the SSBs' standards and guidance are being applied. This is especially important in countries *with very high levels of financial exclusion* and *low levels of capacity* of policy makers, regulators, and supervisors to implement the SSBs' standards and guidance. This white paper advocates application of the proportionality principle—the balancing of risks and benefits against costs of regulation and supervision—in addressing these themes, both in the standards and guidance of the SSBs and in their country-level implementation.

Part I of this white paper discusses financial inclusion in the context of the SSBs' standards and guidance and introduces the essential role that the principle of proportionality will play in ensuring that the SSBs' positions and country-level implementation support the goal of financial inclusion. Part II briefly canvases each of the five SSBs, explaining their composition and current core mandates and the key financial inclusion issues related to their mandates, concluding with a box for each SSB highlighting its activities, processes, and forums that are relevant to financial inclusion. Part III explores three important topics in financial inclusion that relate to the mandates of more than one of the SSBs: formalization of informal providers, financial consumer protection, and branchless banking (including electronic money [e-money], agents, and similar innovations). Part IV sets forth observations and recommendations flowing from the discussions in parts I, II, and III.

PART I. SSBS, FINANCIAL INCLUSION, AND PROPORTIONALITY

A. Implications of SSBs for Financial Inclusion

The standards of the five SSBs provide basic frameworks for country-level regulation and supervision of formal financial services and the institutions that provide them. The SSBs' guidance can significantly shape a country's implementation of SSB standards. Collectively, the standards and guidance (and the regulation and supervision influenced by them) can help enable financial inclusion. However, restrictive application or implementation (which sometimes reflects lack of clarity in either standards or guidance, or both) may have the opposite effect. Regulation and supervision, in turn, affect many aspects of the delivery of formal financial services—and the practical and economic feasibility of reaching financially excluded poor households.

BOX 2

How Many Poor Households Get Access to What Range and What Quality of Formal Financial Services, and at What Cost?

How many poor households get access to formal financial services?

The example of Dalisay on the remote Philippine island of Tingloy shows how country-level implementation of FATF Recommendations and Special Recommendations for identifying (and verifying the identity) of customers can remove barriers to formal financial services. If she lived, instead, in one of the many countries where regulation aimed at implementing FATF's Recommendations and Special Recommendations on AML/CFT requires a formal identification document—and, frequently, also a fixed address, verified by a reliable document—she would be without access to formal financial services.

What range of formal financial services they can access?

Licensing regimes for deposit-taking institutions that rigidly interpret BCBS Core Principles for Effective Banking Supervision can limit the legal feasibility of "transforming" a nondepository microlending institution into one offering savings products as well, and may limit the regulatory feasibility of various innovative models of service delivery (see Part III C, "Branchless Banking: E-Money, Agents, and Similar Innovations").

What quality of formal financial services?

On the positive side, use of the flexibility afforded in IAIS's Insurance Core Principles to facilitate formalization of informal insurance underwriters can result in improved quality of service for the typically poor households they currently serve.

At what cost?

A regulatory regime that reflects the emphasis of the CPSS/World Bank General Principles for International Remittance Services on promoting competition among remittance service providers and proportionate regulation in relation to risk can result in lower cost international remittances for the often poor customers seeking to make small-value transfers.

These examples demonstrate the wide variance of both the potential impact of each of the SSB's standards and guidance on financial inclusion and the directness (or indirectness) of such impact. At one end of the spectrum, FATF's Recommendations and Special Recommendations—and, in particular, the approach countries take to implementing them—are typically easy to link either to successful examples of enabling financial inclusion or to unintended perpetuation of financial exclusion. By contrast, IADI's Core Principles for Effective Deposit Insurance Systems may very well increase trust in formal savings services and the insured institutions that provide them and thus have a positive effect on financial inclusion, but the relationship typically is indirect and attribution may be difficult.

The varying mandates of the SSBs influence both their relevance to financial inclusion and the positions they take on relevant issues. Their differing mandates also sometimes contribute to an understandable "silo" effect in SSB standards and guidance: each emphasizing issues (especially risks and approaches to risk mitigation) most relevant to their members and observers in their national-level policy and regulation.[3,4] These silos can lead to differing—and sometimes even conflicting—perspectives on some of the topics relevant to several SSBs that arise when pursuing a broad financial inclusion policy agenda, which in turn can translate into uncertainty, on the country level, as to how to implement SSB standards and guidance (see, e.g., Part III C, "Branchless Banking: E-Money, Agents, and Similar Innovations").

3. The impact of the SSBs' standards and guidance is, of course, not limited to SSB member and observer countries, nor are nonmember countries without influence on the SSBs. On financial inclusion, in particular, SSBs have a track record of seeking input and information from countries with relevant experience, regardless of their SSB membership or observer status.
4. For some countries that are members of more than one SSB, this silo effect is exacerbated by communication and coordination shortfalls among the country's delegates to the different SSBs.

B. Implications of Financial Inclusion for the SSBs

For all five SSBs, embracing the goal of full financial inclusion represents a potentially significant shift of focus and requires a commensurate evolution in thinking, and the SSBs are at different stages in this evolution. The SSBs were originally formed to provide standards and guidance largely on the regulation and supervision of *existing institutions* and their *existing, typically nonpoor, customers*, often with little consideration for the types of customers that were not being adequately served by the formal financial system. As noted, recognizing that *financial exclusion presents risks* relevant to varying degrees to their core mandates introduces an important new element to this picture for the SSBs.[5] The risks to be considered—when an estimated 2.7 billion working age adults are excluded by the formal financial system—have not yet been systematically studied, but they include threats to financial integrity and international security (e.g., the money-laundering and terrorist financing risks of cash transactions, often across borders, through informal providers), social and political stability, and even potentially financial stability (e.g., political unrest touched off by pyramid schemes organized as informal savings and investment opportunities that trigger lack of confidence in the banking system). In all these cases, progress on financial inclusion offers potential means for mitigating risks that the SSBs might miss if they remain focused only on existing formal providers and their "already served" customers.

Changes in the *nature (and potentially the level) of risks resulting from increased financial inclusion* also carry potentially broad implications for the SSBs. These changes result from a variety of factors, including the characteristics of currently financially excluded customers, which differ from the "already served" with which the SSBs are most familiar (see, e.g., Part III B, "Financial Consumer Protection"), as well as the nature of the products, services, and providers capable of reaching them and, especially, the innovative approaches needed to accomplish significant increases in financial inclusion (see, e.g., Part III C, "Branchless Banking: E-money, Agents, and Similar Innovations"). As progress is made on financial inclusion, and more and more excluded households are brought into the formal financial sector, the range and, potentially, the pace of changing risks will increase as well. The benefits of financial inclusion, such as economic growth, efficiency, and increased welfare (as discussed further in Part I C, "Proportionality"), offset these changing risks (and mitigate the risks of financial exclusion).

As more countries of various levels of income and development adopt a policy agenda to increase financial inclusion, an additional consideration for the five SSBs is the importance of differing country context. Two parameters are particularly important: *(i)* the current level and nature of financial exclusion in a given country (which may vary across the range of products that excluded clients need) and *(ii)* the capacity of policy makers, regulators, and supervisors to implement the SSBs' standards and guidance. For some, particularly lower income, countries with high current levels of financially excluded households, full compliance with existing SSB standards and guidance may be a long-term goal. Thus, while SSBs' normative *standards* of relevance to increasing financial inclusion may be designed to be applied flexibly in all country contexts, advisory *guidance* that considers the

5. Financial exclusion risks are most directly related to FATF's mandate (see Part II C, "FATF") and, to a more limited extent, to that of BCBS (see Part II A, "BCBS"). At the other end of the spectrum, financial exclusion risks are only minimally related to CPSS's primary focus on systemically important payment systems.

implementation challenges encountered in varying country contexts may be needed.[6]

C. Proportionality

To make substantial contributions on financial inclusion, the SSBs need to understand these risks (among many others) and the particular hurdles faced by countries presenting the greatest financial inclusion challenges. The principle of proportionality offers a means of addressing these challenges. The G-20's Principles for Innovative Financial Inclusion counsel country-level policy makers to "[b]uild a policy and regulatory framework that is proportionate with the risks and benefits involved in innovative products and services and is based on an understanding of the gaps and barriers in existing regulation" (see Appendix A, "G-20 Principles for Innovative Financial Inclusion").

This is not necessarily easy. Historically, the SSBs have tended, to varying extents, to base their standards and guidance primarily on the experiences of developed countries' financial systems due to their greater importance to global financial stability and their longer and deeper track record with regulation and supervision. And, although each of the five SSBs now includes in its focus a much broader range of countries, incorporating a financial inclusion agenda requires each SSB to consider specifically the experiences of countries with large numbers of financially excluded households (especially those countries making substantial progress on financial inclusion, from which lessons may be learned).

Another significant challenge to implementing a proportionate approach is that risks and benefits are often perceived and measured differently by different stakeholders. Moreover, some risks and benefits cannot be easily or definitively quantified, although qualitative analysis is possible.[7] These challenges of risk and benefit assessment multiply in complexity when the varied regulatory and supervisory standards of the SSBs are applied across different products, services, and institutions. The difficulty of implementing the differing standards and guidance will challenge even those policy makers, regulators, and supervisors in countries with relatively higher levels of regulatory and supervisory capacity and financial inclusion. For countries at the other end of the capacity and inclusion spectrum, the difficulty will be even greater.

Also, the proportionality calculus requires attention, not just to the risks of financial exclusion, but also to the benefits of financial inclusion beyond the mitigation of financial exclusion risks, such as economic growth, efficiency, and increased welfare. While these benefits may be only indirectly related to the core mandate of a particular SSB, they can feature significantly among the SSBs' motivation to incorporate consideration of financial inclusion issues into their work and priorities for many country-level policy makers seeking to apply their standards and guidance.[8]

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6. Noteworthy instances of SSBs' standards and guidance seeking to accommodate varying country contexts (and, in particular, lower levels of regulatory and supervisory capacity) include FATF's recognition that its Recommendations will need to be implemented progressively, particularly in countries with lower regulatory capacity, and BCBS's inclusion of simpler "standard" approaches to measuring capital adequacy in Basel II and Basel III.
7. Whether a risk in fact exists is also important. As Chatain, Hernandéz-Coss, Borowik, and Zerzan (2008) note "[i]n order to balance perceptions against the fear of over-regulation, which can damage business, actual rather than perceived risks need to be identified."
8. E.g., the involvement of CPSS (together with the World Bank) in the project to develop the General Principles for International Remittance Services (see Part II B, "CPSS") was motivated not only by a connection between small-value cross-border money transfers and CPSS's core mandate to promote the stability of systemically important payment systems, but also by an interest in the welfare gains that might result from the project.

In fact, the five SSBs already explicitly or implicitly incorporate a proportionate approach in their standards and guidance. BCBS, for example, provides in Basel Core Principle 2, Essential Criterion 4 of BCPs, that, while banks should be regulated and supervised in full conformance with the BCPs, there is scope to subject other deposit-taking institutions to "a form of regulation commensurate to the type and size of their transactions," provided they don't collectively hold "a significant proportion of deposits in a [given] financial system" (BCBS 2006a). Similarly, FATF has effectively endorsed the principle of proportionality in its Recommendations and Special Recommendations, which allow countries to follow a "risk-based approach"—in essence a proportionate approach—in certain key respects, such as exemption from AML/CFT controls for certain limited transactions and services, flexibility regarding the nature of the data or information used to identify a customer, and the possibility of applying reduced or simplified customer due diligence procedures to low-risk financial services. In the case of IAIS, the proportionality principle is present throughout the Insurance Core Principles (ICPs), with risk being measured by "nature, scale and complexity," and will be made more explicit in the forthcoming revised ICPs.

But there is still much work to be done to incorporate proportionality into the SSBs' standards and guidance and to elaborate how the proportionality principle should be applied at the country-level in implementing the SSBs' standards and guidance while pursuing a broad financial inclusion agenda. BCBS's focus to date has been primarily on banks and their existing customers. As a consequence, there is as yet little guidance on how to apply proportionality to the types of nonbank deposit-taking institutions and "deposit like" products that, in some countries, are of greatest relevance to financial inclusion.

Similarly, FATF's primary focus to date has been specifically on high-risk providers, products, services, and clients. And, though FATF has recently taken the groundbreaking step of recognizing financial exclusion as a money laundering and terrorist financing risk (FATF 2011), uncertainty remains about applying FATF's risk-based approach to the activities, products, and providers most relevant to financial inclusion.

Similar challenges lie ahead with respect to the other SSBs as well. Overcoming them requires putting aside preconceptions of risk based solely on the "already served" and the products, services, and providers that serve them—recognizing, in the risk-and-benefit assessment, the benefits that will result from bringing financially excluded households into the formal financial system, and considering proportionate approaches that can enable this to happen, such as "test and learn," gradual implementation, and tiering of regulatory and supervisory treatment based on the nature, scale, and complexity of the activities in question.[9]

9. G-20 Principle 7 counsels policy makers to "[u]tilize improved data to make evidence based policy, measure progress, and consider an incremental 'test and learn' approach acceptable to both regulator and service provider" (see Appendix A, "G-20 Principles for Innovative Financial Inclusion"). Consumer research provides a useful tool for generating data for policy makers seeking to understand the behavior of excluded consumers joining the formal financial system and to design and prioritize effective and proportionate regulatory and supervisory measures.

PART II. TOPICS SPECIFIC TO EACH SSB

A. Basel Committee on Banking Supervision

The activities of BCBS have a broad impact on the environment of banking supervision that extends beyond its initial membership and objectives. Although Basel standards and guidance were originally developed with a focus on large, particularly internationally active, banks in developed countries and their existing customers, they are now widely applied in BCBS member countries and nonmember countries alike, to banks large and small, as well as many nonbank deposit-taking institutions. The radically changing landscape of financial inclusion in many countries—reflecting an expansion of the range and scale of deposit-taking institutions, increased integration of banks and nonbanks, and the development of innovative products and delivery channels—has significant implications for BCBS.

BCBS provides an international forum for regular cooperation and the development of common understanding on banking supervisory matters affecting banks and other deposit-taking institutions, particularly those matters linked to stability of financial sectors and the financial health of individual banks. In addition to the BCPs, BCBS is best known for its international standards on capital adequacy and the Concordat on cross-border banking supervision.[10] Responding to a call from G-20 leaders for major SSBs to review their membership, BCBS expanded in 2009 to add important emerging market countries as members.[11] This expansion has helped open the way for changes in BCBS positioning on issues of specific interest to emerging market and developing economies, including financial inclusion. In addition, the Basel Consultative Group (a BCBS subcommittee that reports directly to BCBS) provides a platform and voice for nonmembers, as well as the World Bank, International Monetary Fund (IMF), and the Islamic Financial Services Board, and serves as a forum for deepening BCBS engagement with supervisors around the world on banking supervisory issues and potentially related issues pertaining to nonbank deposit-taking institutions.

Key Financial Inclusion Issues

Although a large number of countries seek to apply BCBS standards and guidance, BCBS focus on banks within the formal financial system has meant that risks of financial exclusion have not yet been explicitly taken into account. Similarly, there has been no comprehensive look at *(i)* the changing risks and benefits of increased financial inclusion, given the types of providers and products involved, nor at *(ii)* the impact of widely varying country contexts (and, in particular, varying levels of supervisory capacity) on implementation of BCBS standards and guidance.[12]

No consideration is currently being given to expanding the mandate of BCBS to include supervision of nonbank deposit-taking institutions. Thus, the focus of

10. Although Basel II and Basel III may have indirect ramifications for financial inclusion, they are not discussed in this white paper.
11. Today, there are 27 BCBS members (see Appendix B, "SSB Membership").
12. The inclusion in Basel II and Basel III of a simpler, "standard" means of calculating capital adequacy represents an important example of recognizing varying country context. Besides a tiering of regulatory and supervisory approach based on the nature, scale, and complexity of the activities in question, a sequenced approach to implementing SSB standards and guidance can also be effective for countries with lower regulatory and supervisory capacity.

BOX 3

BCBS Activities, Processes, and Forums Relevant to Financial Inclusion

In August 2010, BCBS issued "Microfinance activities and the Core Principles for Effective Banking Supervision" (BCBS 2010). This first paper ever by BCBS on a financial inclusion topic offers guidance for the application of the BCPs to depository microfinance. It calls for specialized knowledge, but suggests that the BCPs generally offer a suitable framework for microfinance supervisors, with some tailoring required according to the type, size, and complexity of transactions. It also highlights the need to avoid adding unduly to the compliance costs of providers, and to apply the principle of proportionality in allocating scarce supervisory resources.

