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MEMBER SERIES: FINANCIAL INCLUSION JOURNEY

# HONDURAS: COMPETITIVENESS' CHAIN REACTION FOR FINANCIAL INCLUSION



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## INTRODUCTION

The Alliance for Financial Inclusion (AFI), a network owned and driven by members with a common objective of scaling up financial inclusion at country level, has been able to facilitate the implementation of impactful policy changes at country level through its cooperative model that imbeds peer learning and peer transformation. It has been a decade now since the network began this quest to address the global challenge of financial exclusion. We have witnessed tremendous achievements in financial inclusion from our membership, driven by practical policy solutions that draw on lessons across the network.

AFI members have been focusing on ways to support countries in designing and implementing high-impact, tailor made solutions that meet their needs and challenges. These country-led approaches have created ownership and a sense of pride as ever more ambitious targets are set and achieved. It is imperative that such lessons are highlighted from each member's perspective on how AFI's peer learning approach and in-country implementation have been instrumental in facilitating transformation. Thus, we feature such practical lessons in this Members Series publication.

The Members Series serves to elevate the members' financial inclusion achievements and bring to the fore, key policy lessons that will benefit other members who are pursuing similar objectives. AFI's ethos of cooperation and knowledge sharing is served better when the financial inclusion journeys of our members are recorded and shared amongst the network, and beyond.

AFI membership, which represents about 85% of global unbanked, is uniquely positioned to tackle the global financial inclusion challenges. We have enormous lessons from the network that need to be highlighted and amplified. These range from the effective use of technology, application of national and regional coordinating structures, to the pursuit of specific financial inclusion enablers that are unique to countries and regions.



We are proud of the leaders in our member institutions, who through their unwavering efforts have been able to steer national-wide support in addressing financial inclusion challenges.

This Member Series publication will continue to feature the unique journeys of our members in addressing their financial inclusion challenges. The diversity of the network has the advantages of highlighting multiple approaches to tackle the common goal of financial exclusion.

Join me in this Series and let's journey with our member Comision Nacional de Bancos y Seguros de Honduras (Honduras National Commission of Banks and Insurances) as they champion the transformation of the financial inclusion landscape in Honduras.

**Dr. Alfred Hannig**  
Executive Director, Alliance for Financial Inclusion

## PROLOGUE

Since the launch of the Honduras National Financial Inclusion Strategy (2016 - 2020) (ENIF - in Spanish) as of October 2015, progress has been made in several issues that have facilitated the advancement of some key strategy indicators. One of the major advances has been in regulations and the other, in the systematization of administrative processes at the government level. This is to enable the consolidation of all the existing information of the various financial and transactional operations and thus, proceed to control and mainly, systematize the administration of these multiple operations.

One of the main challenges faced in the development of this strategy is the data and unawareness of financial inclusion among relevant stakeholder institutions, even though there is a complete buy-in and support from the Presidency of the Republic and the Honduras National Commission of Banks and Insurance (CNBS).

Other challenges include the engagement and buy-in from the regulated banking institutions into the process of providing financial inclusion to the excluded sectors of the population.<sup>1</sup> The banking sector has been averse to the risk and ignorant to the financially excluded sector market potential; a sector in which, the vast majority of micro and small enterprises (MSEs) are found.

Notwithstanding the above, this report accounts for the progress that has been made so far in the indicators of access, usage and principally, in the indicators of digital financial services. Outstanding achievements can be found in banking, now standing at just a few points from the LAC average.

One of the most interesting achievements observed is at the level of distribution channels and digital financial services. Exponential growth curves have been witnessed in such a way that several goals planned to be reached in 2020 have already been achieved in 2017.

One of the more influencing factors is the flexibility in the regulations related to the ENIF, as now several regulations, even when they are detached from overriding laws, show that the operation of the market is based on the rules and regulations issued by the regulatory bodies of the country, allowing fast adjustments to regulations to adapt to the changing market conditions.

Another factor has been the existence of a very clear and practical legal framework, related to the control of the laundering of assets in the ecosystem of the country, since it is strengthened by the excellent coordination between the CNBS and the Central Bank of Honduras, as well as

between the CNBS and the judicial entities of the country. This coordination has enabled the quick detection and resolution of cases, but above all, it has allowed the regulatory system to gain confidence in its ability to protect itself from these threats. This confidence has allowed greater agility in the development of financial markets, in the areas of expanded services and digital financial services.

The support obtained from the Alliance for Financial Inclusion (AFI), is of vital importance to advance financial inclusion, as the cross referencing of information which has been given, including periodic publications and guidelines, has allowed for other experiences to be observed and compared to the Honduras context.

