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MEMBER SERIES: FINANCIAL INCLUSION JOURNEY

UGANDA'S JOURNEY TO INCLUSIVE FINANCE THROUGH DIGITAL FINANCIAL SERVICES

CONTENTS

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INTRODUCTION

The Alliance for Financial Inclusion (AFI), a network owned and driven by members, has a shared objective to increase access and use of quality financial services by facilitating the implementation of policy changes at the country level. This is achieved through a cooperative, bottom-up approach that promotes peer learning and knowledge exchange.

AFI's ethos of cooperation and knowledge sharing is better served when the financial inclusion journeys of our members are recorded and shared with the network and beyond. There are enormous lessons from the network that highlight and amplify the pursuit of financial inclusion enablers that are unique to countries and regions. It is imperative that these lessons are shared and that we hear from members how AFI's peer learning approach and in-country implementation have been instrumental in transforming financial inclusion in their countries.

One of the key benefits of a diverse network like AFI is the opportunity to highlight multiple approaches to tackling the common goal of reducing financial exclusion. The member series showcases the financial inclusion achievements and key policy lessons that can benefit other members pursuing similar objectives. This member series publication shares the practical lessons and financial inclusion journey of one of our members as they addressed their unique financial inclusion challenges.

I wish to take this opportunity to thank the Bank of Uganda for sharing their experience in using digital financial services to transform the financial inclusion landscape in Uganda. It is my sincere hope that Uganda's journey will provide useful practical lessons to the AFI network.

Dr. Alfred Hannig
Executive Director, Alliance for Financial Inclusion

FOREWORD

Financial inclusion is defined as access to and usage of quality, affordable and adequate financial services that help to ensure financial security.[1] According to The World Bank's Global Findex survey, global financial inclusion reached 69 percent in 2017, an increase from 62 percent in 2014 and 51 percent in 2011.

In developing economies, financial inclusion stood at 63 percent in 2017. In Sub-Saharan Africa, account ownership at a financial institution has risen by four percentage points since 2014, while mobile money account ownership grew by nine percentage points.

In Uganda, formal financial inclusion[2] has nearly doubled since 2009, increasing from 28 percent in 2009 to 58 percent in 2018. This has been driven largely by digital financial services, namely mobile money. Current evidence indicates that access to financial services, especially through digital financial services, has the potential to increase income-generating capacity, manage risks, lower the cost of money transfers and improve savings behavior.[3]

Financial inclusion efforts in Uganda have generally followed the country's financial sector reforms, through which enhanced prudential regulation and supervision and the diversification of financial markets have strengthened market competition and made the provision of financial services more efficient. In 2009, Bank of Uganda issued a letter of no objection to the country's first mobile money service provider (MTN Uganda) to partner with Stanbic Bank(U) Limited to offer financial services through mobile money. In 2011, Bank of Uganda joined the Alliance for Financial Inclusion (AFI) and made commitments to financial inclusion under the inaugural Maya Declaration.

To improve the coordination of financial inclusion programs and ensure they are implemented effectively, a National Financial Inclusion Strategy (NFIS) 2017–2022 was launched in October 2017 based on the following five pillars:

> Reduce financial exclusion and access barriers to financial services;
> Develop the credit infrastructure for growth;
> Build out the digital infrastructure for efficiency;
> Deepen and broaden formal savings, investment and insurance use; and
> Protect and empower individuals with enhanced financial capability.

Effective implementation of the strategy will enable 80 percent of Ugandans to access and use a broad range of quality and affordable formal financial services.

I invite you to learn more about Uganda's financial inclusion journey, which has focused mainly on digital financial services.