BCBS guidance on the application of the BCPs to depository microfinance represents an important step to elevate supervisor understanding of microfinance activities. However, it does not address many issues triggered by the newest developments in financial inclusion more broadly, particularly in emerging market and developing economies, nor does it address the topic of differential treatment that might be accorded to different types of bank and nonbank deposit-taking institutions based on the nature, scale, and complexity of the activities in which they are permitted to engage.

The revision of the BCPs currently in process provides an opportunity to examine the relevance of the BCPs with regard to financial inclusion.[a] In particular, there is an opportunity to address more clearly the links among financial inclusion, prudential oversight, and financial consumer protection (see Part III B, "Financial Consumer Protection"). While the existing BCP framework is considered adequate for microfinance (BCBS 2010), the revision process also offers a chance to reconsider the BCPs' implications for a broader financial inclusion agenda, and to assess which aspects of financial inclusion are appropriately addressed in the BCPs (because of linkages to banks and the banking sector) and which may be more effectively dealt with in subsidiary guidance.

a. The process of revising the BCPs was launched in February 2011. The Revised Core Principles will be circulated for public comment at the end of 2011. BCBS sign-off is expected in June or July 2012, with final approval anticipated at the International Conference of Banking Supervisors in September 2012.

the BCPs remains institutions licensed and supervised as banks, with nonbanks being relevant only to the extent that their linkages with banks and the banking sector raise micro- or macroprudential concerns.[13] However, BCBS has provided some initial guidance beyond banks and banking that is relevant to financial inclusion (see Box 3, "BCBS Activities, Processes, and Forums Relevant to Financial Inclusion"). Both financial exclusion-related risks and the changing risks and benefits associated with increased financial inclusion implicate BCBS's stability objectives clearly enough to merit further study and guidance.

Implications for banks and other deposit-taking institutions. Beyond direct engagement in microfinance activities,[14] financial inclusion as defined in this white paper has broad implications for the activities of banks and other deposit-taking institutions. The expansion of branches and of new delivery channels (such as nonbank retail agents) and the introduction of new products (such as

13. The current BCPs reference the appropriateness of the Principles to nonbank financial institutions that provide deposit and lending services similar to those of banks, noting that some of these categories of institutions may be regulated distinctly from banks as long as they do not hold, collectively, a significant proportion of deposits in a financial system (BCBS 2006a). The Core Principles Methodology, however, focuses entirely on banks, referencing assessment of nonbank financial institutions' activities only to the extent they have an impact on supervised banks (BCBS 2006b).
14. "Microfinance" is defined by BCBS as the provision of financial services in limited amounts to low-income persons and small, informal businesses (BCBS 2010). "Financial inclusion" as defined in this white paper is a broader concept that incorporates not only the full range of financial products, but also the concept of "effective access": convenient and responsible service delivery, at a cost affordable to the customer and sustainable for the provider, with the result that financially excluded customers use formal financial services rather than existing informal options (see Box 1, "'Financial Inclusion': A Working Definition").

"simplified" savings products) provide avenues for bringing the savings of excluded populations into the formal financial intermediation system and channeling them into investment. Due to the importance of remittances in many emerging market and developing economies, banks are increasingly taking the opportunity to capture these large flows of funds. Moreover, the rapid expansion of e-money—and in particular, mobile money—in emerging market and developing economies creates new opportunities for banks and other deposit-taking institutions in terms of customer acquisition and business development, especially among financially excluded customers.

Financial inclusion, seen as both a business opportunity for the financial services industry and clear policy objective for governments, implies changing risk exposures that are distinguishable from traditional retail banking. New players are entering the market, creating greater competition. Banks are refinancing and, in some cases, even forming microfinance institutions (MFIs), deepening the integration between the two sectors in many markets and fostering concern about over-indebtedness and asset quality deterioration in some.[15] Rapid moves into markets where the quality of information, financial sector infrastructure, and level of financial literacy and capability are weak may create new risks. Previously excluded customers may also behave differently from traditional depositors, with possible implications (good or bad) for stability of a deposit-taking institution's balance sheet and asset and liability management. The range of innovation alone may elicit different appreciation of changing risk profiles and increase the complexity of risk management functions for both bank and nonbank providers, especially when it is remembered that, in many markets, customers of formal providers may also be borrowing extensively from informal sources.

Implications for supervisors. Supervisors around the world are increasingly being called upon to address the challenge of supporting financial inclusion while also understanding and mitigating potential risks. This requires a balance between safety and openness to innovation, while working to achieve core goals of systemic stability and depositor protection. In many instances, supervisors face important resource and human capacity constraints. The inclusion of large numbers of low-income customers who are inexperienced with formal finance also adds new dimensions to consumer protection and additional issues in achieving market discipline—a precondition of the BCPs (see Part III B, "Financial Consumer Protection").

In many emerging market and developing economies, traditional nonbank deposit-taking institutions, such as various types of financial cooperatives, are also growing fast, sometimes with strong political backing but little attention to the resulting supervisory challenges. In an increasing number of countries, new players, such as mobile network operators (MNOs) and technology companies, are offering e-money, bringing more nonbank actors into the supervisory scope (see Part III C, "Branchless Banking: E-Money, Agents, and Similar Innovations"). With these latter developments, the historical division between payments and banking supervision as well as proven approaches to banking oversight warrant new attention.

In the absence of implications for the stability of individual banks and the banking system, generally, these phenomena are not currently a focus of BCBS.

15. In some instances, the incursion of banks and new players into microfinance has led to unhealthy competition, leading to irresponsible lending and over-indebtedness (Schicks and Rosenberg 2011).
16. See Appendix B, "SSB Membership" for the current membership of CPSS.

However, their relevance to the overall stability of the financial system and confidence of retail depositors is clear in some countries—especially in those emerging market and developing economy countries where the current reach of the conventional banking sector is limited. Incorporating into supervisory practices consideration of both the risks of financial exclusion as well as the changing risks and benefits that accompany increased financial inclusion calls for careful thinking about the application of existing BCBS standards and guidance with these new factors in mind. As BCBS has acknowledged (BCBS 2010), it is ever more important to build adequate supervisory resources with the right (new) set of skills and knowledge to cope effectively with the fast changing landscape.

B. Committee on Payment and Settlement Systems

Payment systems represent the essential infrastructure necessary for the delivery of most formal financial services. As a result, CPSS standards and guidance have an indirect relevance to financial inclusion that extends beyond retail payment operations. The primary objective of CPSS is to strengthen this financial market infrastructure through promoting safe and efficient payment and settlement systems, with a focus on the stability of systemically important systems. CPSS serves as a forum for its members (the central banks from 24 developed and larger emerging market countries in their role as payment systems overseers)[16] to monitor and analyze developments in domestic payment, settlement, and clearing systems, as well as in cross-border and multi-currency settlement schemes. Because its emphasis is on systemically important payment systems and their oversight, CPSS is a step removed from payment system participants.

Key Financial Inclusion Issues

Notwithstanding the focus of CPSS standards and guidance on large-value and systemically important payment systems, CPSS has expanded its attention to safe and efficient retail payment systems and payment instruments.[17] CPSS is increasingly engaged in work focused specifically on those retail payments issues of most direct relevance to financial inclusion, such as remittances and innovative retail payments and instruments. These engagements are not only motivated by a connection to CPSS's core mandate, but also by an interest in potential welfare gains resulting from such work.

In principle, all of CPSS's work is potentially positively correlated with the goal of financial inclusion, to the extent that the implementation of relevant CPSS standards and guidance leads to a larger share of the population benefiting from better quality payment services at a lower cost. And CPSS standards address issues that are central to financial inclusion, such as *(i) cost-efficiency of payments,* by encouraging central banks to provide services that are most effective for the particular market, by ensuring efficient clearing and settlement services through

17. CPSS publications relevant to retail payments include "General principles for international remittance services" (developed jointly with the World Bank) (2007); "General guidance for national payment system development" (2006), "Survey of developments in electronic money and internet and mobile payments" (2004), "Policy issues for central banks in retail payments" (2003), "Survey of electronic money developments" (2000), "Clearing and settlement arrangements for retail payments in selected countries" (2000), "Retail payments in selected countries: A comparative study" (1999), and "Security of electronic money" (1996) (developed jointly with the G-10 countries).

BOX 4

CPSS Activities, Processes, and Forums Relevant to Financial Inclusion

Currently, there are two main work streams on retail payment systems and payment instruments with which CPSS is involved. The *Joint World Bank–CPSS Retail Forum* aims to foster an exchange of views on relevant topics of mutual interest and to keep abreast of the key global developments in retail payments. The *CPSS Working Group* on innovative retail payments intends to classify relevant developments in retail payments and to identify *(i)* drivers of innovation in different countries and factors that influence the success of innovations, *(ii)* the potential advantages and any implications from the perspective of payment systems users, and *(iii)* potential issues for public authorities, especially for central banks.[a]

In addition, CPSS participates in the following forums that are relevant to financial inclusion:

- The International Advisory Group for Government Payments, chaired by the World Bank, which aims to provide general guidelines to assist countries that want to improve their public payment systems. This includes government-to-person (G2P) payments, which are particularly relevant in the context of financial inclusion[b]
- The Global Remittances Working Group (GRWG), which is also chaired by the World Bank. GRWG was set up to provide an institutional framework to support the efforts in implementing the CPSS–World Bank general principles for international remittance services and, more broadly, to encourage the safe and efficient provision of remittance services.

a. The Payment Systems Development Group at the World Bank, which works with CPSS on a number of collaborations relevant to financial inclusion, is working to define a comprehensive retail payment strategy for client countries. This attempt at a holistic framework is anticipated to be closely coordinated with the work of the Joint Retail Forum.

b. G2P refers to all financial flows that go from a government to its citizens. CGAP estimates a minimum of 170 million poor people globally receive a regular G2P payment (Pickens, Porteous, and Rotman 2009). These payments offer a potential means to bring the generally very poor recipients into the formal financial system. Advances in technologies, such as mobile phones and debit cards, have made it possible to re-engineer G2P programs with four goals in mind: *(i)* bringing down the costs of delivery; *(ii)* reducing the opportunities for leakage and corruption; *(iii)* making the service more convenient for the beneficiary, e.g., by reducing the time taken to receive payments; and *(iv)* giving recipients access to a range of financial services by providing them with a transactional bank account (Pickens, Porteous, and Rotman 2009).

their operational and oversight role, and by supporting the development of effective infrastructure arrangements that have the potential to reduce the costs for processing payments; *(ii) safety and trust in money as the medium of exchange,* by promoting safe clearing and settlement systems and safe payment instruments; *(iii) innovation in payments* and the consequent encouragement to central banks to address legal and regulatory impediments to innovation; *(iv) competitive payment markets,* by calling on central banks to foster competitive market conditions and behaviors; *(v)* by promoting *open and fair access to payment systems,* provided that adequate risk-mitigation measures are in place to ensure participants do not threaten the safety of the system; and *(vi) improvements in the remittances markets,* through implementation of the general principles for international remittance services.

Current CPSS standards permit the goals of national payment system development to be pursued while also allowing space for innovative payment platforms and instruments, such as e-money, which not only provide new ways of reaching financially excluded customers, but also are gaining transaction volume, particularly in the emerging market and developing economy countries, where a majority of financially excluded people live (see Part III C, "Branchless Banking: E-Money, Agents, and Similar Innovations"). As long as such innovative providers get fair indirect access, the fact that they may not be permitted to participate directly in systemically important payment systems should not limit their financial inclusion potential.[18]

18. In some countries, entities not supervised by the banking authority cannot gain direct access to systemically important payment systems (see Part III A, "Formalization").

C. Financial Action Task Force

The FATF Recommendations set standards for national AML/CFT regulation, covering a broad range of financial service providers, as well as certain nonfinancial businesses and professions at risk of exploitation for financial crime. The FATF definition of "financial institution" is *activity-focused* rather than institutional and covers the full range of products and providers used in this white paper.[19] Until recently, FATF has focused largely on the integrity of financial services rendered to the population groups already reached: the financially excluded had not been addressed in FATF guidance before the June 2011 "Anti-money laundering and terrorist financing measures and Financial Inclusion." As a consequence, in many countries, the AML/CFT rules do not reflect an appreciation of the challenges that the rules pose to the financially excluded. Although recognized in FATF's groundbreaking guidance paper on financial inclusion (discussed later), financial exclusion as a money laundering and terrorist financing risk has not yet been specifically addressed in the current FATF Recommendations, nor is it considered explicitly in the current FATF mutual evaluation methodology (also discussed later).

National implementation of FATF's 40 Recommendations on money laundering and 9 Special Recommendations on terrorist financing have potentially the most profound and direct impact on financial inclusion among the standards and guidance of the five SSBs discussed in this white paper.[20] Especially relevant are *(i)* the challenge of identifying (and verifying the identity of) poor, financially excluded customers and *(ii)* the potential for AML/CFT compliance to increase the costs of delivering formal financial services to such customers. At the same time, *financial exclusion* poses a profound challenge to FATF's financial integrity mandate. Because financial inclusion brings more customers and transactions from the untraceable world of cash into the traceable world of formal financial services, it bears a highly complementary relationship to FATF's core objective of AML/CFT (FATF 2011).

The Recommendations set standards for action to be implemented by countries according to their particular circumstances and legal frameworks. They focus on the minimum countries must do, but are nevertheless ambitious and, in some cases, represent mutually agreed objectives rather than a description of current practice. FATF and its stakeholders have been effective in moving countries progressively toward compliance with the objectives, but no country has yet attained full compliance with all of the Recommendations.

FATF is organized as a task force-style body, the mandate of which is revisited from time to time by FATF members. Nonmembers are indirectly represented by eight FATF-style regional bodies (FSRBs) in Africa, Asia and the Pacific, the Caribbean, Europe, Eurasia, the Middle East and North Africa, and South America. FATF also has 19 representative international bodies that serve as observers, including IMF, the World Bank, BCBS, IAIS, and OECD.[21] FATF and the FSRBs use mutual evaluation mechanisms to assess the extent to which countries have implemented

19. See "Money Laundering, Glossary to the 40 Recommendations." Retrieved 9 August 2011 from http://www.fatf-gafi.org/glossary/0,3414,en_32250379_32236930_35433764_1_1_1_1,00.html.
20. The other SSBs discussed in this white paper also incorporate the FATF Recommendations in their own standards.
21. There are currently 36 FATF members: 34 countries and two regional organizations (the European Commission and the Gulf Cooperation Council). The FSRBs, which collectively have 166 members, hold associate membership in FATF and represent regional perspectives within FATF. Associate FATF membership provides FSRB members with access and input to FATF meetings, documents, and discussions. The current members, associate members, and observers of FATF and the FSRBs are listed in Appendix B, "SSB Membership."

BOX 5

FATF Activities, Processes, and Forums Relevant to Financial Inclusion

The June 2011 FATF guidance paper "Anti-money laundering and terrorist financing measures and Financial Inclusion" represents unprecedented and rapid progress in recognizing the importance of financial inclusion to FATF's core objectives. The guidance paper provides country examples of AML/CFT regulation relevant to financial inclusion products as well as industry risk-mitigation measures. Although the examples are not necessarily endorsed as FATF-compliant, they help regulators consider creative solutions that will align financial inclusion and money laundering and terrorist financing risks within their own jurisdictions. However, although the guidance paper acknowledges financial exclusion as a money laundering and terrorist financing risk, it does not explicitly guide countries on addressing this risk. As a consequence, many questions regarding general risk assessment and mitigation still remain.

In addition to the financial inclusion guidance paper, FATF has issued broad guidance papers on global and national risk assessment and is continuing the development of guidance on national risk assessment and mitigation. FATF has also formed a subgroup to address what it refers to as "new payment methods" (NPMs), which include a broad range of innovations, some of particular relevance to financial inclusion (see Part III C, "Branchless Banking: E-money, Agents, and Similar Innovations"). This work follows on the publication of FATF's 2010 paper on NPMs (FATF 2010c). The subgroup has been tasked to develop a best practices paper and policy suggestions on NPMs and plans to review a range of actors, payment chains, use of agents, and how FATF Recommendations apply to them.