Topics such as interoperability, KYC, regulatory aspects of the ENIF and Digital Financial Services, are critical topics for the success of the strategy, and all the information that AFI consolidates and provides to the different members makes it possible to advance in an expeditious way. This is due to the successful experiences and lessons learned from other member institutions that in the past have tried to do what Honduras financial authorities are trying to implement today in our country.

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<sup>1</sup> 70% of the population older than 15 years, according to the Global Findex 2014.

## FINANCIAL INCLUSION JOURNEY: BACKGROUND/ CONTEXT

The National Financial Inclusion Strategies have been initiatives that in many developing and emerging countries, have been inspired by the Alliance for Financial Inclusion (AFI), which represents the world's first commitment platform that allows member institutions to establish specific goals of financial inclusion, implement policy changes in the country, and share progress updates.

In 2014, Honduras was undergoing serious economic and security problems, aspects that threatened the socioeconomic development of the country, so the Government of the Republic undertook an aggressive recovery plan that included macroeconomic adjustments, with the support of the International Monetary Fund (IMF), Inter-American Development Bank (IDB), the World Bank (WB) and other international agencies.

At the same time, strong expenditure-containment measures, investment promotion, national security, including socio-economic development programs in the poorest sectors of the country, were initiated under the umbrella of the Presidential VIDA MEJOR ("Better Life") Program, and in the National Plan, Plan 20/20 and other government strategies, aimed at fostering the country's socioeconomic development.

This country vision developed by the Government of Honduras included the objective of improving access to credit to the lowest-income population of the nation, to promote their development. At this point, when they attempted to recruit people, they encountered varied and insurmountable barriers that hindered the financial system in achieving these goals of access and financial use that the government had set.

One of the main reasons for these barriers, according to the IDB, was that Honduras had, as of 2014, 70% of its population aged over 15 years old and excluded from the country's regulated financial system, which turned this population into a highly vulnerable sector, due to the lack of access to credit from the regulated system.

Therefore, in October 2015, the Presidency of the Republic of Honduras launched the National Strategy of Financial Inclusion (ENIF) at the Regional Forum on Financial Inclusion, which was promoted by the CNBS and disseminated throughout the supervised financial institutions, governmental entities and civil society.

The ENIF HONDURAS established the objective, for a period of 5 years (2015 - 2020), to ensure that excluded persons have access to a wide range of financial services provided under favorable conditions and appropriate to their characteristics and needs.

To achieve this goal, there was a need for these people to have financial education and sufficient technical skills to optimize their access to, and the usage of, financial services, in order to reduce poverty.

Always with the aforementioned objective, we analyzed the four strategic lines of an ENIF: a) Supply, b) Demand, c) Financial Education & Transparency and d) Protection of the Financial User, and within these lines it was decided to concentrate on five target segments: 1) Salaried persons; 2) Micro and small traders and entrepreneur; 3) Remittance recipients; 4) Micro and small agricultural producers; and 5) Beneficiaries of conditional transfers of the State.

It is also important to note that the ENIF has 15 follow-up targets and indicators, projected for the next 5 years (2015-2020) and divided into two levels: one level corresponding to access and another level corresponding to the usage of financial services. It is important to mention that the goals established for the year 2020 were defined by taking the average values at the Latin American and the Caribbean mean levels, published by the World Bank (Global Findex) and by the Latin American Federation of Banks (Felaban) as references.

Within these indicators, the percentage of adults with accounts stands out, which is expected to increase from 31.5% in 2015 to 51.4% by 2020, as well as the number of bank agents, which is expected to reach the 2,000 nationwide by 2020. The number of users of electronic wallets is expected to pass through from 1 million in the 2015 to 1.3 million in 2020.

As the basis of this national effort, since September 2014, Honduras, through the CNBS, signed-off the MAYA DECLARATION,<sup>2</sup> establishing 4 qualitative objectives:

- a) To approve regulations on mobile financial services by June 2015;
- b) To publish the first financial inclusion report by November 2014;
- c) To publish the first statistical newsletter on financial inclusion indicators by April 2015; and
- d) To design and develop a nationwide comprehensive financial inclusion strategy, and begin its implementation by 2015.

<sup>2</sup> The Maya Declaration, launched in 2011, is a means to promote financial inclusion, contributing to the range of the United Nations Sustainable Development Goals (SDGs), focusing specifically on Goal 1: No poverty.