Prof. E.M. Tumusiime
Governor

UGANDA'S DIGITAL FINANCIAL SERVICES MILESTONES

2009	> Bank of Uganda issues a no-objection letter to Uganda's first mobile money service provider. > MTN Uganda launches operations in March with 11,016 registered accounts in the first month. The second player, Zain (Airtel) Uganda, enters the market in June.
2010	> Uganda Telecom Ltd enters the market (March).
2011	> Bank of Uganda becomes a member of AFI and goes on to be represented in AFI's six working groups. > Bank of Uganda issues enhanced no objection letter to mobile money service providers.
2012	> Warid Telecom and Mcash join the mobile money market.
2013	> Bank of Uganda issues mobile money guidelines. > Formal financial inclusion nearly doubles, increasing to 52 percent from 28 percent in 2009, driven by mobile money. > Orange Uganda and EzeeMoney join the market.
2016	> Financial Institutions Act is amended to permit agent banking, Bancassurance and Islamic banking. > Micropay joins the market. > MTN Uganda, in partnership with Commercial Bank of Africa, introduces a savings and loan product (Mokash) accessible through a mobile phone.
2017	> Agent banking regulations issued.
2018	> Uganda Bankers' Association launches a shared agent platform/switch to facilitate access to bank agents. > Banks roll out agent networks across the country.

A student happily responding to a question during an interactive session with Financial Sector players in commemoration of World Savings Day, 31st October 2016 in Kampala, Uganda.

UGANDA'S DIGITAL FINANCIAL SERVICES JOURNEY

MOTIVATION

Evidence shows that a financially included population is key to reducing income inequality and poverty while also boosting household livelihoods, productivity, development and economic growth. Evidence also indicates that financial inclusion supports monetary policy transmission mechanisms and financial stability.

Aware of the importance of financial inclusion for its population, and in line with Uganda's blueprint for development, Vision 2040, Bank of Uganda (BoU) became a member of the Alliance for Financial Inclusion (AFI) in 2011 and made commitments under the Maya Declaration. Bank of Uganda is currently represented in all six AFI Working Groups.

The country's financial inclusion program began as a project based on four pillars: financial literacy, financial consumer protection, financial innovation and financial data and measurement. This, combined with efforts outside the central bank, resulted in an increase in formal financial inclusion[1] from 52 percent in 2013 to 58 percent in 2018, driven largely by the uptake of mobile money services (56 percent of adults either had an account or used mobile money services).

FIGURE 1: FORMAL FINANCIAL INCLUSION IN UGANDA, 2018, %

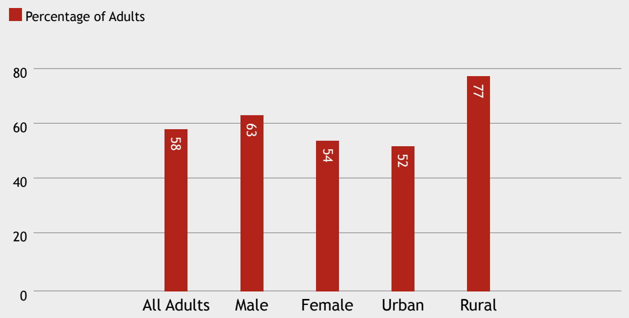
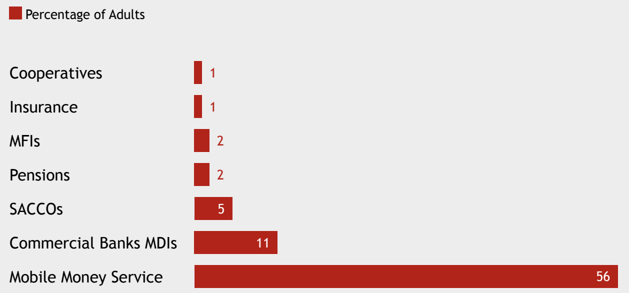


FIGURE 2: UPTAKE BY TYPE OF FINANCIAL SERVICES PROVIDER, %



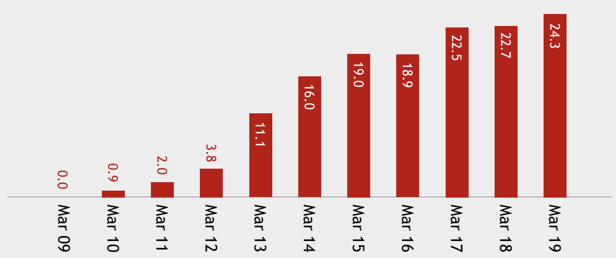
DIGITAL FINANCIAL SERVICES IN UGANDA

The digital financial services (DFS) market in Uganda is dominated primarily by mobile money service providers (MMSPs). The ecosystem is comprised of mobile network operators (MNOs), commercial banks, non-bank financial institutions, the BoU, third-party operators and technology providers. However, interoperability remains limited and stop-gap measures include bilateral agreements between the various MMSPs and their respective financial institution partners.