NPMs work and the financial inclusion guidance paper collectively suggest a new era within FATF, where closing the financial access gap will be an increasingly important subject of engagement. However, both the NPMs paper and the financial inclusion guidance paper, like all FATF guidance below the level of the Recommendations, are nonbinding. FATF is currently reviewing its Recommendations and, as part of this process, it is expected to provide greater clarity regarding aspects of its CDD standards and, in particular, to issue an interpretative note on its risk-based approach. It is envisaged that the amendments will be adopted in 2012. Those amendments will need to be reflected in the mutual evaluation methodology before the next round of evaluations commences.

the FATF Recommendations. The assessment is also undertaken by the World Bank and IMF using the same standard evaluation methodology (FATF 2004).[22] FATF initiates countermeasures against noncompliant countries with strategic AML/CFT deficiencies by publishing gray and black lists. These countermeasures can have significant repercussions.[23] All FATF and FSRB members have formally committed to implementing the Recommendations and to participating in mutual evaluations of their compliance.

Key Financial Inclusion Issues

Since 2009, FATF has acknowledged that financial inclusion and AML/CFT are complementary policy objectives (Vlaanderen 2009 and Urrutia Corral 2010). FATF underscored this point in its June 2011 guidance paper "Anti-money laundering and terrorist financing measures and Financial Inclusion," produced jointly with the World Bank and the Asia-Pacific Group, FSRB for the Asia and Pacific region (FATF 2011). The guidance paper recognizes financial exclusion as a money laundering and terrorist financing risk—the first time one of the five SSBs has explicitly identified financial exclusion as an important risk. Despite this ac-

22. See, also, Appendix C, "Financial Sector Assessments and Evaluations and Financial Inclusion at the Country Level."
23. Key in this regard is Recommendation 21, which stipulates that financial institutions should be required to give special attention to dealings with any persons and institutions of a noncompliant country. In practice, these measures can slow the pace of transactions, and they may even lead to a decision to avoid business relationships with those persons and institutions.

knowledgment, in some countries, the AML/CFT requirements intended to meet FATF's Recommendations still impose unnecessary costs and regulatory hurdles, thus perpetuating financial exclusion. In particular, many countries set customer due diligence (CDD) identification and verification requirements that many low-income persons are unable to meet.

FATF Recommendations of greatest relevance to financial inclusion. Four FATF Recommendations are especially relevant to financial inclusion.[24] Recommendation 5 requires countries to ensure that financial institutions identify their clients and verify their identities using reliable, independent source documents, data, or information and monitor their clients.[25] As noted, overly conservative or inflexible CDD compliance requirements and procedures at the country level can undermine financial inclusion initiatives.

Recommendation 8 requires that countries ensure financial institutions *(i)* pay special attention to money laundering and terrorist financing threats that may arise from new or developing technologies that might favor anonymity and *(ii)* have policies and procedures to address risks associated with nonface-to-face relationships and transactions.[26] Conservative implementation of this standard may lead to processes and procedures that limit the financial inclusion impact of responsibly employed new payment methods.

Recommendation 10 requires customer and transaction records to be kept, and Recommendation 13 requires reporting of suspicious transactions. Agent-related record-keeping and suspicious transaction reporting obligations that are unnecessarily onerous may prevent the involvement of many agents that are otherwise well-positioned to advance financial inclusion using e-money and other branchless banking models (see Part III C, "Branchless Banking: E-money, Agents, and Similar Innovations").

Special Recommendation VII (wire transfers) requires countries to ensure that financial institutions include accurate and meaningful originator information (name, address, and account number) on all funds transfers, including remittances. Countries are currently allowed to exempt remittances below a de minimis threshold of USD/EUR 1,000.[27] Failure to establish such a de minimis threshold in national regulation or overly strict verification requirements may limit the financial inclusion impact of remittances.

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24. The FATF guidance paper on financial inclusion highlights six broad topics regarding the interplay of AML/CFT and financial inclusion: *(i)* CDD, *(ii)* record-keeping of CDD data and transactions, *(iii)* ongoing due diligence and business relationship monitoring, *(iv)* reporting of suspicious transactions, *(v)* use of agents, and *(vi)* internal controls. The four Recommendations discussed here (R5, R8, R10, and R13) correlate generally with these six topics, though other Recommendations are relevant as well.
25. Recommendation 5, in general, does not require the performance of CDD measures on clients who engage in occasional transactions below USD/EUR 15,000 or wire transfers below USD/EUR 1,000, but does require such measures to be imposed on a risk-based basis whenever a "business relationship" is established. Fairly large occasional transactions are, therefore, automatically exempted from the relevant AML/CFT controls, while small, low-value accounts are subject to CDD controls. However, countries have the flexibility to lower the threshold, or to have no threshold at all.

    Recommendation 5 also includes obligations related to identifying the beneficial owner, as well as the purpose and intended nature of the "business relationship," which can present significant challenges in the financial inclusion context.
26. In the current review of FATF Recommendations, FATF is considering focusing Recommendation 8 only on new technology issues. Issues regarding nonface-to-face relationships and transactions would be addressed in Recommendation 5.
27. FATF is currently considering applying identification obligations to all remittances (i.e., originators and beneficiaries), irrespective of value, but verification below the threshold may not be mandatory. If increased identification obligations require particulars that financially excluded persons cannot furnish with ease, or an increase in verification obligations is introduced for low-value payments, the amendment portends serious ramifications for financial inclusion initiatives.

FATF's "risk-based approach" and financial inclusion. National measures implementing the FATF Recommendations need not affect financial inclusion adversely, as FATF's financial inclusion guidance paper recognizes. The Recommendations provide for countries to follow a "risk-based approach" to AML/CFT.[28] This permits countries to exempt financial services rendered on a very limited basis from most AML/CFT controls and to impose simplified CDD measures on "low risk" financial services. In practice, however, uncertainty and a lack of knowledge about the application of the risk-based approach at the country level, coupled with conservative regulatory approaches (sometimes triggered by fear of an adverse mutual evaluation), can hamper the adoption of regulatory frameworks favorable to financial inclusion and can dampen service provider appetite to innovate.

Since 2007, FATF has provided high-level guidance on its risk-based approach in the form of a series of guidance notes aimed at affected institutions and professions. Traditionally FATF's primary focus has been on *high*-risk products, services, and clients (i.e., those with the greatest potential for money laundering and terrorist financing abuse), and its standards and guidance on these topics are more developed, clearer, and more consistent. Moreover, as previously noted, with the recent noteworthy exception of the financial inclusion guidance paper, FATF has not yet specifically addressed financial exclusion as a money laundering and terrorist financing risk in its standards and guidance.[29] As a consequence, FATF's high-level guidance on the risk-based approach is of great value in relation to high-risk financial services, but of more limited assistance in relation to the lower risk services that are most relevant to financial inclusion. Importantly, the guidance also focuses primarily on money laundering risks, leaving unaddressed critical questions regarding a risk-based approach to terrorist financing.

The lack of clarity on low-risk financial services has affected the views of some assessors conducting FATF mutual evaluations, who tend to be strict in their evaluation reports, as well as the approach of emerging market and developing economy regulators, who tend to act cautiously to avoid negative evaluation findings and the potential adverse economic consequences they may carry (Urrutia Corral 2010). Examples of open questions that have impeded the adoption of national AML/CFT regulation supporting financial inclusion in some countries include the following:

- What is the threshold for an "acceptable" low level of money laundering or terrorist financing risk?
- What can "simplified" CDD consist of?[30]
- May a country with a high money laundering and terrorist financing risk profile, limited customer identity infrastructure, and a large cash economy allow simplified controls of financial inclusion products, where risk is limited by restrictions on the value and frequency of transactions?

28. FATF's risk-based approach is essentially the proportionality principle called by a different name (see Part I C, "Proportionality").
29. As noted, because financial inclusion brings more customers and transactions from the untraceable world of cash into the traceable world of formal financial services, it bears a highly complementary relationship to FATF's core objective of combating money laundering and terrorist financing. Financial exclusion is a money laundering and terrorist financing risk because it leaves billions of customers and transactions functionally untraceable.
30. E.g., can client verification be distinguished from client identification and, in certain circumstances where clients are unable to furnish credible and reliable verification of their identities, can client verification requirements be dispensed with in relation to account-based financial inclusion products (such as "basic accounts" with limited functionality and transaction volume)?

- To what extent can relaxed procedures for account opening be justified by access to information on transaction flows that would otherwise take place in an untraceable cash economy?

The discussion of questions such as these within FATF has only begun relatively recently (though the pace of change during the past two FATF presidencies has been significant), and further work to clarify the concept of a risk-based approach is ongoing.

D. International Association of Deposit Insurers

In recent years, and particularly in the context of the global financial crisis, there has been increased recognition of the critical role that explicit deposit insurance systems play in promoting public confidence in financial systems.[31] Deposit insurance, which is generally designed to protect less sophisticated depositors, can increase confidence and trust in the financial system, potentially contributing to financial inclusion by advancing financial awareness and knowledge of banking products that can provide protection against loss.

Founded in 2002, IADI is a voluntary association comprised of over 70 members and associates representing more than 65 jurisdictions. IADI provides a forum for international cooperation among deposit insurers, central banks, and international organizations on issues related to financial stability, deposit insurance, and resolution activities. As part of its objective to enhance the effectiveness of deposit insurance systems, IADI, together with BCBS, published "Core Principles for Effective Deposit Insurance Systems" and issued a methodology for assessing compliance with the Core Principles.

The Core Principles are intended as a voluntary framework for effective deposit insurance practices, developed for the benefit of countries considering the adoption or reform of a deposit insurance system, and were designed to be adaptable to a broad range of country circumstances, settings, and structures. IADI's Core Principles recognize necessary preconditions for effective deposit insurance systems, including the sound governance of agencies comprising the financial "safety net," strong prudential regulation and supervision of insured deposit-taking institutions, and a well-developed legal framework and accounting and disclosure regime.

Key Financial Inclusion Issues

Since it is an association and IADI's members join voluntarily, IADI lacks authority to influence its members to alter their public policy objectives or adopt new practices or positions. Although IADI's diverse membership makes it well-positioned to study the issues and debate the trade-offs involved, IADI faces a number of other challenges with respect to financial inclusion. First, its members represent only one part of a comprehensive financial safety net in any given country.

31. Depositor protection can be explicit or implicit. Explicit deposit insurance systems are rules based and provide for specific limits on deposit insurance coverage, both as to types of accounts (or persons) that receive coverage and the amount of coverage provided. Implicit insurance is not formally specified. Rather, it exists where an assumption prevails that a bank would not be allowed to fail or where some form of protection would be available to depositors, and perhaps other creditors, in the event of a bank failure. The term "deposit insurance system" as used in this paper refers to explicit deposit insurance.

BOX 6

IADI Activities, Processes, and Forums Relevant to Financial Inclusion

In 2010, IADI formed a Financial Inclusion and Innovation Subcommittee (FIIS) under its Research and Guidance Committee to study issues related to financial inclusion and deposit insurance. FIIS conducted a Financial Inclusion Workshop for IADI Executive Council members and other interested parties at BIS in February 2011 to increase awareness of issues related to financial inclusion and deposit insurance. FIIS is currently conducting a survey of IADI members to identify the range of practices among its members and to provide a factual basis for future work efforts. IADI also regularly includes presentations and discussions on topics related to financial inclusion in conferences and regional meetings. While it is premature to anticipate the future work streams that FIIS may pursue, some countries may be giving thought to the challenges of extending deposit insurance coverage to nonbank deposit-taking institutions and deposit-like products, such as e-money, that have demonstrated potential to reach financially excluded customers. However, the first challenge for emerging market and developing economy countries interested in expanding deposit insurance to nonbank deposit-taking institutions will be to establish strong and independent supervision of those institutions, a precondition for inclusion in effective deposit insurance systems.

The involvement of deposit insurance in the promotion of financial inclusion would therefore need to be undertaken along with the strong engagement of the banking supervisory authorities and other financial safety net participants. Second, as with BCBS, IADI's focus (and the focus of its Core Principles) is on banks and their existing depositors. Expanding deposit insurance coverage to cover nonbank deposit-taking institutions and innovative "deposit-like" services of relevance to financial inclusion, such as e-money, raises a number of significant complications that have not yet been extensively studied, including *(i)* the need for the development of adequate supervision methods and resolution regimes for covered entities; *(ii)* consideration of the implications of the costs related to such supervision methods and resolution regimes; and *(iii)* consideration of potential funding mechanisms to address new delivery channels or mechanisms for financial services and products. Further, where there is inadequate capacity of the relevant prudential supervisors, as is the case in many emerging market and developing economy countries, the risks to the deposit insurer from such an expansion of the financial safety net could represent a poor policy choice.

Membership in deposit insurance systems. Given IADI's focus on banks and their existing retail depositors, the possible expansion of existing deposit insurance systems to include nonbank deposit-taking institutions that are well situated to reach financially excluded poor households merits study and analysis.[32] Furthering the goal of financial inclusion appears to complement the objective of deposit insurance to contribute to financial stability and protect less sophisticated depositors. However, the investment needed to accomplish this needs to be balanced against investment in deposit insurance preconditions (such as strong

32. This question in relation to IADI mirrors the question in relation to BCBS, where BCPs are now widely applied in practice in BCBS member countries and nonmember countries, alike, to both banks and many nonbank deposit-taking institutions (see Part II A, "BCBS").

and independent supervision), particularly in countries with lower current levels of basic supervisory capacity.

IADI considers membership in the deposit insurance system compulsory for all financial institutions accepting deposits from those deemed most in need of protection (e.g., retail and small business depositors), to avoid adverse selection. This idea, which on its face could support expansion of coverage to include nonbank deposit-taking institutions, would require strong prudential supervision for all institutions that the system covers. Financial systems vary greatly in the types of institutions that are authorized to take deposits, but in many countries, there is a range of nonbank providers that operate outside the banking supervision regime and are subject to widely varying regulatory and supervisory treatment (if they are supervised at all). Before these types of institutions' deposits can be insured, they must first be subject to effective supervision.

Funding of deposit insurance systems. Funding of deposit insurance systems also presents a potential challenge for expanding the financial safety net to include insurance for some products of nonbank deposit-taking institutions. Deposit insurance systems are required to have available adequate funding mechanisms to ensure the prompt reimbursement of insured depositor claims, including a means of obtaining supplementary back-up funding. The primary cost of such insurance is borne by the insured depository institutions, since they and their customers benefit from the insurance. Funding raises a number of important issues, including the following:

- What would the funding structure look like?
- How would deposit insurance premiums be determined and assessed?
- What would be the impact of deposit insurance premiums on interest rates paid to or fees assessed upon consumers?
- What would be the impact of deposit insurance premiums on the viability of the delivery channel or mechanism as a means of reaching financially excluded households?

Innovative "deposit-like" products. Another financial inclusion topic of relevance to deposit insurers is the potential insurability of "deposit-like" products, such as e-money, with high financial inclusion potential. On the one hand, bringing such products within a deposit insurance system's coverage may contribute to the broad policy objective of protecting less sophisticated depositors (or their functional equivalent, if e-money is not treated as a deposit in the country in question). On the other hand, such coverage would require providers to submit to comprehensive regulation and supervision, which could lead to additional costs that trigger practical and business case problems in some countries. Further, the risks to banking sectors and deposit insurers of insuring deposit-like products have not been assessed (see Part III C, "Branchless Banking: E-money, Agents and Similar Innovations").

Public awareness. For a deposit insurance system to be effective, it is essential that the public be informed about its benefits and limitations. As trust is an important element in inducing financially excluded customers to use formal financial products and providers, public awareness of the existence and limits of a given country's deposit insurance system (if it has one) could have substantial relevance for financial inclusion.

Through public awareness and other initiatives, explicit deposit insurance systems can play a potentially significant role in ensuring that all depositors are informed about safe methods of storing their money. This may be particularly important in countries that have experienced banking crises resulting in losses to uninsured depositors and undermining public confidence. In addition, deposit insurance protection, where it exists, may not apply to all types of entities providing deposit services to low-income depositors or to all types of deposit and deposit-like services. It is important in such countries to promote public awareness as to which providers and products are and are not covered.

E. International Association of Insurance Supervisors

One of the two primary objectives of IAIS is to "promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders."[33] This insurance market development mandate, coupled with very broad membership—over 190 insurance supervisors in almost 140 jurisdictions,[34] many of which have high levels of financial exclusion—make financial inclusion a fundamental priority for IAIS.

Alongside insurance market development, the IAIS mandate also includes promotion of insurance market stability and integrity through sound supervision. Fundamentally, however, insurance supervision in many jurisdictions has developed with the conception that consumer protection and prudential issues are of equal importance, mutually reinforcing, and closely intertwined. Concern for the fair treatment of consumers of insurance—and the recognition that responsible market conduct is essential to achieving IAIS's insurance market development objectives—distinguishes the IAIS work program.