## STRATEGIC EXECUTION FRAMEWORK

Every development process faces the four “mortal development items,” as follows:

- > Ignorance
- > Disinterest
- > Misinformation
- > Distrust

Overlooking these four items has led to many failures; thus, staying informed and establishing simplified strategies to deal with the threats, and opportunities that this scheme provides, dramatically improves the probabilities of success in any operation.

The above was relevant at the time of implementing the ENIF Honduras, as this made it clear that the problem of supply in the financial system lies in the RISK that is perceived as affecting the profitability of the operation, and a deep, and recognized ignorance of a market segment (MSEs), which they perceived to be risky and therefore, unprofitable.

The interesting thing is that much of the problem lies in the aversion to risk in the system and a deep distrust of the unknown, based on false information from the MSEs and EXCLUDED SECTORS. A lack of interest in penetrating the said sectors also affects the current profitability and increases the level of risk that they have been operating under.

This is relevant because it shows that even if the risk in the country’s financial system is real, there is no measurement or analysis related to RISK AVERSION or the standard creation of RISK THRESHOLDS. These are composed by a series of guiding indicators that allow the investments of the financial system entities to be guided, so that at the strategic level, it is considered as a field of opportunity of action.

When analyzing the financial market and its interaction with the customers of the financial system, the ENIF establishes that the demand is being affected by two great elements: MISTRUST and IGNORANCE, which in turn, generate the barriers that block financial inclusion.

The foregoing is highly relevant because even though the perceptions and attitudes of the existing financial and regulatory system almost paralyzed the SECTOR OF PRODUCTIVE CREDIT, it has been and still is, one of the main strategic priorities of the Government of the Republic and one of the priority areas that the country opted for to initiate the drive toward Financial Inclusion.

In this scenario, the government has created incentives that are focused on reducing the risk of penetrating the segments of the MSEs and the traditionally excluded sectors, which helps to simplify the processes to allow progress in access and usage of financial services.

Under this framework, Honduras has led several actions aimed at increasing the profitability of banking and reducing the risk of banks in the operations of the system, as one of the means of helping to expand the financial system and to contribute to massive operations to achieve FINANCIAL INCLUSION in these excluded productive sectors.

# ENIF ACHIEVEMENTS

One important fact to note since the launch of the ENIF Honduras is the country has made substantial progress in the issues of access and usage, particularly in Digital Financial Services.

## ACCESS

Levels of banking ACCESS (“bankarization”) has recorded great strides from 2014 to 2017, rising from a level of 30% in 2014 to 42.9% in 2017, an increase of 43%.

At the same time, the percentage of adults financed in regulated institutions has risen from 7.1% in 2014 to 12.36% in 2017, which represents an increase of 74%. This is described as a “High impact” indicator because it exceeded the goal that the ENIF Honduras had set for the country for 2020, doing so in just 2 years.

With respect to access, another “High impact” indicator is that of Bank Agents (CNBA), as it achieved an exponential growth in the country’s financial ecosystem, of over 250% in 2 years. The initial goal for this indicator was set at 2,000 bank agents for the year 2020, from 640 CNBA in 2014. However, by 2017, the number of bank agents had increased to an astounding 2300, as shown in figure1.

The growth of up to 30% every year, from 2014 to 2016, led to achieving this goal. Ultimately, this also made way to a record growth of 82.5% in 2017.

This exponential growth of bank agents was not generated by the growth of the first banks that ventured into that market sector, but rather by all the other competing banks that decided to venture into said segment. It was also spurred on by the opportunity to increase business and a large part, as a reaction to competition because allowing competition to gain market share was riskier than penetrating the sector that was excluded from the economy.

Another reason for this high growth was due to the need to provide service to a high growth market, such as national transfers and remittances. The above is directly related to the constant growth that remittances have had in the country over the last few years.

In addition to this, the coverage of bank agencies has remained stable; the financial system has determined that the best way to provide coverage to these sectors is through bank agents.<sup>3</sup> It should be noted that these statistics come only from actors identified in the regulated sector of the financial system and do not include the network of bank agents that other sectors of cooperatives and microfinances are developing.