Mobile money services were launched in Uganda in March 2009 through a partnership between Stanbic Bank and MTN Uganda. Mobile money has driven financial inclusion in Uganda ever since with impressive growth and a competitive market. Seven MMSPs currently provide a wide range of financial services on their platforms: MTN Uganda, Airtel Uganda, UTL, Africell, M-Cash, EzeeMoney and Micrpopay.

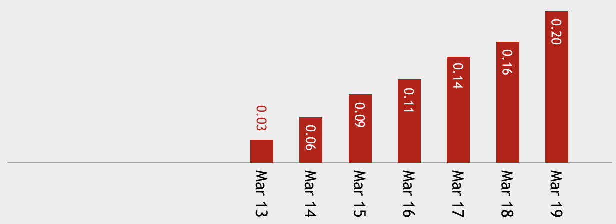
For the BoU, the regulatory concern has been to ensure the safety of customer funds when electronic value (e-value) is purchased with cash from mobile money agents. Currently, mobile money services are offered by MNOs and other MMSPs that use the MNOs' networks in partnership with supervised financial institutions. The MMSPs are required to hold escrow accounts with their partner deposit-taking supervised financial institution (SFI), equivalent to all the e-value issued to their customers and agents.

FIGURE 3: REGISTERED ACCOUNTS (MILLIONS)



Source: Bank of Uganda

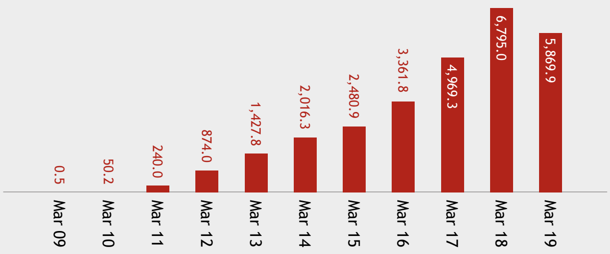
FIGURE 4: NUMBER OF AGENTS (MILLIONS)



Source: Bank of Uganda

1 Formal financial inclusion is having access to or using financial services provided by formal financial services providers.

FIGURE 5: VALUE OF TRANSACTIONS (UGANDA SHILLINGS, BILLIONS)



Source: Bank of Uganda

DIGITAL FINANCIAL SERVICES ENHANCE FINANCIAL INCLUSION FOR FORCIBLY DISPLACED PERSONS (FDPS)

Uganda is host to over 1.2 million forcibly displaced persons (FDPs), the largest number in Africa and third largest in the world.

In 2017, UNCDF partnered with DanChurchAid and Airtel Uganda to digitize cash-based transfers to refugees living in the Bidi Bidi refugee settlement, which hosts about 287,801 refugees. Payments of about $38 per month were successfully made to over 15,000 refugees through mobile wallets, and Airtel Uganda on-boarded over 86,000 new customers during the pilot.

MOBILE MONEY SERVICES ENABLE THE TRANSFER OF SOCIAL BENEFITS

The Social Assistance Grants for Empowerment (SAGE) program is the Government of Uganda's first major cash transfer initiative, aimed at senior citizens and vulnerable families. The Expanding Social Protection (ESP) agency under the Ministry of Gender, Labour and Social Development (MGLSD), with funding from the UK Department for International Development (DFID), Irish AID and UNICEF, designed the unconditional payment scheme with several objectives in mind: reliability, cost-effectiveness, transparency, scalability and financial inclusion.

The SAGE pilot was expected to reach around 600,000 people in about 95,000 households over four years (April 2011–February 2015), covering approximately 15 percent of households in 14 pilot districts. Two methodologies were employed in the districts' various sub-counties. One, the Vulnerable Family Support Grant (VFSG), used a composite index based on demographic indicators of vulnerability to determine eligibility. The other, the Senior Citizens Grant (SCG), used age to determine eligibility. For both types of grants, a mobile money service provider (MTN) was contracted to transfer cash to beneficiaries using electronic transfers.