Since its inception, IAIS's orientation has extended well beyond a pure standard-setting and guidance issuing role to include actively supporting members in the practical implementation of IAIS standards and guidance. Limited supervisory and policy-making capacity has also been a challenge for insurance supervisors in many IAIS member countries, increasing the demand for IAIS to play a member-convening role to discuss issues and seek capacity-building solutions.

Key Financial Inclusion Issues

Within IAIS, financial inclusion is synonymous with the concept of microinsurance, defined as "insurance that is accessed by the low-income population, provided by a variety of different entities, but run in accordance with generally accepted insurance practices (which should include the Insurance Core Principles)" (IAIS 2007). Since the inception of its work in the area of microinsurance, IAIS has recognized two distinct classes of relevant issues: *(i)* those applicable to the extension of conventional insurance to reach excluded customers and *(ii)* those applicable to bringing existing informal providers of insurance products (which

33. www.iaisweb.org
34. See Appendix B, "SSB Membership," for the current membership of IAIS. IAIS also includes a small number of nonvoting, international organization members, including the World Bank. There are also more than 120 observers representing industry associations, professional associations, insurers, and reinsurers.

BOX 7

IAIS Activities, Processes, and Forums Relevant to Financial Inclusion

Like IAIS itself, many of its insurance supervisor members, particularly those in emerging markets, have an insurance market development mandate as well as a prudential mandate. As such, they also tend to have a stronger orientation toward increasing accessible markets for insurance products. Commitment to addressing financial inclusion issues among these members has added impetus to the IAIS's interest in forming working groups and developing initiatives around financial inclusion in insurance at the global level.

In late 2005, IAIS became the first of the five SSBs to establish a formal mechanism to consider financial inclusion issues, co-founding (together with the Regulation, Supervision, and Policy working group of the Microinsurance Network [formerly the CGAP Working Group on Microinsurance]) a joint working group on regulation and supervision of microinsurance.[a] The Joint Working Group brings together supervisors, organizes seminars, and recommends activities for IAIS in the area of financial inclusion.

In June 2007, IAIS published jointly with the Microinsurance Network its first issues paper on microinsurance, "Issues in Regulation and Supervision of Microinsurance" (IAIS and CGAP Working Group on Microinsurance 2007). Its second microinsurance paper, "Issue Paper on the Regulation and Supervision of MCCOs in increasing access to Insurance Markets," deals with the specific issues relating to regulation and supervision of mutuals, cooperatives, and other community-based organizations in microinsurance (particularly relevant to financially excluded poor households) (IAIS, Microinsurance Initiative, and Access to Insurance Initiative 2010).

Currently, IAIS is in the final stages of preparing concrete guidance on the implementation of the ICPs in the context of inclusive insurance markets. "Guidance on Regulation and Supervision supporting Inclusive Insurance Markets" is expected to be approved in early 2012. IAIS plans to follow this with further material for training and self-assessment on market access aspects of regulation and supervision by IAIS members. The Draft Guidance Paper will follow the revisions to the ICPs, which are expected to be adopted at IAIS's fall 2011 annual meeting. The revised ICPs make the principle of proportionality more explicit, and the Draft Guidance Paper on inclusive insurance markets includes guidance on how to apply the revised ICPs in practice, including the proportionality principle, to support financial inclusion (see Part I C, "Proportionality").

IAIS is a founding partner in the Access to Insurance Initiative, a collaboration of international development agencies and insurance supervisors that aims to *(i)* strengthen the capacity and understanding of insurance supervisors, regulators, and policy makers; *(ii)* facilitate their role as key drivers in expanding access to insurance markets; and *(iii)* support the implementation of sound policy, regulatory, and supervisory frameworks consistent with international standards.

a. Although IAIS has a microinsurance subgroup, the Joint Working Group is the body that generates the microinsurance-related work products of IAIS.

abound in communities around the world where financially excluded poor households reside) into compliance with the Insurance Core Principles (ICPs) and ultimately under supervision.[35] Both these classes of issues, but particularly the latter, trigger important questions of proportionate regulation and supervision to facilitate financial inclusion (as discussed in Part I C, "Proportionality"), and the latter obviously revolves fundamentally around the practical and regulatory challenges of formalization (as discussed in Part III A, "Formalization").

IAIS work on financial inclusion issues has, to date, focused on highlighting the balance between sensible regulation and avoiding regulatory impediments to access. Case studies and country experiences have brought into focus how regulation can facilitate innovation or impede it, often inadvertently, with the effect of restricting key access channels. The importance of mutual and other community-based organizations has been a key focus given that many self-help and informal

35. Informality in microinsurance includes both officially sanctioned informality, where certain insurance products are explicitly excluded from the insurance law, and informality that is not sanctioned, where certain insurance products are offered in a more "underground" fashion. Funeral and burial insurance are common examples of informal insurance in many countries (in some cases sanctioned, and in other cases not). Other examples include community risk-pooling schemes based on family connections and cultural expectations to contribute when called on to assist in adversity that can cover a range of contingencies.

risk-pooling schemes operate on mutual concepts, and thus can be important to understanding both formal and informal insurance risk management by the poor. Through its discussion papers, seminars, and supervisory forums, IAIS has also developed the regulatory thinking on consumer disclosure that is effective for excluded customers and on the pros and cons of regulatory definitions in advancing inclusive insurance.

As improving access to insurance markets can involve innovations in product design, service delivery, or both, most of the ICPs are relevant to the financial inclusion agenda. The particular models, and the access challenges that are overcome by them, show great variation. However, the ICPs that are usually considered to be the most relevant are those relating to government policies and supervisory objectives (ICP 2), licensing (ICP 6), intermediaries (ICP 24), and business conduct (ICP 25). Many of the other ICPs relating to the operation of insurers are relevant, particularly recognizing the need to design proportionate approaches (see Part I C, "Proportionality").

PART III. TOPICS OF JOINT RELEVANCE

The five SSBs have a history of addressing issues of relevance to the mandates of more than one of them, often in response to emerging trends and developments. The Joint Forum (a collaboration of BCBS, IAIS, and the International Organization of Securities Commissions), for example, was established in 1996 to deal with issues common to banking, securities, and insurance, including the regulation of significant financial conglomerates bridging all three sectors. BCBS and IAIS are both FATF Observers, and FATF is represented on BCBS's AML/CFT Expert Group. To date, however, none of these SSB collaborations has directly and explicitly addressed financial inclusion.

The three topics discussed next are each critically important to the goal of financial inclusion, and each is highly relevant to the core mandates of several SSBs—in some cases all five. On some aspects of each topic, financial inclusion will be advanced by SSBs arriving at common positions. On others, all that will be required is an understanding of each other's differing concerns and perspectives.

Formalization of informal providers is important to the SSBs, as it effectively demarcates the institutions that lie outside the current main scope of their work. It is also a critical topic to financial inclusion, given the large (and, in many countries, growing) numbers of such providers that already serve poor households. Proportionality (discussed in Part I C, "Proportionality") and formalization are intertwined concepts, as proportionate regulation can be critical to formalization: where regulatory and supervisory approaches are not proportionate to the risks and benefits involved, informal institutions may not be able to formalize.

Effective *financial consumer protection* is an essential element of "financial inclusion" as defined in this white paper (see Box 1, "'Financial Inclusion': A Working Definition"). It is also a topic of concern for four of the five SSBs, although to varying degrees. The topic triggers specific considerations for financially excluded poor households, and for countries with high levels of financial exclusion and low levels of capacity among policy makers, regulators, supervisors (to implement standards and guidance), providers (to comply with regulation and supervision), and the customers themselves (in terms of financial literacy and capability).

Branchless banking, including e-money, agents, and similar innovations, is relevant in its own right due to its unique potential to increase financial inclusion. It is also important because of its relevance to the mandates of particular SSBs (e.g., FATF) and because of the blurring of the lines between the SSBs' spheres of interest (e.g., BCBS and CPSS) that it represents. As with other developments in financial service delivery on which SSBs have worked jointly (such as the growth of global financial conglomerates that provided impetus for the formation of the Joint Forum), the better each SSB understands the risks and benefits of branchless banking, e-money, agents, and similar innovations as perceived by the others, the more likely that SSB engagement will reflect a proportionate approach to regulation and supervision of the relevant actors and products.

A. Formalization

Formalization of financial service providers is important to financial inclusion efforts given that a primary objective is to motivate customers to shift from using informal providers to formal providers that offer appropriately designed, responsibly and sustainably delivered, affordable products and services (see Box 1, "'Financial Inclusion': A Working Definition"). Customers who use informal providers are usually those who cannot access the services of formal financial institutions (due to factors such as price, location of the provider, lack of appropriate services, or immigration status of the customer) or do not want to access such services (due, for instance, to lack of confidence or knowledge, or feeling unwelcome). In many cases, the services provided by informal providers are less reliable and more expensive than equivalent services (if available) provided by formal providers.[36,37]

This is not to say, however, that formal products and providers in all cases offer customers a better value proposition or that informal products and providers are inherently inferior. Moreover, the reality for many financially excluded households is that informal options may be all they have available for years to come for at least some of their financial service needs. This makes the question of formalization a complicated one: in many situations, closing off access to informal financial services because the providers cannot or do not want to meet the requirements of formalization runs counter to the overall objective of financial inclusion to improve the well-being of poor households. Indeed, there is a strong justification for permitting certain small institutions (such as small financial cooperatives that pose no systemic threat) to operate informally if their members have no access to safer options (Christen, Lauer, Lyman, and Rosenberg 2011).[38] Finally, to view formalization of all informal providers as a simple yes or no question oversimplifies the picture. Across the different types of services and providers likely to figure importantly in closing the financial access gap, varying degrees of formalization are a feature of the current landscape faced by country-level policy makers pursuing a financial inclusion agenda.

36. In *Portfolios of the Poor* (Collins, Morduch, Rutherford, and Ruthven 2009), based on financial diaries of low-income financial consumers in three countries, the authors identify "unreliability" as one of the primary shortcomings of informal financial instruments.
37. A review of data on informal lending in 21 countries and the West African Monetary Union found that "in all of these countries except Ghana, microcredit rates were lower—usually far lower—than informal rates. The median informal rate reported was 10–25 percent per *month*" (Rosenberg, Gonzalez, and Narain 2009).
38. Some of the other options to which excluded households commonly have access often appear manifestly less safe, such as saving in livestock, gold jewelry, or cash sewn into clothing; asking a friend or family member to hold some cash; trusting a traveler to deliver cash; or riding a bus or walking long distances to pay a bill.

BOX 8

Formal and Informal Providers

The meaning of terms "formal" and "informal" and the need to "formalize" depends on the particular service or product being offered and the particular regulatory system in question. For purposes of this white paper, to be considered "formal," the financial service provider must have a recognized legal status.[a] However, above this minimal threshold, the concept of formality varies with the SSB in question and the types of services and providers falling within its mandate.

In the discussion of BCBS standards and guidance with respect to deposit-taking institutions and IADI's Core Principles, "formal" refers to an institution that is subject to prudential regulation and supervision. For IAIS, an insurance underwriter will be "formal" if it is licensed and supervised; a distributor of insurance will be "formal" if registered and, in some jurisdictions, authorized or licensed. In contrast, CPSS has noted that for remittance service providers (RSPs), the fact that a particular type of institution is subject to regulation may *not* be a useful measure for distinguishing such institutions from "unregulated" institutions given that *(i)* some RSPs may ignore or evade the law or *(ii)* regulations may be drafted to apply to only certain types of RSPs, leaving other RSPs outside regulation but operating legally (CPSS and World Bank 2007). Further, CPSS has explicitly eschewed the use of the terms "formal" and "informal" in the realm of retail payments in its 2007 "General principles for international remittance services," where it states that "there can [not] be a presumption that the formal sector (however defined) is in some sense 'better'" (CPSS and World Bank 2007). For FATF, none of these criteria (i.e., registered, licensed, regulated, supervised) is relevant for purposes of imposing the AML/CFT rules given that FATF's definition of "financial institution" is activity-based and does not depend on regulatory status, licensure, or supervision of the entity (although the topic is important to FATF, given that formalization of providers will often mean bringing their customers' transactions into the electronically traceable realm).

a. As noted in the definition of "financial inclusion" used in this white paper (see Box 1, "'Financial Inclusion': A Working Definition"), a "formal" institution connotes a financial service provider that has a recognized legal status, and includes entities (and in some countries even some natural persons) with widely varying regulatory attributes subject to differing levels and types of external oversight.

As discussed below, each of the SSBs addresses the issues of informality at least implicitly, and three of them (BCBS, IADI, and IAIS) address need for formalization explicitly, although in different ways, depending in large part on the perceived risks of the particular informal service providers.

BCBS. Formalization in the context of deposit-taking institutions can refer to *(i)* registration and licensing of a legal entity that previously operated but was unregistered and unregulated, *(ii)* an existing entity being licensed to engage in new activities, including deposit taking, or *(iii)* bringing an existing entity or type of entity under a prudential regulatory and supervisory regime due to a change in law. There has been significant experience at the country level with all three, including, in particular, the recent efforts to bring a diverse array of financial cooperatives under prudential supervision. However, BCBS is interested in the topic primarily with respect to deposit-taking institutions of a size that would necessitate prudential regulation due to systemic risks posed. It has not issued any guidance specific to the supervision of financial cooperatives (nor is this likely, given that even with respect to banks, BCBS has not provided guidance on specific classes of institution).

Formalization efforts in some countries have been driven by the concern of regulators regarding the systemic risk of large numbers of unsupervised (and sometimes financially significant) institutions taking savings. In other countries, supervisors are responding to the concern of customers regarding the safety of their savings, in some cases, held by unregulated and unsupervised financial co-

operatives and community groups (Kasekende 2011). Although there has been a great deal written about the costs of regulation and supervision of depository institutions (including depository MFIs) and the potential impact on access to financial services for poor households, little work has yet been carried out to identify the specific challenges that BCBS standards and guidance pose to formalization. This is an important issue, as there are countries in which some unsupervised financial cooperatives have hundreds of thousands of members and assets in the tens of millions of dollars.

CPSS. The Core Principles for Systemically Important Payment Systems require that any Systemically Important Payment System have a "well founded legal basis" (Core Principle 1). This requirement is also widely applied to retail payment systems. In addition, the Core Principles allow access criteria to be based on risk mitigation measures. The risks to be mitigated are those that the individual participants can bring to the system through their participation. Therefore, it is often the case that access criteria for participation in Systemically Important Payment Systems permit only those entities supervised by the banking supervisory authority to participate directly.

FATF. The formality of a provider is generally not relevant for purposes of imposing the AML/CFT rules given that FATF's definition of "financial institution" is activity-based and does not depend on regulatory status, licensure, or supervision of the entity.[39] Recommendation 23 requires that countries ensure that financial institutions are subject to adequate regulation and supervision and are effectively implementing the FATF Recommendations. This Recommendation and Special Recommendation VI, which requires money or value remitters to be licensed or registered, both support the formalization of "financial institutions" as defined by FATF (see Part II C, "FATF"). Formalization of informal providers—whether through compliance with AML/CFT rules or due to independent registration or licensing[40]—brings them and their clients into the traceable realm of formal finance, accomplishing an important FATF objective. A risk-based approach to the FATF standards can help to enable formal financial institutions to serve those customers currently using informal providers (see Part I C, "Proportionality").

Particularly for some smaller service providers, AML/CFT requirements can effectively create impediments to formalization when they impose an overly burdensome regime (e.g., cost of compliance and performing CDD, regulatory requirements, or legal risk). The requirements pose two sets of challenges: whether the provider institutions can cost-effectively comply (e.g., with record-keeping requirements and reporting of suspicious transactions) and whether the clients can comply (with identification requirements). The primary focus of financial inclusion advocates thus far has been whether clients can comply, although some of the smaller providers particularly relevant to financial inclusion, such as agents offering e-money, may be in a situation similar to their cus-

39. As noted (Box 1, "'Financial Inclusion': A Working Definition"), financial service providers may have a recognized legal status for different purposes by different government authorities, and with differing levels of regulation and oversight. E.g., a grocery store that offers money remittance activities might be regarded as "formal" if it has registered its activities, as may be required by that country's laws. It may or may not be subject to other regulatory or oversight requirements (including anti-money laundering) and may be risky from a money laundering perspective. On the other hand, such a remitter may not have registered its activities and would thus be conducting an illegal activity if registration is required by law, or it may be subject to full regulatory controls, but not be subject to any registration or licensing requirement, and thus in some cases may be less risky.