On the topic of the bank agents, it is also necessary to mention the growth of ATMs in the financial system market, since this element has been growing at a maximum of 2%

FIGURE 1: MONITORING GOALS AND INDICATORS OF THE ENIF BANK AGENTS (CNBA)

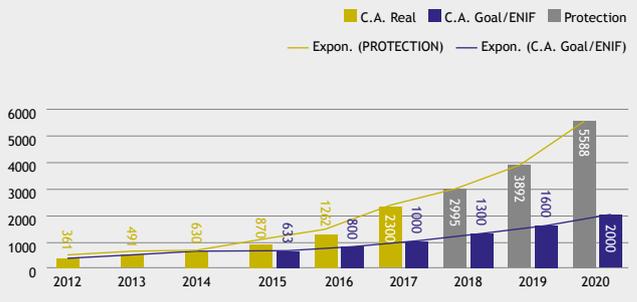
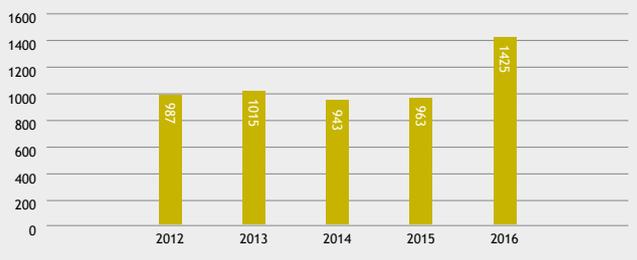


FIGURE 2: MONITORING GOALS AND INDICATORS OF THE ENIF ATM



in previous years. However, we now see a growth of 47% in 2016 alone, which is congruent with the developments that are being witnessed at the level of the entire financial sector.

## USAGE

On the subject of USAGE, progress is being made especially within the indicators of usage of accounts to receive salaries and government transfers. From 2014 to 2017, both have experienced growth levels of 76% and 368%, respectively, results that put these indicators at levels far above the programmed schedule in the ENIF Honduras.

The use of accounts to receive salaries increased from 5.8% in 2014 to 10% in 2017. One of the more relevant influences on this growth have been private companies that increased the payment of its employees by 94% by means of savings accounts, from 3.2% in 2014 to 6.3% in 2017.<sup>4</sup>

In the usage of accounts for government transfers, this movement is not related to the development of basic accounts, but rather to the policies that the country has implemented in the area of modernization of the payment system of the country, especially in government administration and restriction of controlled spending and investment.

3 At the time the ENIF was launched, Honduras had 98 of 298 municipalities without any financial coverage and banking agencies, with the above only existing in 51 of those municipalities.

4 Global Index 2017.

The main policy that has influenced this change is the government’s example or model by channeling its funds and transfers via the financial system, thus reducing cash transfers from 68% to 29%, a decrease of 57%. At the same time, operations using Banks rose from 29% to 53%, an increase of 82.76%, as shown in figure 3.

### CASH BANKS

Another positive effect observed in the system is that the culture towards “bankarization”, driven by the policies of the government, is influencing other markets, such as the remittances market and the payment of public utilities and services.

The number of people paying public services in 2017 is 51.7% but from 2014 to 2017, the number of people making these payments in the banking system more than tripled by 322% - from 4.5% in 2014 to 19.2% in 2017, all resulting in a 38% reduction in cash handling in these transactions.

Another area that is showing a great trend towards banking is domestic remittances, which has increased by 59.6% in the regulated financial system and increased by 61% in the unregulated financial system. One of the areas that grew strongly was the sending and receiving of remittances via e-wallet, which grew by 65% for sending and 55% for receiving.

### DIGITAL FINANCIAL SERVICES

In this strategic line, there has been a great advance in the financial markets, especially in the distribution channels for these products. Unfortunately, there is no systematized information submission flow to allow a thorough analysis of this sector.

In view of the above, the results of research from multiple sources shows a representative map of what is happening in the market, in the graph below. The growth of TIGO users can be seen with the TIGO MONEY product, increasing from one million users in 2015 to 1.5 million in 2017 (50% growth). As shown below, the growth has exceeded the goal established by the ENIF for the development of users of electronic wallets, which was set in 1.314 million users by 2020; this goal surpassed in 2017.

According to the GLOBAL FINDEX 2017, the growth of mobile wallets grew by 82% from 2014 to 2017, increasing from 3.41% to 6.20%. Even with this growth, the gender gap is still present because mobile accounts grew 147% with men, while the growth was only 7.5% with women. This growth is directly related to the usage of these mobile accounts, both for the realization of various payments and for sending or receiving transfers or remittances.

The Global Findex also reports that payments made or sent digitally grew 70%, from 21.9% to 37.2% from 2014 to 2017. One of the items that have become part of the portfolio of managed services via mobile accounts is the payment of services and public accounts, which increased from 0.67% in 2014 to 2.67% in 2017, denoting a growth of 298% in this period.