TABLE 1: PRODUCTS AND SERVICES OFFERED THROUGH MOBILE MONEY

PRODUCT	DESCRIPTION
Domestic money transfers	Cash-in/cash-outs at agent locations
International money transfers	Partnerships with money transfer operators (MTOs) to send remittances to a mobile wallet
Airtime top-up	Purchase of prepaid and post-paid airtime
Data top-up	Purchase of internet data bundles
School fees payments	Pay school fees directly from a mobile wallet
Savings	Ability to save and earn interest on balances in a bank savings account linked to a mobile money wallet
Credit	Ability to access credit directly through a mobile wallet
Insurance	Ability to pay for insurance premiums and receive claims using mobile money
Utility payments	Pay for power and water
TV subscription	Pay for TV subscriptions
Bulk payments	Business-to-person (e.g. wage payments) and government-to-person funds transfer (e.g. tax payments)
ATM withdrawals	Cardless mobile money withdrawal
Mobile ticketing	Airline tickets, Playing the lotto, Sports betting
Merchant payments	Paying for fuel, goods, health services, etc.
Mobile wallet linked to bank account	Funds pulled from bank account to mobile wallet and pushed from mobile wallet to bank account

In July 2017, agent banking regulations[4] were issued by the BoU to:

> Provide agent banking as a delivery channel for financial services to foster financial inclusion in a cost-effective way;
> Specify the activities that an agent may carry out and provide a framework for offering agent banking services; and
> Provide a set of minimum standards for customer protection and risk management to be followed.

An "agent" is a person authorized and contracted by a financial institution to provide approved banking services on behalf of a financial institution. Agents are typically established traders or businesspeople. Agent banking opens opportunities for commercial banks to establish a network of agents in locations where bank branches or ATM facilities cannot be set up easily.

A key milestone in agent banking in Uganda was the establishment of the Agent Banking Company, a subsidiary of the Uganda Bankers' Association, which in April 2018 launched an Agent Shared Platform to provide switching services for subscribing members. The shared platform is critical to addressing the challenges affecting the cost structure of banks and the delivery of diversified financial services to the masses. As of March 2019, 14 commercial banks have obtained approval from the BoU to conduct agent banking and 10 are in active operation. The total number of approved agents exceeds 7,000 while those in active operation currently number 3,995.

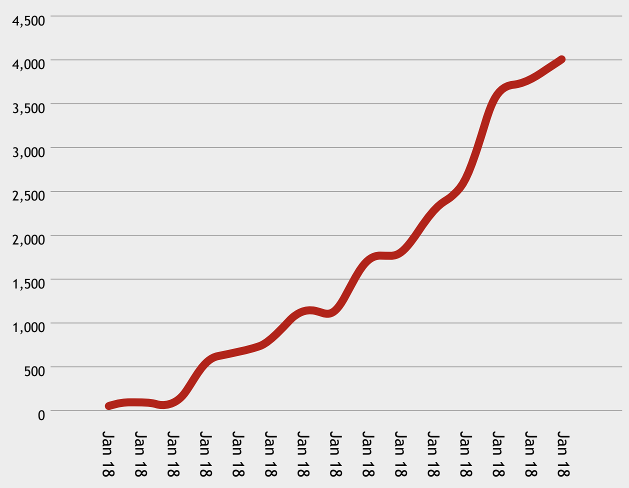
BANK OF UGANDA'S ELECTRONIC PAYMENT INITIATIVES

Over the last 10 years, the BoU has undertaken several initiatives to develop payment systems in Uganda. First, the National Cheque Standard was developed and adopted in 1999 to minimize the risk of fraud and forgery associated with checks as a payment instrument. In 2002, the Electronic Clearing System (ECS) was implemented to automate the process of clearing checks, and in 2003 the payment instruments in the clearinghouse were expanded to include electronic fund transfers (EFTs), such as credit transfers and direct debits. In 2005, the Real Time Gross Settlement System (RTGS), an interbank funds transfer system also known as the Uganda National Interbank Settlement System (UNISS), was implemented to create efficiencies and manage risks in payment processing.

Financial institutions have automated most of their payment processes to ensure straight-through processing (STP) by interfacing their back-office systems with BoU systems, such as the RTGS. BoU and government accounting systems have also been integrated to facilitate efficient and secure processing of government payments. Currently, all government payments are sent electronically and this has had a positive impact on the uptake of electronic payments.