40. Both are required by FATF Recommendations for most relevant financial institutions.

tomers when it comes to CDD requirements (in addition to cost of compliance barriers).

IADI. IADI's Core Principle 8 on compulsory membership states that "[m]embership in the deposit insurance system should be compulsory for all financial institutions accepting deposits from those deemed most in need of protection (e.g. retail and small business depositors) to avoid adverse selection." Formalization, for members and potential members of IADI, would have two components. First, to satisfy IADI's necessary *preconditions,* deposit-taking institutions would need to be brought under effective supervision. Second, such institutions would need to be brought into an explicit deposit insurance system. In many developing economies, the reality is that nonbank deposit-taking institutions are not currently subject to effective supervision. And in many countries today, nonbank deposit-taking institutions are not covered by deposit insurance. If the goal is to ensure that nonbank institutions—and the large numbers of financially excluded customers they reach—are not excluded unnecessarily from the protections of deposit insurance, then such institutions would need to be brought under effective supervision, and their inclusion in an effective system of deposit insurance would need to be designed in a way that is consistent with IADI's Core Principles.

IAIS. Formalization in microinsurance is relevant to the two distinct roles of insurance providers: underwriting (where formalization involves informal insurance risk carriers becoming licensed and supervised or transferring their insurance risk to formal providers) and intermediation between the underwriter and the customer (where formalization means satisfying the conditions to act as an agent on behalf of an underwriter).[41] IAIS is opposed to informal insurance services of either type *over the long run,* recognizing that formalization is a process and that applicable requirements should be proportionate. This view is supported in the revised IAIS Core Principles (to become effective in October 2011, assuming approval) and the forthcoming IAIS guidance on accessible insurance markets (see Part II E, "IAIS," and Part I C, "Proportionality"). There are two reasons for the IAIS position. First, informal insurance can significantly underperform for clients at the time that they are most vulnerable and its protections are needed most (e.g., the post-tsunami failure in one country of the policies of all informal insurers, where such providers were well-established, but were operating without adequate reserves for future liabilities). Second, consumer understanding and confidence in insurance is greatly undermined when informal products and services are inadequate, inappropriate, or fail outright.

Formalization of existing informal insurance markets presents challenges in practice. IAIS is conscious of and developing guidance on the challenges in formalizing informal insurance markets that may, in some cases, involve very large numbers of providers and would place considerable burdens on scarce supervisory resources if all providers were immediately licensed and subject to supervision.

41. Agent activities include the sale and distribution of microinsurance as well as collecting premiums, administering policy, and handling claims (assessment and settlement). Many MFIs and others currently acting as intermediaries for microinsurance may have difficulty meeting criteria to operate as agents established for mainstream insurance intermediaries.

B. Financial Consumer Protection

Financial consumer protection plays an essential role in reinforcing the benefits and mitigating the risks of financial inclusion by building consumer trust and improving service value. Previously excluded people are more likely to take up formal financial services if they perceive them as safer and better options. In turn, as consumers gain experience in using diverse formal services, their financial literacy skills increase.

The specific characteristics of excluded consumers have significant implications for effective consumer protection regulation and supervision and, therefore, also SSB standards and guidance aimed at enabling financial inclusion. Relevant characteristics are likely to include limited experience with, and sometimes trust in, formal financial service providers; lower levels of education and financial literacy and capability; few formal providers to choose from, if any; and remote locations. These factors can exacerbate the already significant power differentials between providers and consumers that underlie unfair treatment and improper practices in financial services, and so call for specific attention in efforts to extend protection of these types of consumers.

Without basic protective measures, previously excluded and inexperienced consumers may be subject to abusive sales and collections practices and risk being sold products that do not fit their needs and may even be harmful. Expanding and improving the effectiveness of financial consumer protection for excluded consumers contributes fundamentally to financial inclusion and is a definitional element of the concept as it is used in this white paper. (See Box 1, "'Financial Inclusion': A Working Definition.") At the same time, care is warranted to design proportionate consumer protection regimes that don't set the bar so high that responsible providers are dissuaded from entering the market or offering new services.

Financial Consumer Protection Aspects of SSB Mandates

The global financial crisis made the connections between stability and consumer protection much more obvious to policy makers and the general public. This influenced the G-20 in 2010 to make two calls relevant to financial consumer protection. At the June 2010 Toronto Summit, G-20 leaders identified consumer protection and financial literacy and capability among their nine Principles for Innovative Financial Inclusion (see Appendix A, "G-20 Principles for Innovative Financial Inclusion") and urged countries to take concrete steps to implement them. At the November 2010 Seoul Summit, the leaders requested the Financial Stability Board, OECD, and other international organizations to prepare a report on options for strengthening financial consumer protection. Subsequently, the February 2011 meeting of the G-20 Finance Ministers and Central Bank Governors requested that OECD, the Financial Stability Board, and other international organizations draft high-level "common principles" for consumer protection in financial services that will be applicable to all countries. An OECD Task Force has prepared a draft of the principles that will go out for public comment and be presented at the October 2011 meeting of the G-20 Finance Ministers and Central Bank Governors.[42]

42. In addition, the World Bank has prepared a detailed diagnostic tool for financial consumer protection, "Good Practices for Financial Consumer Protection," which has been tested in 11 countries to date. The document was released as a consultative draft in March 2011 and will be finalized in September 2011. It is subject to ongoing review and adaptation based on emerging experience. www.worldbank.org/consumerprotection.

Financial consumer protection—especially as it relates to financial inclusion—primarily concerns itself with provider market conduct related to their retail relationships with customers. This retail focus makes it most relevant to IAIS, BCBS, and IADI, and of secondary (but perhaps growing) relevance for CPSS.

BCBS. Effective market discipline is a precondition for effective bank supervision under the Core Principles and Basel III. The Core Principles set the parameters for overseeing and assessing risk management practices of banks, but there is increasing recognition by supervisors that consumer protection and market discipline contribute to the health of individual banks and of the system as a whole. More specific BCBS guidance would be timely and useful, specifically for lower capacity countries with limited supervisory resources and low levels of financial inclusion. As noted, the revision of the Core Principles process currently underway offers important opportunities to address more clearly the links among financial inclusion, prudential oversight, and market conduct supervision.

CPSS. CPSS is focused primarily on systemically important payment systems, which affect retail consumers only indirectly. Nonetheless, consumer trust and confidence in e-money schemes and similar innovations being used to reach excluded clientele and the promotion of safe and reliable clearing and settlement systems that build in appropriate safeguards for retail consumers, including those who are low-income, are topics of possible interest to the CPSS Working Group on innovative retail payments.[43]

IADI. Protection of retail depositors and public awareness concerning which deposits are insured are Core Principles for deposit insurance and key financial consumer protection issues, as insuring of deposits has the potential to increase trust in formal savings options. But expanding deposit insurance systems to include nonbank deposit-taking institutions and deposit-like products, such as e-money, that are particularly likely to reach financially excluded customers would have to consider country context and the necessary preconditions identified by IADI for effective deposit insurance systems (see Part II D, "IADI").

IAIS. Protection of customers is important to IAIS and is one of the ICPs. IAIS's encouragement of formalization of all insurance providers—including informal underwriters that disproportionately serve the poor or financially excluded—has important consumer protection implications. Bringing these providers under supervision should improve their financial solvency and their ability to pay out claims to customers (see Part III A, "Formalization"). Similarly, IAIS, through ICP 24, calls for proper supervision of insurance intermediaries, including licensing or registration of intermediaries, disclosure to customers on status as independent or affiliated intermediaries, and measures to safeguard any client funds handled by intermediaries (IAIS 2003). Such supervision may be direct or indirect (through insurance providers).

43. As noted (see Part II B, "CPSS"), the working group was established to investigate factors that influence the success of innovations, the implications of payment system innovations from the perspective of users, and potential issues for public authorities, especially for central banks in their payment system oversight function.

Considerations for SSBs on Inclusive Financial Consumer Protection

Several broad considerations concerning financial consumer protection merit attention from the SSBs in their efforts to support financial inclusion in their standards and guidance and in the implementation of their standards and guidance at the country level.

Regulation by product, not provider type. Consumers should receive the same level of protection irrespective of provider type, suggesting market conduct rules and oversight that have broad coverage (e.g., apply to all formal providers of a particular service). Regulation by product can help ensure that, while the typical profile of financially excluded clients is considered in designing financial consumer protection policies, financially excluded clients are not afforded a lower level of protection than other consumers in the market solely due to the types of providers to which they may have access. This approach also avoids the potential for providers to seek out segments of the market or provider classifications with more lax consumer protection standards. Through their guidance, SSBs can facilitate regulatory approaches focused on product type, for example, by exploring risks and risk mitigation strategies for given products across the range of possible providers, as is currently done by FATF with regard to AML/CFT risks.

Formalization as a tool to facilitate improved consumer recourse and redress. Increased formalization of financial service providers can help establish a "regulator of record" for previously unsupervised providers. Even where specific provisions on recourse and redress for financial service providers are limited or nonexistent, the identification of a responsible regulatory body for previously unsupervised institutions at the least offers consumers an official entity through which they can submit complaints or concerns about a financial service provider. SSBs can also take further steps to address recourse and redress directly, as the IAIS does through Explanatory Note 25.3 on ICP 25 (Consumer Protection), which states that "a good claim resolution process is essential for the fair treatment of consumers" (IAIS 2003). A good starting point to improve recourse in lower access markets is for regulation to set standards for financial service provider internal dispute resolution, to integrate oversight of such systems into regular examination procedures, and to require reporting on complaints and resolution processes and statistics.

Branchless banking and similar innovative delivery channels. Because of the potential of branchless banking to reach excluded populations (see Part III C, "Branchless Banking: E-money, Agents and Similar Innovations"), the consumer protection issues raised by these delivery mechanisms are especially relevant for financial inclusion (Lyman, Pickens, and Porteous 2008; Dias and McKee 2010). In addition to protecting customers' interests in e-money float (see Part III C, "Branchless Banking: E-money, Agents, and Similar Innovations"), one of the most critical issues raised by these innovative business models is the liability of the financial service provider for its use of agents or other third-party intermediaries (e.g., retailers performing cash-in and cash-out transactions or account opening in branchless banking models, insurance distributors, outsourced collections agents). Clear rules about the respective liability of providers and agents, and disclosure of these arrangements to consumers at the point of sale, are essential to ensure that consumers receive adequate protection. This provides the incentive for providers to monitor agent behavior in delivery of the service, and it establishes accountability to the customer. The principal's liability for its agents is established in certain SSB standards and guidance and should be reinforced as

business models evolve and clarified, where needed, in the case of third-party service providers that do not qualify as true "agents" under local law (Dias and McKee 2010).[44] Disclosure and dispute resolution regimes will also need to be adapted to reflect agent involvement in service delivery.

Country context: Level of financial exclusion and capacity of supervisors and providers. A country's level of financial exclusion and the capacity of its policy makers, regulators, and supervisors to implement the SSBs' standards and guidance (and the capacity of providers to comply with the resulting regulation and supervision) are particularly important considerations with respect to financial consumer protection. Consumer protection regulation and supervision need to be designed with sensitivity to potential unintended negative effects on access, using the principle of proportionality to tailor the regulation and supervision to the specific risks observed in the market. The lower levels of regulatory and supervisory capacity particularly common in low-income jurisdictions also suggest the need for careful prioritization of the most important risks observed, as well as incremental phasing in of consumer protection measures over time as markets and regulatory and supervisory capacity develop (Brix and McKee 2010). As a first step, it may be advisable to focus on basic protections, such as transparent pricing, fair treatment, and effective recourse and dispute resolution—which can help lead to expanded provision of formal financial services to excluded consumers—while avoiding setting the consumer protection bar so high that responsible providers are dissuaded from entering the market. Consumer research provides a useful tool for policy makers seeking to understand the behavior of excluded consumers joining the formal financial system and to design and prioritize effective and proportionate measures to protect them.

C. Branchless Banking: E-money, Agents, and Similar Innovations

"Branchless banking" generally refers to the delivery of financial services outside conventional bank branches, using agents or other third-party intermediaries as the principal interface with customers, and relying on technologies, such as card-reading point-of-sale (POS) terminals and mobile phones, to transmit the transaction details (Ivatury, Lyman, and Staschen 2006). Due to its reliance on *existing* technology and infrastructure (e.g., mobile phones, automated teller machines, POS devices) and *existing* operational retail establishments as agents, branchless banking has already demonstrated, in some markets, its potential to lower costs of delivery and reach financially excluded households that could not be served profitably with conventional branch-based approaches—particularly, those customers in remote and sparsely populated areas.

The common element in all approaches to branchless banking is the use of agents (or other nonbank, third-party service providers) to serve as a principal (in some cases, exclusive) interface with retail customers. Depending on what regulation permits, these agents—who may be individuals, small retail shops, post offices, petrol stations, or large retailers—offer customers convenient and affordable cash-in/cash-out services, as well as other services, such as account opening and transmission of other documentation, on behalf of remote financial service providers.

44. In most countries, a principal is liable for the actions of its agents within the scope of the agency, whether such actions are explicitly or implicitly authorized. Liability for the actions of a third-party intermediary who is not legally an agent usually depends on the specific terms of the agreement. There are important policy reasons for ensuring that a financial service provider retains ultimate responsibility for regulatory compliance when it contracts with third-party service providers, regardless of the terms of their agreement (Dias and McKee 2010).

Branchless banking frequently involves e-money—an electronic store of value with the functionality to serve as a kind of virtual transactional account—but can also involve access through agents to a conventional bank account or bank-based payment service (Lyman, Pickens, and Porteous 2008). Depending on the particular model and the applicable regulatory regime,[45] branchless banking can provide remote customers with access to a potentially broad array of formal financial services. Although, to date, few models offer retail credit, and branchless banking providers typically do not underwrite insurance, both lenders and insurers may use branchless banking channels to disburse loans and settle insurance claims, as well as collect loan repayments and microinsurance premiums.

For policy makers, regulators, and supervisors at the country level and for the SSBs, branchless banking, e-money, and agents present challenges because they implicate new actors and new relationships among actors. In addition, the pace of innovation is challenging, with new models evolving rapidly. SSB guidance needs to recognize that the various emerging models place the different elements of the financial services value chain in different hands. This calls for unbundling the

BOX 9

General Description of Some Commonly Used Branchless Banking Terms

Different jurisdictions have given varying definitions to the terms "branchless banking", "e-money", and other related terms (such as "mobile money"). Importantly, these terms are also frequently used differently by industry actors outside the standard-setting and regulatory context. In some cases, definitions have been revised over the past several years to reflect the evolution in technology and models.

The following are general descriptions of "agent", "e-money", "e-money issuer", "float", and "mobile money" that synthesize many of the current definitions and models. *These are not intended as definitions for standards, guidance, or regulation,* but they describe how these terms are used in this white paper's discussions of branchless banking, e-money, agents, and similar innovations.

"Agent" refers here to any third party acting on behalf of a bank or other e-money issuer or distributor in its dealings with customers, whether or not a principal–agent relationship exists under the law of the country in question.[a]

"E-money" (short for "electronic money") is a type of stored-value instrument or product. E-money is generally understood to have the following attributes: *(i)* it is issued upon receipt of funds; *(ii)* it consists of electronically recorded value; *(iii)* the electronically recorded value is stored on a device such as a chip, prepaid card, a mobile phone, or a computer system; *(iv)* it is accepted as a means of payment by parties other than the issuer; and *(v)* it is convertible into cash.

The "e-money issuer" is the entity that initially sells or "issues" the e-money. Some countries permit only banks to issue e-money; other countries permit banks and nonbanks to issue e-money.

"Float", sometimes referred to as "e-float" (Tarazi and Breloff 2011), refers to the total outstanding e-money issued by a given e-money issuer.

"Mobile money" is a term used with widely varying meanings, which can include a type of e-money that can be transferred by an MNO. As with the other e-money issuers, the issuer of mobile money may (depending on local law and the business model in question) be an MNO or a third party, such as a bank.

a. As noted (see Part III B, "Financial Consumer Protection"), in most countries, a principal is liable for the actions of its agents within the scope of the agency, whether such actions are explicitly or implicitly authorized. Liability for the actions of a third-party intermediary who is not legally an agent usually depends on the specific terms of the agreement. There are important policy reasons for ensuring that a financial service provider retains ultimate responsibility for regulatory compliance when it contracts with third-party service providers, regardless of the terms of their agreement (Dias and McKee 2010).