A number of regional initiatives have also been undertaken to integrate payment systems across borders. The East African Payment System (EAPS) was implemented in 2013 to link the RTGS systems of the central banks of East African Community (EAC) partner states to allow for efficient transfer of funds within the EAC region and process cross-border payments in Uganda shillings (UGX), Kenya shillings (KES), Tanzanian shillings (TZS) and Rwandan francs (RWF). Similarly, a Common Market for Eastern and Southern Africa (COMESA) Regional Payment and Settlement System was implemented in 2014 to enable the transfer of funds within COMESA member states. The system currently processes payments in US dollars and euros.

FIGURE 6: COMMERCIAL BANK AGENTS IN UGANDA



In 2018, the BoU introduced the automated clearing house (ACH) system, which has the ability to process both debit and credit EFTs and checks in five currencies (UGX, USD, EUR, GBP and KES). The system has eliminated the physical exchange of instruments through meetings and the cheque truncation functionality enables participants to present checks electronically as digital images.

Payment card switches operated by the private sector in Uganda include Interswitch, agent banking, Visa, American Express and Mastercard. Other payment methods, using internet banking, are steadily growing.

UGANDA'S NATIONAL FINANCIAL INCLUSION STRATEGY

With support from AFI, the BoU and the Ministry of Finance, Planning and Economic Development, Uganda's National Financial Inclusion Strategy (NFIS) 2017–2022 was launched in October 2017. The NFIS was developed in consultation with internal and external stakeholders and captures local, regional and international trends and emerging issues in financial inclusion. The Strategy clearly defines the vision, objectives/pillars and key performance indicators (KPIs) with a focus on five key areas: (i) reducing financial exclusion and access barriers to financial services; (ii) develop the credit infrastructure for growth; (iii) build out the digital infrastructure for efficiency, (iv) deepen and broaden formal savings; investment and insurance usage; and (v) empower and protect individuals with enhanced financial capability.

Some of the main initiatives under objective (iii) include:

> A regulatory framework that promotes innovation, including a provision for regulatory sandboxes;

> A requirement for interoperability among financial services providers;

> The promotion of cashless transactions across government entities and within the private sector; and

> Passage of the National Payment System (NPS) bill to update the payment system environment. The draft NPS bill has been finalized and submitted to cabinet for approval and onward submission to the Parliament of Uganda for debate and passage into law.

FIGURE 7: NUMBER OF ELECTRONIC TRANSACTIONS

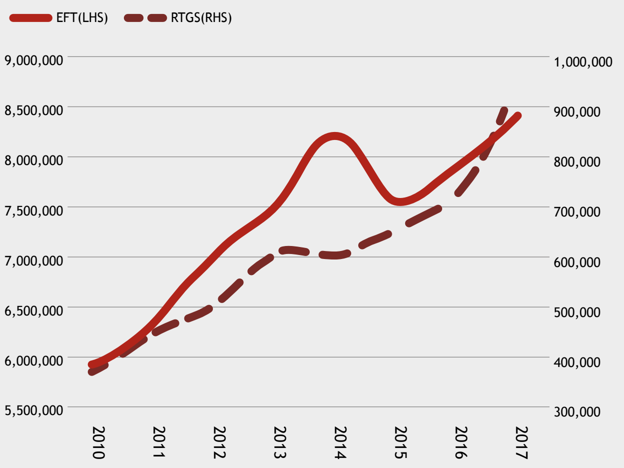
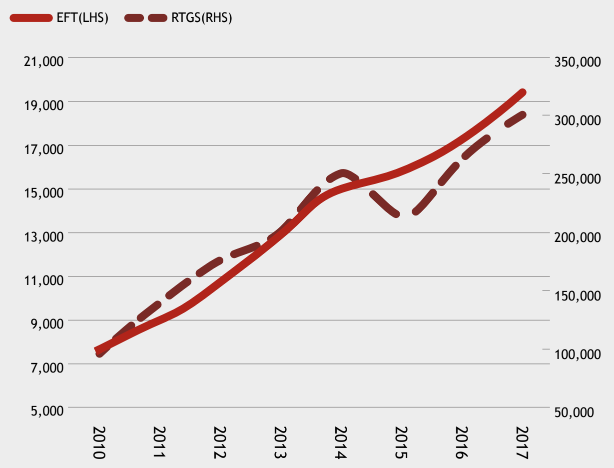


FIGURE 8: VALUE OF ELECTRONIC TRANSACTIONS (UGX BILLIONS)



KEY LESSONS LEARNED AND OUTLOOK

LESSONS

Digital financial services have enormous potential to drive financial inclusion in Uganda, but success will depend on having an appropriate regulatory framework that does not stifle innovation, as well as strong commitment, support and coordination from other regulatory bodies. The rapidly evolving technology comes with risks, and requires that regulators and providers stay in constant communication to assess the risks of each product/service.