45. The different models can be divided roughly into two general groups, at least for purposes of thinking about their regulation and supervision: *(i)* nonbank-based models, where the customer has a contractual relationship with a nonbank e-money issuer (such as an MNO) and a bank typically holds the e-money float and *(ii)* bank-based models, where the customer has a contractual relationship with the bank (such as a limited transaction account, prepaid card, or one-off payment transaction) and the bank outsources certain activities to one or more service providers (such as an MNO, for transmission of transaction details and sometimes maintenance of individual client subaccounts). Both the bank-based and nonbank-based models rely on agents for the critical cash-in/cash-out functions.

value chain and taking a service-based approach, regulating to the extent feasible based on the activity and the risks it involves, while taking due account of the risk profile of the party executing the activity in question (Dittus and Klein 2011).

Key Regulatory and Supervisory Issues Relevant to Branchless Banking, e-Money, and Agents

Across the countries where branchless banking models have launched, widely ranging regulatory frameworks and practices exist.[46] However, there is increasing convergence on a number of issues. The following topics, in particular, have occupied regulators' attention: use of agents by both banks and nonbank e-money issuers; the regulation of e-money issuers; protection of the float of nonbank e-money issuers; CDD and record-keeping for AML/CFT purposes; and the application of financial consumer protection to all such actors and services (see Part III B, "Consumer Protection"). Other issues—including the interoperability of branchless banking schemes, competition and fair access to payment systems and communications infrastructure, and data security—have more recently started to attract significant attention, including, in particular, from policy makers concerned with financial inclusion.

The five SSBs are studying some of these topics and, in some cases, have recently issued or are already working on new or updated guidance. The lack of comprehensive guidance that captures the full range of innovations commencing or being proposed in their markets causes some policy makers and regulators to move cautiously with respect to branchless banking. By contrast, some branchless banking models have flourished in the absence of a specific legal and regulatory framework—in particular, the Kenyan nonbank e-money issuer M-PESA—because relevant regulators have employed a test-and-learn approach and implemented proportionate new regulation incrementally as needed.[47]

Agents, Account Opening, and Cash-in and Cash-out Transactions

Many important policy issues with respect to the use of agents in branchless banking do not depend on whether the legal provider of the service is a bank or nonbank. Whether agents are permitted to open or facilitate the opening of accounts and to do cash-in/cash-out transactions has raised questions for many policy makers concerned about risk management. Account opening raises bank "know your customer" issues and closely related AML/CFT CDD issues for all types of providers. The cash-in function raises concerns regarding the security of individuals and nonbank legal entities handling funds that may seem indistinguishable from a retail deposit. Increasing numbers of countries do permit such activities, but some impose transaction and balance limitations. However, in many countries, there is still a lack of regulatory clarity regarding what is permitted with respect to the use of agents by banks, nonbank e-money issuers, or both.

46. No comprehensive estimates exist for the full range of branchless banking models. Mobile money models have been launched in more than 50 emerging market and developing economy countries. See Mobile Money for the Unbanked Web site. Retrieved 13 June 2011 from www.wirelessintelligence.com/mobile-money/unbanked.
47. M-PESA benefited from a banking regulator willing to take a test-and-learn approach. See Appendix A, "G-20 Principles for Innovative Financial Inclusion." See also Dittus and Klein (2011).

The use of agents, whether by banks or nonbank e-money issuers, raises issues relevant to the mandates of FATF, BCBS, CPSS, and IAIS, although, to date, only FATF has issued guidance specifically addressing agent issues.[48] And while valuable insights are to be found in FATF's 2011 guidance paper "Anti-money laundering and terrorist financing measures and Financial Inclusion" (FATF 2011), further guidance on the risk-based approach—taking into consideration the potential role of agents in advancing financial inclusion and the current impediments to their use that are posed by AML/CFT requirements—will be useful (see Part II C, "FATF").

For BCBS, guidance regarding account opening and the cash-in function when performed by agents acting on behalf of banks and other deposit-taking institutions could have a similar effect. In addition, general guidance on banks' use of agents could provide clarity on risk management and dissuade supervisors from taking an unduly burdensome approach. For CPSS, further exploration of payment service providers' use of agents falls arguably within the ambit of existing initiatives on retail payments, generally, and innovation in retail payments, in particular.[49]

For IAIS, the subject of intermediaries is of fundamental importance to building inclusive insurance markets. The upcoming IAIS Draft Guidance Paper on this subject will be of significant utility to policy makers, regulators, and supervisors working to enable increased access to insurance using e-money offered through agents. To a greater or lesser extent, all five SSBs share an interest in ensuring the financial service provider's legal responsibility for regulatory compliance by its agents (see Part III B, "Financial Consumer Protection").

E-money issuers

Many countries have not yet adopted specific regulation governing e-money.[50] In some, nonbank entities are issuing e-money based on the conclusion that it is not prohibited by law or regulation. In others, regulators and providers have interpreted the definition of a bank "deposit" or of "banking activity" to extend to e-money issuance. In most of these countries, regulators typically permit only banks to be e-money issuers. In countries where regulators have permitted nonbanks to be e-money issuers based on the position that a "deposit" involves the payment of interest on the repayable funds held, nonbank e-money issuers have been permitted as long as they do not pay interest. In other countries where "banking activity" is defined as involving both deposit-taking and intermediation of such funds, nonbanks are permitted to be e-money issuers provided that they do not intermediate the float.[51]

48. The Joint Forum issued general guidance on outsourcing in 2005, which has been useful for some countries in their attempts to regulate and supervise banks' use of agents. BCBS recently issued principles for operational risk management that address the operational risks of outsourcing and, by implication, the use of agents (BCBS 2011b). However, neither body has issued explicit guidance on the use of agents, either generally or specifically in connection with branchless banking, nor any guidance that would apply to nonbank e-money issuers.
49. CPSS is not specifically interested in agents as the mechanism for cash-in/cash-out functions in branchless banking. Agents will be addressed, however, in the World Bank's comprehensive retail payments strategy under development (see Part II B, "CPSS").
50. E-money regulation is not necessarily free-standing, but may be incorporated into broader regulatory schemes, such as a national payment systems law.
51. Of those countries that do have regulation governing e-money, some require all e-money issuers (including banks) to be licensed. However, today, most countries view e-money issuance as effectively one of a bank's core activities and do not require banks to obtain a separate license.

Identification of the specific risks posed by e-money issuers is critical to regulating them proportionately. Typically nonbank e-money issuers have a limited scope of permitted activities that excludes lending and risky investments (see "Protecting the Float"). Consequently, the risks are significantly more limited than those posed by retail banking generally and by e-money issued by banks (assuming that the nonbank e-money issuer is not permitted to intermediate the float). This reduces the need for extensive prudential regulation and supervision. Moreover, today, most nonbank e-money issuers do not handle significant volumes of funds, making systemic risk (in the event of failure of the e-money issuer) unlikely.[52]

Protecting the Float

Protecting the float resulting from the issuing of e-money is of limited concern if a bank is the e-money issuer, as the bank is already prudentially regulated and supervised. (There would be some concern, nonetheless, if the funds held by the bank are treated as general accounts payable rather than as bank deposits, as they may be easier for bank creditors to reach in the event of insolvency.) Regulators and policy makers are increasingly focused on the risk presented by a nonbank e-money issuer when the float is not matched and backed by an equivalent amount of funds held in appropriate investments—either bank deposits or other approved safe and liquid investments. The concern is with the risk of loss of public funds as well as liquidity management.

Experience with approaches to protecting the float is increasing in both developed and developing countries, as is consensus on proportionate approaches to regulation of e-money. While the particular model employed will affect regulatory treatment, basic regulation should address the safety of the float ("fund safeguarding") and segregation of customers' funds from the reach of the issuer's creditors ("fund isolation") (Tarazi and Breloff 2010). The float should be held in one or more prudentially regulated and supervised institutions or in specified low-risk and highly liquid investments. Segregation of customer funds is increasingly typically accomplished by establishing trust accounts or the equivalent (if such a concept exists and is enforceable under local law). This should serve to protect customer funds from creditors of the e-money issuer in the event of issuer insolvency.

Deposit Insurance and E-Money

A frontier issue related to e-money is whether a customer's stored value should be covered by deposit insurance, if a deposit insurance system exists in the country in question.[53] Although not widely used for this product, "pass-through" deposit insurance could provide a means of insuring such amounts, as is currently practiced with certain prepaid e-money accounts in the United States (Ehrbeck and Tarazi 2011). Under this approach, as long as the float is placed in an insured depository

52. In an effort to better understand the risks posed by e-money, regulators in some countries are starting to collect data on the payment volumes for e-money.
53. Even if the float is held by a commercial bank that is a member of a deposit insurance system, the total amount of any e-money float will typically exceed the maximum coverage amount.

institution, it can be considered an insured deposit, with pass-though protection afforded for each customer's funds held in pooled custodial accounts, up to the insurance limit. The conditions in the United States to qualify for pass-through insurance on customers' e-money balances suggest that this approach may be challenging to implement in countries with more limited supervisory and provider capacity.[54] Moreover, the additional costs and regulatory burden involved—and the risk that these costs may, in turn, serve to limit the financial inclusion potential of the product—may also warrant consideration. This said, some countries have significant and growing experience with e-money as a means of reaching financially excluded households, and this is a frontier issue worth exploring.

PART IV. OBSERVATIONS AND RECOMMENDATIONS

Building on the momentum to integrate financial inclusion into the work of the five SSBs, this white paper concludes with general observations that synthesize the broad themes introduced and recommendations for further engagement specific to each of the SSBs. The SSBs (including their members and observers and their secretariats) are the primary audience for these observations and recommendations. Recognizing that each SSB has its own processes for developing, reviewing, and issuing standards and guidance, the recommendations reference such processes where they are relevant to the specific financial inclusion issues in question.

However, the observations and the recommendations are also relevant for a broader audience: SSB resources are limited, and there are others who may be well-positioned to contribute to further developing these observations and undertaking these recommendations (particularly those related to research)—whether on their own or in partnership with the SSBs, as has worked effectively with past projects related to financial inclusion.[55] Depending on the specific topics, potential partners include, among others, GPFI and its Implementing Partners AFI (and its members, representing more than 70 emerging markets and developing economies pursuing a financial inclusion agenda), CGAP, and IFC; technical specialists, such as the World Bank experts who contributed to the preparation of this white paper; leaders of related initiatives, such as OECD with its Financial Consumer Protection Task Force; and provider organizations active in financial inclusion, such as GSM Association, World Savings Bank Institute, and the various industry groups representing financial cooperatives.

The observations and recommendations are informed by the varying relevance of financial inclusion to the each of the SSBs' core mandates and the varying length and nature of each SSB's engagement on the subject. These factors result in different levels of depth in the application of the observations across the five SSBs as well as wide variation in the level of specificity in the SSB-specific

54. These include *(i)* disclosure of the custodial nature of the pooled account, *(ii)* disclosure of the names of the individual owners and the amount owed to each owner, and *(iii)* the agreement between the issuer and the customers must indicate that ownership of the funds remains with the customer (FDIC 2008).

55. The SSBs have a strong track record of partnerships on financial inclusion-related guidance, including, for BCBS, "Microfinance activities and the Core Principles for Effective Banking Supervision" (the Workstream that produced the paper was co-chaired by CGAP and BCBS member Central Bank of Argentina); for CPSS, "General principles for international remittance services" (a joint publication of CPSS and the World Bank); for FATF, "Anti-Money laundering and terrorist financing measures and Financial Inclusion" (a joint publication of FATF, the World Bank, and Asia/Pacific Group on Money-Laundering); and for IAIS, "Issues in Regulation and Supervision of Microinsurance" (a joint publication of IAIS and the Microinsurance Network).

recommendations. However, for all SSBs, pursuing the ambitious agenda inherent in the concept of financial inclusion proposed in this white paper will take time. This white paper is a first step toward framing the issues involved in proportionate SSB standards and guidance on financial inclusion.

A. General Observations

All five SSBs have demonstrated interest to continue—and in some cases intensify—their work on financial inclusion, which offers an encouraging context for the observations that follow. All five have activities, processes, and forums that are being actively used to explore possible contributions to promoting financial inclusion. Three of the five (BCBS, FATF, and IAIS) are presently engaged in reviews of their standards, providing an opportunity to ensure that the highest level norms offer a workable framework within which more detailed guidance on specific topics relevant to financial inclusion can be developed. In all these activities, the SSBs will be well served by considering what is different about financially excluded households and the products and providers capable of reaching them responsibly and sustainably, and what will change in bringing them increasingly into the formal financial system.

Deepening understanding of financial exclusion risks. More needs to be known about the risks of financial exclusion. For FATF and IAIS, this is fundamental; it is important, as well, for BCBS and IADI. Thus far, the ramifications of high levels of financial exclusion for institutional and systemic stability and integrity are understood from anecdotes and specific occurrences. While these examples can be powerful, the SSBs need a stronger empirical basis to reflect these risks properly in proportionate standards and guidance.

Deepening understanding of changing risks and benefits of financial inclusion. *Similarly,* each SSB's standards and guidance should be shaped by a deeper understanding of the changing risks accompanying increased financial inclusion. These will continue to change over time as large numbers of financially excluded households join the formal financial system. While some of the specific providers, products, and delivery channels most promising for increasing financial inclusion are already well understood by some of the SSBs, others—particularly the more innovative ones—raise new issues for all five. Equally important, proportionate standards and guidance call for a deeper understanding of the benefits that result from increased financial inclusion. In addition to mitigating the risks of financial exclusion and offsetting the changing risks that accompany increased financial inclusion, benefits, such as economic growth, efficiency, and increased welfare, go well beyond those directly relevant to the SSBs' core mandates. Nonetheless, they can feature significantly in the SSBs' motivation to incorporate financial inclusion issues into their work and are, of course, priorities for country-level policy makers seeking to apply the SSBs' standards and guidance.

Considering country context. To date, the SSBs' binding normative standards have appropriately aimed for the flexibility necessary to be applicable across all (or most) country contexts. But their advisory guidance has also not yet reflected the widely varying situations of country-level policy makers, regulators, and su-

pervisors and the specific challenges faced by countries with higher current levels of financial exclusion and lower levels of regulatory and supervisory capacity. These countries would benefit, in particular, from guidance on prioritizing risk areas. This work calls also for deeper understanding of the profile of financially excluded customers entering the formal financial system. Consumer research provides a useful tool for policy makers seeking to understand the behavior of excluded consumers joining the formal financial system and to design and prioritize effective and proportionate measures to protect them.

Proportionality principle applied to financial inclusion. All the above observations underscore the importance of proportionality in crafting both SSB standards and guidance relevant to financial inclusion and at the country implementation level. Given the dynamic nature of the picture, assessing risks and benefits and balancing them against the costs of regulation and supervision will be an ongoing process (particularly as experience is gained with new products, providers, and delivery channels). Various approaches—such as test and learn, gradual implementation, and tiering of regulatory and supervisory treatment based on the nature, scale, and complexity of the activities in question—have been used successfully in countries pursuing a financial inclusion agenda and warrant consideration and controlled experimentation more broadly. Beyond the consumer protection realm, consumer research can provide useful evidence for policy makers seeking to design proportionate approaches.

Enhancing coordination and collaboration among SSBs on financial inclusion. Joint work among the SSBs on issues of relevance, and even perhaps joint guidance, will help countries balance the potentially competing policy objectives introduced by a broad financial inclusion agenda.[56] The development of consistent policy positions on financial inclusion among the SSBs will also benefit from coordination among the delegates of countries and organizations participating in the activities of multiple SSBs.

B. Recommendations

The recommendations that follow begin with topics of specific relevance to the individual SSB synthesized from the discussion in Part II, followed by recommendations related to topics of joint relevance—formalization of informal providers, financial consumer protection, and branchless banking (including e-money, agents, and similar innovations)—synthesized from the discussion in Part III. Where joint work among multiple SSBs could be beneficial, this is noted.

SSB-Specific Recommendations

BCBS

Review the BCPs. In the process of reviewing the BCPs, it will be important to ensure that they neither contradict nor impede financial inclusion. There is also an opportunity to address more clearly the links among financial inclusion, pru-

56. Some specific possible topics for joint work are proposed in the next part.

dential oversight, and financial consumer protection. While the existing BCP framework is considered adequate for microfinance (BCBS 2010), the revision process offers a chance to reconsider the BCPs' implications for a broader financial inclusion agenda, and to assess which aspects of financial inclusion are appropriately addressed in the BCPs (because of linkages to banks and the banking sector) and which may be more effectively dealt with in subsidiary guidance.