CHALLENGES

REGULATORY

The DFS offered by the four MNOs and three other MMSPs are currently regulated by the Uganda Communications Commission and the BoU. However, there are other payments service providers and FinTech companies operating in the payment space that are not regulated at all.

INTEROPERABILITY

Interoperability across different financial services providers in the ecosystem depends largely on bilateral arrangements between the players. Card networks remain largely unintegrated and card infrastructure is quite small with frequent network failures. Lack of interoperability and a fragmented card market has kept fees high, resulting in low usage of ATM/POS terminals across the country.

COST

Limited acceptance of digital payments by merchants implies that clients have to cash out e-value to make payments; cashing out e-value attracts additional charges.

INFRASTRUCTURE

Although Uganda has made significant progress in developing the necessary infrastructure for DFS deployments, rural areas still have limited or no mobile networks or internet access. In addition, 42.2 percent[5] of the population do not have access to any power source at all, and only 28.9 percent of the population have access to the main electric grid.

AGENT PENETRATION

Mobile money agents are located primarily in urban areas and face challenges such as liquidity management, fraud, limited support from MMSPs and theft, among others.

LITERACY LEVELS

Low levels of financial and digital literacy limits the adoption of digital financial services. According to the 2017 Financial Inclusion Insights (FII) survey, financial and digital literacy levels in Uganda were 24 percent and 55 percent, respectively.[6]

MOBILE PHONE PENETRATION

Limited mobile phone penetration inhibits access to digital financial services. The FII survey found that 46 percent[7] of adults in Uganda did not own a mobile phone, and the 2018 FinScope survey showed that lack of a mobile phone is a perceived barrier to accessing mobile money services.[8]

OUTLOOK

Digital financial services hold tremendous promise to deliver financial services to underbanked and excluded population, in Uganda. However, a conducive legal and regulatory framework is urgently needed for these groups to reap the benefits. The BoU has finalized a draft NPS bill that is currently with the cabinet and is expected to be presented to the legislature for debate and approval.

In partnership with stakeholders in the payments ecosystem, the BoU is working on establishing a national switch that will support cashless payments and be interoperable with cards and mobile financial services.

In preparation for regulation of the payment system, the BoU will need to build the capacity of its staff to provide effective oversight.

Critical to the adoption of digital financial services in Uganda are financial awareness and literacy, empowerment and consumer protection. Together with other stakeholders, the BoU has finalized the National Strategy for Financial Literacy (2019–2024), and implementation of the strategy is expected to address financial awareness and literacy issues.

Children receive Savings Boxes as part of 'Save with a Plan" initiative in commemoration of the World Savings Day, 31st October 2018 in Kampala, Uganda.

NOTES

1 Definition as per Uganda's National Financial Inclusion Strategy (2017-2022).

2 FinScope Uganda. June 2018. Topline Findings Report. Available at: http://fsduganda.or.ug/wp-content/uploads/2018/10/FinScope-Uganda-Survey-Report-2018.pdf

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4 Statutory Instruments Supplement. 14 July 2017. The Financial Institutions (Agent Banking) Regulations, 2017. Available at: https://www.bou.or.ug/bou/bou-downloads/acts/other_acts_regulations/Agent-Banking-Regulations-2017.pdf

5 NITA Uganda. March 2018. National Information Technology Survey: 2017/18 Report. Available at: https://www.nita.go.ug/sites/default/files/publications/National%20IT%20Survey%20April%2010th.pdf

6 Financial Inclusion Insights (FII). March 2018. Uganda: Quicksights Report – Fifth Annual FII Tracker Survey. Available at: http://finclusion.org/uploads/file/uganda-wave-5-quicksites_final.pdf

7 Ibid.

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