Coverage of guidance papers. Even assuming no changes to the BCPs are necessary to accommodate financial inclusion, BCBS could take further steps to incorporate financial inclusion considerations in new or updated guidance. Possible areas include *(i)* the broad implications of financial inclusion for the banking sector and bank supervision (as distinguished from a narrow focus on microfinance activities); *(ii)* specific supervisory issues relevant to financial inclusion, such as capital adequacy for microfinance activities and providers, classification, provisioning and risk weighting for microloan portfolios, and supervision of banking agents; *(iii)* innovative deposit-like products, such as e-money offered through agents; and *(iv)* differentiated prudential regulation and supervision for deposit-taking institutions with restricted activities (see also "Recommendations—Topics of Joint Relevance").

Research. Possible areas for research include *(i)* the risks of unregulated markets and unregulated deposit-taking entities serving financially excluded poor households, including the risks of loss of funds presented by unregulated deposit-taking entities; *(ii)* the risks of loss of confidence in the financial sector and the regulator that can result from pyramid schemes or failure of large informal deposit-taking providers; *(iii)* the changing risks and benefits presented by new, deposit-like products, providers, and delivery channels used to reach the currently financially excluded households as compared with conventional products, providers, and delivery channels; and *(iv)* the particular behavior of financially excluded customers as they shift to using formal deposit-taking institutions.

CPSS

Retail payment services. In the ongoing work of the Joint World Bank–CPSS Retail Forum on retail payment systems, consider adapting the General Principles on International Remittance Services as guidance for retail payment instruments and services generally. Such a guidance project would provide an opportunity to clarify that Guideline 11 in the 2006 CPSS General Guidance on National Payment System Development, which calls for expanding the "availability of retail payment services," specifically includes households that are currently financially excluded.

New payment systems/methods. In the ongoing work of the CPSS Working Group on innovative retail payments, specific emphasis could be placed on accessibility of retail payments innovations to financially excluded customers (see also "Recommendations—Topics of Joint Relevance—Branchless Banking, Including E-money, Agents, and Similar Innovations").

Research. Possible areas for research include *(i)* the changing risks and benefits presented by new payment products, providers, and delivery channels used to

reach the currently financially excluded households as compared with conventional formal products, providers, and delivery channels and *(ii)* further exploration regarding whether the failure of widely used innovative retail payments platforms could have systemic implications.

FATF

Build off 2011 guidance paper "Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion." This first SSB guidance paper explicitly addressing financial exclusion risks is a key step toward aligning AML/CFT controls and financial inclusion. The paper provides important perspectives that can guide FATF to incorporate financial inclusion principles, where appropriate, into its standards, guidance, and its work in general.

Reflect relevant principles in the revised Recommendations. In the current review of the Recommendations, it will be important to ensure that FATF's standards consistently reflect appropriate principles relating to the AML/CFT risks of financial exclusion and the alignment between financial integrity and financial inclusion.[57]

Incorporate relevant principles into guidance papers and the mutual evaluation methodology and expand guidance, where required. It will be important to incorporate principles relating to financial inclusion, where relevant, into new or updated guidance and its mutual evaluation methodology.[58] Expansion of current guidance could include *(i)* appropriate alignment between financial inclusion and combating terrorist financing, specifically in relation to low-value transactions and products; *(ii)* the determination by countries of thresholds for an acceptable low level of money laundering risk and terrorist financing risk; *(iii)* clearer guidance on the simplified CDD;[59] and *(iv)* whether a country with a high money laundering and terrorist financing risk profile, limited customer identity infrastructure, and a large cash economy may allow simplified controls in relation to account-based financial inclusion products, where risk is primarily mitigated by restrictions on the value and frequency of transactions.

Research. Possible areas for research include *(i)* a range of practice survey on simplified CDD schemes for low-risk products[60] and *(ii)* the practical implications of a risk-based approach as applied to restricted small transaction accounts.

57. E.g., the current FATF Recommendations do not require the performance of CDD measures on clients who engage in occasional transactions below USD/EUR 15,000 or wire transfers below USD/EUR 1,000, but do require such measures to be imposed on a risk-based approach whenever a business relationship is established. Fairly large occasional transactions are therefore automatically exempted from the relevant AML/CFT controls, while small, low-value accounts, on which the annual turnover may be even less than USD/EUR 15,000, are subject to CDD controls. Considering the approach taken for the occasional transactions, CDD controls could be simplified for low-value accounts, where justified by the level of risk.
58. This would include updating FATF's financial inclusion guidance after the adoption of its amended Recommendations and incorporating relevant principles into its guidance to low-capacity countries and its guidance on the risk-based approach. This guidance could be enriched by FATF's ongoing typology and risk assessment work.
59. E.g., can client verification be distinguished from client identification and, in certain circumstances where clients are unable to furnish credible and reliable verification of their identities, can client verification requirements be dispensed with in relation to account-based financial inclusion products, such as basic accounts that have limited functionality and transaction volume?
60. E.g., Mexico adopted such a scheme during the year that it held the FATF presidency.

IADI

Survey of deposit insurers. IADI's survey of its members currently underway will help it to gain potentially rich data on its members' involvement in a range of practices related to financial inclusion and deposit insurance. The data will also serve as a resource base for further work, as suggested below.

Public awareness. IADI could further explore the role of public awareness around the issues of financial inclusion and public awareness aimed at ensuring depositors are informed about safe ways of storing their money. Country-level deposit insurers could be encouraged to do the same.

Guidance on application of IADI Core Principles. Following the survey of IADI members and analysis of survey results, IADI could identify those Core Principles and deposit insurance issues of greatest relevance to financial inclusion. IADI could consider developing guidance to address such issues.

Research. Possible areas for research include the many complex issues and challenges associated with expanding deposit insurance coverage to nonbank deposit-taking institutions and innovative deposit-like services, such as *(i)* ways of ensuring the necessary preconditions for effective supervision are met for all insured institutions; *(ii)* better understanding of the risks (as well as the benefits) associated with expansion of deposit insurance to nonbank deposit-taking institutions and innovative deposit-like services; *(iii)* appropriate funding mechanisms that take into account all necessary factors in such situations; and *(iv)* adequate resolution regimes, especially novel circumstances for the deposit insurance system or situations where the deposit insurer may face new and emerging risks due to exposure to rapidly growing innovations and markets.

IAIS

Showcase for incorporating financial inclusion into standards and guidance. As the first of the SSBs to establish a permanent mechanism to consider the impact of its standards and guidance on financial inclusion, IAIS is well positioned to share its lessons learned.[61] In particular, IAIS's experiences can provide other SSBs with useful insights (see "Recommendations—Topics of Joint Relevance—Formalization") into the challenges and opportunities of formalization of informal providers.

Develop tools for country-level implementation. IAIS could follow through on plans for the development of tools for country-level implementation of financial inclusion-related standards and guidance following approval of its Draft Guidance Paper on inclusive insurance markets. A2II is well positioned to assist with the development of these tools and to provide support to implementation efforts.

Research. A possible area for research is the risks of loss of confidence in the financial sector and the regulator that can result from widespread failure of informal providers of microinsurance and their products.

61. E.g., the Joint IAIS and Microinsurance Network Working Group shared lessons learned with IADI upon the establishment of IADI's Sub-Committee on Financial Inclusion and Innovation.

Topics of Joint Relevance

Formalization

Sharing of experiences on promoting formalization. Of the five SSBs, IAIS has grappled most with the opportunities and challenges of promoting formalization of informal providers through its standards and guidance. The lessons learned may have relevance for the others, particularly BCBS and IADI. The specific challenges of formalizing large numbers of small providers in the face of scarce supervisory resources warrant particular attention.

Formalization of nonbank deposit-taking institutions. In many countries, existing prudential regulation and supervision present difficult and sometimes insurmountable challenges to formalizing existing informal deposit-taking institutions (i.e., institutions not presently subject to effective prudential supervision). Many countries, including several BCBS members, have experience with these challenges, particularly in the context of financial cooperatives. A range of practice survey of such efforts and a review of BCBS standards could support the development of guidance to help regulators take a proportionate approach that promotes formalization. More specifically, it would be helpful to clarify the circumstances under which informal deposit-taking institutions should be brought under regulation and supervision, including careful sequencing to ensure those currently not served by formal institutions are not deprived of their best available informal options.

Tiered approach to formalization. *Proportionate* regulation can be designed to encourage institutions to "graduate" from regulatory and supervisory tiers appropriate to smaller and simpler institutions and products to tiers appropriate to larger and more complex and risky institutions and products. Such an approach holds particular promise for currently informal providers, provided the simplest tier is within their reach. Such approaches, however, require careful design to prevent regulatory arbitrage.

Informal institutions should not be formalized in all cases. Wholesale formalization of a sector or subsector of provider types may not help the financially excluded if it results in closing off their best available informal option. Careful sequencing of formalization efforts is therefore particularly important.

Financial Consumer Protection

Global dialogue. The global dialogue on financial consumer protection could benefit from greater engagement by the relevant SSBs to help develop clear guiding principles for financial consumer protection in the various products and sectors that fall within their mandates. Such efforts should support and complement existing efforts, such as those of the Financial Stability Board and OECD.

Basic protections; gradual implementation. The SSBs, in their guidance on financial consumer protection measures, should acknowledge that *(i)* in all jurisdictions, basic protections[62] should be put in place covering all financial consum-

62. The basic protections include effective disclosure, protection from abusive practices, and recourse mechanisms for effective resolution of errors, complaints, and disputes.

ers and *(ii)* a gradual implementation approach may be a justifiable strategy for jurisdictions with limited regulatory and supervisory capacity. Gradual implementation should be based on an understanding of the particular consumer protection-related risks of financial exclusion (e.g., customers of informal providers may not benefit from measures such as pricing transparency rules) as well as those risks that may be introduced or may change as a result of increased financial inclusion.[63] This understanding may help the SSBs and country-level policy makers, regulators, and supervisors identify the more urgent of those risks.

Country context. Approaches to consumer protection may require further adaptation or prioritization in countries with lower levels of financial access, poorer and less experienced consumers, and more constrained regulatory and supervisory capacity, to ensure their effectiveness in these conditions. Consumer research is a useful tool for policy makers seeking to understand the behavior of excluded consumers that are joining the formal financial system and to design and prioritize effective and proportionate measures to protect them.

Consistency in protection across consumers and product types. Guidance on financial consumer protection should encourage country-level policy makers, regulators, and supervisors to aim for rules that are consistent by product across diverse provider types to minimize the risk of regulatory arbitrage.

Branchless banking and similar innovative delivery mechanisms. One of the most important issues raised by branchless banking business models is the financial service provider's liability for its agents or other third-party intermediaries (e.g., retailers performing cash-in/cash-out services or account opening in branchless banking models, insurance distributors, outsourced collections agents). The principal's liability for its agents is established in certain SSB standards and guidance and should be reinforced as business models evolve and clarified, where needed, in the case of third-party service providers that do not qualify as "agents" under local law.

Branchless Banking: E-Money, Agents, and Similar Innovations

Involvement of new actors. Branchless banking introduces new actors, such as nonbank e-money issuers and agents. SSB guidance should recognize these new actors and their activities (including cash-in/cash-out functions, data transmission, float handling, AML/CFT compliance, and account administration) and the differing risks and risk mitigation that will be appropriate for each.

Importance of a "service-based" regulatory approach. SSB guidance should recognize that various models place the different elements of the branchless banking value chain in different hands. This calls for unbundling the value chain and taking a "service-based" approach; regulating to the extent feasible, based on the activity and the risks it involves; and taking due account of the risk profile of the party executing the activity in question.

63. In principle, financial inclusion should mitigate consumer protection risks if consumer protection measures apply across the board to all providers of similar products and services.

Issues of interest to all five SSBs

Given that branchless banking, and in particular e-money offered through agents, blurs lines between conventional deposit and payment products and introduces new actors that deal directly with customers, regulation and supervision would benefit from coordinated guidance across all five SSBs. Issues on which coordinated guidance might be explored include the following:

- For BCBS, guidance on regulation of nonbank e-money issuers and the regulation and supervision of bank agents facilitating account opening and performing cash-in function.
- For CPSS, further guidance on fair and open access to payment systems.
- For FATF, further clarification on the treatment of agents involved in AML/CFT compliance (e.g., nonface-to-face identification and verification, record keeping, and suspicious transaction reporting), especially with respect to small-value accounts and transactions; further guidance on the risk-based approach—taking into consideration the potential role of agents in advancing financial inclusion and the current impediments to their use that are posed by AML/CFT requirements.
- For IADI, possible extension of deposit insurance to cover deposit-like e-money balances and satisfaction of preconditions.
- For IAIS, qualification of banking and e-money agents to serve as microinsurance agents.

Importance of experimentation. To harness the financial inclusion potential of branchless banking and similar future innovations, it is important to permit controlled experimentation with different business models. Guidance should, therefore, permit regulation that enables a "test and learn" approach to such experimentation, but can be tightened as necessary if the innovations in question reach significant scale or grow in complexity.

APPENDIX A
G20 PRINCIPLES FOR INNOVATIVE FINANCIAL INCLUSION

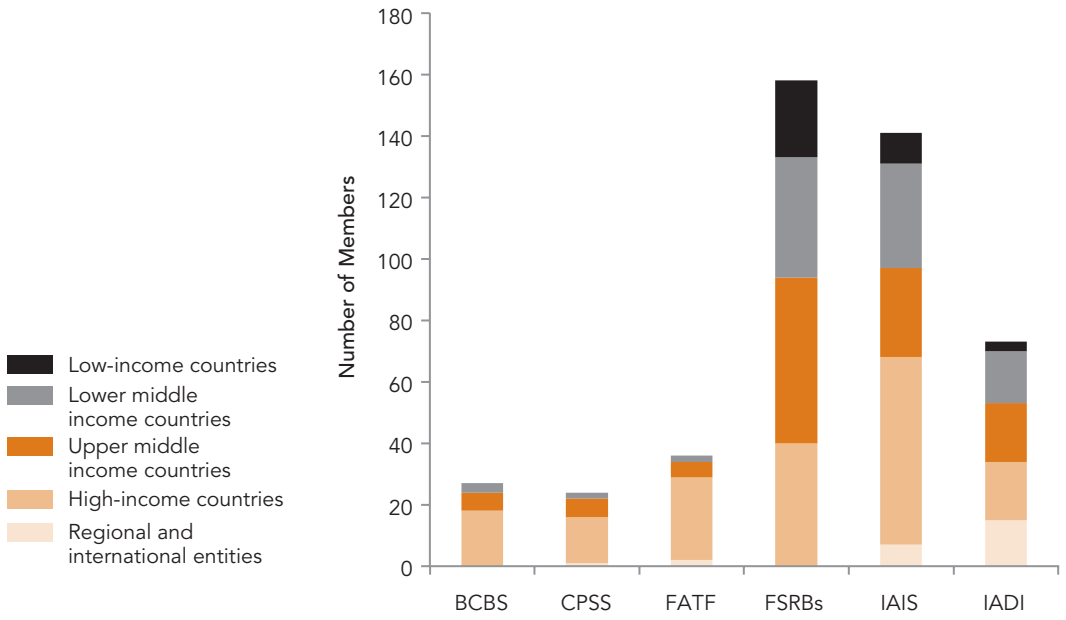
Innovative financial inclusion means improving access to financial services for poor people through the safe and sound spread of new approaches. The following principles aim to help create an enabling policy and regulatory environment for innovative financial inclusion. The enabling environment will critically determine the speed at which the financial services access gap will close for the more than two billion people currently excluded. These principles for innovative financial inclusion derive from the experiences and lessons learned from policymakers throughout the world, especially leaders from developing countries.

1. **Leadership:** Cultivate a broad-based government commitment to financial inclusion to help alleviate poverty.
2. **Diversity:** Implement policy approaches that promote competition and provide market-based incentives for delivery of sustainable financial access and usage of a broad range of affordable services (savings, credit, payments and transfers, insurance) as well as a diversity of service providers.
3. **Innovation:** Promote technological and institutional innovation as a means to expand financial system access and usage, including by addressing infrastructure weaknesses.
4. **Protection:** Encourage a comprehensive approach to consumer protection that recognizes the roles of government, providers and consumers.
5. **Empowerment:** Develop financial literacy and financial capability.
6. **Cooperation:** Create an institutional environment with clear lines of accountability and coordination within government; and also encourage partnerships and direct consultation across government, business and other stakeholders.
7. **Knowledge:** Utilize improved data to make evidence based policy, measure progress, and consider an incremental "test and learn" approach acceptable to both regulator and service provider.
8. **Proportionality:** Build a policy and regulatory framework that is proportionate with the risks and benefits involved in such innovative products and services and is based on an understanding of the gaps and barriers in existing regulation.
9. **Framework:** Consider the following in the regulatory framework, reflecting international standards, national circumstances and support for a competitive landscape: an appropriate, flexible, risk-based Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) regime; conditions for the use of agents as a customer interface; a clear regulatory regime for electronically stored value; and market-based incentives to achieve the long-term goal of broad interoperability and interconnection.

These principles are a reflection of the conditions conducive to spurring innovation for financial inclusion while protecting financial stability and consumers. They are not a rigid set of requirements but are designed to help guide policymakers in the decision making process. They are flexible enough so they can be adapted to different country contexts.

APPENDIX B
SSB MEMBERSHIP

SSB Membership Affiliation by Country Income Level
Includes Associate Members, where applicable



LIST OF SSB MEMBERS[64]

(*italics* denote Associate Member or Observer)

BCBS: Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR China, India, Indonesia, Italy, Japan, Korea, Republic of, Luxembourg, Mexico, Netherlands, Russian Federation, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States

CPSS: Australia, Belgium, Brazil, Canada, China, European Central Bank, France, Germany, Hong Kong SAR China, India, Italy, Japan, Korea, Republic of, Mexico, Netherlands, Russian Federation, Saudi Arabia, Singapore, South Africa, Sweden, Switzerland, Turkey, United Kingdom, Board of Governors of the Federal Reserve System, Federal Reserve Bank of New York

FATF: Argentina, *the Asia/Pacific Group on Money Laundering,* Australia, Austria, Belgium, Brazil, Canada, *Caribbean Financial Action Task Force,* China, *the Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism,* Denmark, *Eastern and Southern Africa Anti-Money Laundering Group, Eurasian Group,* European Commission, *the Financial Action Task Force on Money Laundering in South America,* Finland, France, Germany, Greece, Gulf Co-operation Council, Hong Kong SAR China, Iceland, India,

64. All information from SSBs' respective Web sites.

Inter Governmental Action Group against Money Laundering in West Africa, Ireland, Italy, Japan, Korea, Republic of, Luxembourg, Mexico, *Middle East and North Africa Financial Action Task Force,* Netherlands, New Zealand, Norway, Portugal, Russian Federation, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States

FATF Style Regional Bodies (FSRBs)

Asia/Pacific Group on Money Laundering: Afghanistan, Australia, Bangladesh, Brunei Darussalam, Cambodia, Canada, China, Cook Islands, Fiji, Hong Kong SAR China, India, Indonesia, Korea, Republic of, Japan, Lao People's Democratic Republic, Macau SAR, Malaysia, Maldives, Marshall Islands, Mongolia, Myanmar, Nauru, Nepal, New Zealand, Niue, Pakistan, Palau, Papua New Guinea, Philippines, Samoa, Singapore, Solomon Islands, Sri Lanka, Chinese Taipei, Thailand, Timor-Leste, Tonga, United States, Vanuatu, Vietnam

Caribbean Financial Action Task Force: Anguilla, Antigua and Barbuda, Aruba, Bahamas, The, Barbados, Belize, Bermuda, Cayman Islands, Costa Rica, Dominica, Dominican Republic, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Montserrat, Netherlands Antilles, Nicaragua, Panama, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, Trinidad and Tobago, Turks and Caicos Islands, Venezuela, Republica Bolivariana de, Virgin Islands

Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism: Albania, Andorra, Armenia, Azerbaijan, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Georgia, Hungary, Holy See, Israel, Latvia, Liechtenstein, Lithuania, Macedonia, former Yugoslav Republic of, Malta, Moldova, Monaco, Montenegro, Poland, Romania, Russian Federation, San Marino, Serbia, Slovak Republic, Slovenia, Ukraine

Eurasian Group: Belarus, China, India, Kazakhstan, Kyrgyz Republic, Russian Federation, Tajikistan, Turkmenistan, Uzbekistan

Eastern and Southern Africa Anti-Money Laundering Group: Botswana, Comoros, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Uganda, Zambia, Zimbabwe

Inter Governmental Action Group Against Money Laundering in West Africa: Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, The, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, Togo

Financial Action Task Force on Money Laundering in South America: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Panama, Paraguay, Peru, Uruguay

Middle East and North Africa Financial Action Task Force: Algeria, Bahrain, Egypt, Arab Republic of, Republic of Iraq, Jordan, Kuwait, Lebanon, Libya, Morocco, Mauritania, Oman, Qatar, Saudi Arabia, Sudan, Syrian Arab Republic, Tunisia, United Arab Emirates, Yemen, Republic of

IADI: Albania, *Algeria,* Argentina, *Asian Development Bank Institute (Partner Organization), Association of Supervisors of Banks of the Americas (Partner Organization),* Bahamas, The, Bangladesh, Barbados, Belgium, Bosnia and Herzegovina, Brazil, Bulgaria, Canada, Canada (Quebec), *Centro de Estudios Monetarios Latinoamericanos (Partner Organization),* Colombia, Czech Republic, *Deloitte & Touche LLP (Observer Organization),* Ecuador, El Salvador, *European Bank for Reconstruction and Development (Partner Organization), European Forum of Deposit Insurers (Partner Organization), Excel Technology International (Observer Organization),* France, *Goodmans LLP (Observer Organization),* Guatemala, Guernsey, Hong Kong SAR China, Hungary, India, Indonesia, *Inter-American Development Bank (Partner Organization), International Monetary Fund (Partner Organization),* Jamaica, Japan, Jordan, Kazakhstan, Kenya, Korea, Republic of, Lebanon, Malaysia, Mexico, *Mongolia,* Morocco, Nicaragua, Nigeria, Peru, Philippines (Philippines Deposit Insurance Corporation), *Philippines (Bangko Sentral ng Pilipinas),* Poland, Romania, Russian Federation, Singapore (Singapore Deposit Insurance Corporation), *Singapore (Monetary Authority of Singapore),* South Africa, *the South East Asian Central Banks Research and Training Centre (Partner Organization),* Sudan, Sweden, Taiwan, Tanzania, Thailand (Deposit Insurance Protection Agency of Thailand), *Thailand (Bank of Thailand), The Toronto International Leadership Centre for Financial Sector Supervision (Partner Organization),* Trinidad and Tobago, Turkey, Ukraine, United Kingdom, United States, *Office of Technical Assistance, United States Department of the Treasury, International Affairs (Partner Organization), Union of Arab Banks (Partner Organization),* Uruguay, Venezuela, Republica Bolivariana de, Vietnam, *The World Bank (Partner Organization),* Zimbabwe

IAIS: Africa–CIMA, Albania, Anguilla, Argentina, Aruba, Australia–APRA, Australia–NSW, Australia–PHIAC, Austria, Azerbaijan, Bahamas, The, Bahrain, Barbados, Belarus, Belgium, Belize, Bermuda, Bhutan, Brazil–ANS, Brazil–SUSEP, British Virgin Islands, Cambodia, Canada–OSFI, Canada–Quebec, Cape Verde, Cayman Islands, Chile, China, Chinese Taipei, Colombia, Costa Rica, Croatia, Cyprus, Czech Republic, Denmark, Ecuador, Egypt, Arab Republic of, El Salvador, Estonia, European Commission, Finland (Authority), Finland (Ministry), France (ACP), Georgia, Germany (Ministry), Ghana, Gibraltar, Guatemala, Guernsey, Guinea, Hong Kong SAR China, Hungary, Iceland, International Monetary Fund, India, Iraq, Ireland, Isle of Man, Israel, Italy, Jamaica, Japan, Jersey, Jordan, Kazakhstan, Kenya, Korea, Republic of, Kosovo, Labuan (Malaysia), Latvia, Lebanon, Lesotho, Liechtenstein, Lithuania, Luxembourg, Macau SAR, Macedonia, former Yugoslav Republic of, Malawi, Malaysia, Maldives, Malta, Mauritius, Mexico, Moldova, Mongolia, Montenegro, Morocco, Namibia, Nepal, Netherlands DNB, Netherlands Antilles, New Zealand, Nigeria, Norway, OECD, Oman, Pakistan, Palestine, Panama, Papua New Guinea (Department of Finance and Treasury), Peru, Philippines, Poland, Portugal, Qatar, Romania, Russia, Rwanda, Samoa, Saudi Arabia, Serbia, Singapore, Slovak Republic, Slovenia, South Africa, Spain, Sri Lanka, Sudan, Suriname, Swaziland, Sweden, Switzerland, Syrian Arab Republic, Tanzania, Thailand, Trinidad and Tobago, Tunisia, Turkey, Turks and Caicos Islands, Uganda, Ukraine, United Kingdom, United Arab Emirates, Uruguay, NAIC and 56 jurisdictions in the United States, USA Federal Insurance Office, Uzbekistan, Vanuatu, Vietnam, World Bank, Zambia

APPENDIX C
FINANCIAL SECTOR ASSESSMENTS AND EVALUATIONS AND FINANCIAL INCLUSION AT THE COUNTRY LEVEL

With the exception of FATF, the SSBs do not themselves assess a country's adherence to their standards and guidance.[65] There is currently no commonly accepted "universal" methodology for assessing a country's financial system for its performance on financial inclusion. Even benchmarking is problematic due to ongoing lack of agreed metrics (although work in this area is in process within the GPFI Financial Inclusion Data and Measurement Sub-Group). This means that, at present, Reports on the Observance of Standards and Codes (ROSCs), Financial Sector Assessment Programs (FSAPs), and FATF mutual evaluations constitute the main vehicles for assessing and evaluating country-level compliance with standards and guidance of the five SSBs discussed.

FSAPs, ROSCs, and Financial Inclusion

FSAPs, established in 1999, are comprehensive analyses of countries' financial sectors. In emerging market and developing economy countries, FSAPs are the joint responsibility of IMF and the World Bank. They include two major components: a financial stability assessment and a financial development assessment.[66]

FSAPs include assessments of key international standards (endorsed by FSB, IMF, and the World Bank) in three areas: (1) financial sector regulation and supervision, (2) market integrity, and (3) policy transparency. FSAPs also regularly include assessment of risks, stress testing, financial markets, and sectors development (e.g., capital markets, insurance, pension, housing finance), financial infrastructure, competition analysis, and incentives and governance.

Within the areas and topics mentioned, FSAPs consider issues of financial inclusion. For example, analysis of the different sectors and markets may cover financial inclusion issues (e.g., microinsurance). Financial system infrastructure analyses take into account issues related not only to stability but also to inclusion (e.g., coverage of remittances in payment system analysis, consumer protection issues in credit reporting system analysis). During FSAPs, assessors also analyze the preconditions for effective banking supervision regimes that contribute to stability and serve as the foundations for adequate access to financial services and sustained financial development. These preconditions are sound and sustainable macroeconomic policies, effective market discipline, prudential safety nets, and others.[67]

65. IAIS has plans for self-assessment tools linked to its upcoming guidance on microinsurance. Within IADI, the establishment of a peer review process is being discussed by its Executive Council; IADI is encouraging its members to do self-assessments using its assessment methodology and handbook.
66. These two reviews can be undertaken independently and need not necessarily be covered in one document.
67. E.g., assessors evaluate whether countries have designed and implemented mechanisms that provide an appropriate level of systemic protection to depositors.

Additionally, by agreement with the subject country, standalone analysis within the FSAP can be conducted on financial inclusion. Quite often, FSAP reports contain a specific chapter or sections dedicated to access to finance and financial inclusion. For example, policies related to microfinance have been addressed in most FSAPs since 2003. Moreover, deeper analyses are being conducted that take the form of Technical Notes, where specific assessments of issues of access, microfinance, and small and medium enterprises, among others, are undertaken. In this regard, FSAPs examine the degree of access that specified target groups (e.g., farmers, the poor, small and medium enterprises, or different geographic regions) have to those financial services. They also analyze the factors behind missing or underdeveloped services and markets, and identify obstacles to the efficient and effective provision of a broad range of financial services. The dimensions along which service provision is assessed include range, scale (depth), and reach (penetration), as well as the cost and quality of financial services provided to the economy.

ROSCs are assessments by IMF, the World Bank, or both, of a country's observance of standards and codes in 12 policy areas within three broad groups: (1) policy transparency, (2) financial sector regulation and supervision, and (3) institutional and market infrastructure. BCBS and IAIS Core Principles fall under "Financial Sector Regulation and Supervision"; IADI and CPSS Core Principles and FATF Recommendations fall under "Institutional and Market Infrastructure." Many, but far from all, ROSCs are undertaken in the context of FSAPs.

As with other issues assessed in the FSAPs and ROSCs, there is an opportunity to improve the framework of analysis used with respect to financial inclusion. In this regard, the World Bank has already taken some concrete steps. For example, in addition to the "on-site" job of the FSAP, the program has developed some tools for assessors, such as guidance notes and questionnaires, to provide examples and information on how to better assess financial inclusion. Further initiatives are possible in response to the call of the G-20 Financial Inclusion Action Plan to "integrate financial inclusion into all types of financial sector assessments."[68]

Mutual Evaluations of FATF and FATF-Style Regional Bodies (FSRBs)

AML/CFT assessments are different from assessments of other core standards for the following reasons:

- *A broader range of assessor bodies.* AML/CFT assessments can be conducted by FATF, FSRBs, and IMF and the World Bank. All assessments are done against the same standards and using the same methodology.
- *A mutual recognition of assessments.* There is an explicit and formal agreement among the FATF "family" and the World Bank and IMF that the assessments by the World Bank and the IMF are presented to the relevant plenaries as mutual evaluations, and that FATF and FSRB assessments can become ROSCs, subject to pro forma review.

68. The seventh action step in the Financial Inclusion Action Plan approved at the Seoul G-20 Summit reads as follows:

Integrate Financial Inclusion into all types of Financial System Assessments: Recognising the complementarity between financial stability, financial integrity and financial inclusion, G-20 Leaders call on governments and relevant national and international bodies to improve the way financial inclusion is built into assessments of financial system performance.

- *Unique relationship to FSAPs and ROSCs.* AML/CFT is the only set of standards under FSAPs and ROSCs for which there is a mandatory link between FSAPs and FSAP updates and up-to-date AML/CFT assessments.

Furthermore, and of fundamental practical significance for the countries assessed, FATF has put in place a process by which jurisdictions presenting strategic deficiencies (largely identified out of the AML/CFT assessments and mutual evaluations) are publicly identified. This obviously raises the stakes regarding the conclusions drawn in FATF mutual evaluations.

The current methodology for FATF and FSRB mutual evaluations does not call for an explicit analysis of financial inclusion where relevant, particularly in the context of the effectiveness of the AML/CFT regime (although it also does not preclude it). While evaluators have been increasingly trained to evaluate effectiveness, this is generally approached on a recommendation-by-recommendation basis. As a result, a comprehensive picture does not emerge as to how increased financial inclusion could improve the effectiveness of the AML/CFT regime as a whole. Ongoing discussions within FATF on the broader question of effectiveness in evaluating country AML/CFT regimes could provide an opportunity to introduce the topic as a response to the G-20 call to integrate financial inclusion into "all types" of financial sector assessments.

Mutual evaluations are deemed successful in part because there is effective peer pressure, and jurisdictions are under political and often economic pressure to improve their compliance with FATF Recommendations. There is significant anecdotal evidence that this concern has led some countries to adopt an overly strict approach in their implementation of the Recommendations. As Luis Urrutia Corral (2010), FATF's then president, remarked: "...perhaps the FATF's unique enforcement structure has encouraged regulators and legislators to follow the FATF standard in an overly strict manner and without taking into account the type of customers envisaged by the term 'financial inclusion'."

In this context, it seems important that the assessment process and evaluation methodology consider *(i)* the risks of financial exclusion, *(ii)* the changing risks and benefits that will result from increased financial inclusion, and *(iii)* the importance of country context and, in particular, the situation of countries with high current levels of financial exclusion and low regulatory and supervisory capacity. Attention to these themes will help to counter the potential of FATF mutual evaluations instead to result in regulation that perpetuates financial exclusion. This will be a key challenge in responding to the G-20's call.

APPENDIX D
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GPFI Global Partnership for Financial Inclusion

The Global Partnership for Financial Inclusion (GPFI) is the main platform for implementation of the G-20 Financial Inclusion Action Plan. The group engages partners from G-20 and non-G-20 countries, private sector, civil society, and others. It is chaired by the G-20 troika countries, currently Korea, France, and Mexico. GPFI is supported by three implementing partners: the Alliance for Financial Inclusion (AFI), CGAP (Consultative Group to Assist the Poor), and the International Finance Corporation (IFC).

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