FIGURE 3: GOVERNMENT PAYMENT CHANNEL

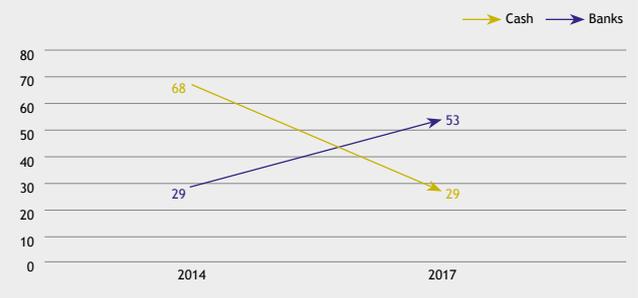
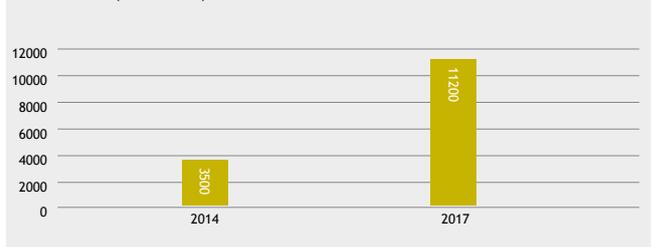


FIGURE 4: DIGITAL FINANCIAL SERVICES TRANSACTIONS MARKET GROWTH (MILLIONS)



The e-wallet market still does not operate as a wallet, due to the regulatory restrictions of our system and mainly due to the almost non-existent presence of channels that receive mobile money. Therefore, the main product is the electronic transactions of sending and receiving money.

It has been detected that the transactional mobile money market has almost tripled from 2014 to 2016 and that TIGO, which had 100% of the market in 2014 and despite having almost doubled its volume of operations (6.5 million) in 2016, now has a participation of 60%, since the 2016 market had a volume of 11.2 million Lempiras compared to 3.5 million in 2014. (See figure 4)

This shows that the behavior of financial markets is experiencing strong growth, as there are several actors who are expanding their distribution channels, which is resulting in strong exponential growth that if it continues, will be very productive for the ENIF.

## THE CHANGE CONTROLLERS

One of the main difficulties at the time of initiating a national financial inclusion process is to define the starting point amid so many urgent situations that are presented on a daily basis. In addition to this situation is the issue of relevant information that makes it possible to make the best decisions, in relation to the ENIF and to be able to move forward on the subject.

Another difficulty is the ability to perform strategic benchmarking processes that allow us, the ENIF coordinating authorities, to access, study and adopt the best practices existing in the world, to accelerate the learning curve thanks to the experiences of others who started their process before, and for those who come after us.

For Honduras, being able to share experiences through AFI's support has been vital, since it not only provided the Information necessary to start our process of Financial Inclusion, but has also allowed us to realize the great strengths that the country has, in terms of financial inclusion that we would not have detected otherwise.

Examples of the above are Digital financial Services, a service that has had huge growth in the country, and also the issue of regulation, which has been analyzed in relation to existing rules. Through the support of AFI and the Maya Declaration, efforts have been focused towards a simple but effective regulation and a systematic thrust towards the Digital financial Services as a means of driving the ENIF.

More recently and thankfully with the support of AFI, we have been able to know about new strategic trends, helping us to mainly detect deficiencies in our ENIF processes. An example of this is the topic of Gender, which, even though it is part of the country's development strategy as a target of impact, has not been considered in-depth in the ENIF. At the present, this has allowed us to perform the necessary adjustments to consider it.

## KEY LESSONS AND FUTURE PERSPECTIVES

### I. WHAT ARE THE MAIN LESSONS (POLICIES, REGULATIONS, INNOVATION OR APPROACH) LEARNED DURING THIS JOURNEY?

The most important lesson and perspective we have learned is what we consider to be the main challenge of creating an effective ENIF; it is the collection and management of the relevant data to guide the actions of the country.

The second lesson we have learned is that even if the political will exists and the guiding institutions are committed, Financial inclusion implies as a start, the culturalization - awareness and buy-in - of all stakeholders involved in the same, especially those in a position to make decisions relevant to the strategy.

Another is the need to maintain the necessary flexibility of the system to enable a quick and efficient response to the variables that are present in the financial and digital markets, because regulations based only on laws may lose the flexibility. Thus, this scheme must be managed to enable a quick response to the change.

### II. WHAT ARE THE MAIN FACTORS THAT LEAD TO THE ACHIEVEMENT OF THE GOALS OF FINANCIAL INCLUSION?

One of the main factors is the flow of data and the integral capacity of each country to collect the same. Without information, the effort of the ENIF is relegated to perceptions, assumptions and conjectures.

Another main factor is the trust that can exist in the system. One of the most important issues that have been discussed in the AFI are the Know Your Customer (KYC) policies and the impact on the development of Financial ecosystems; this is an aspect that is directly related to the trust that exists in the system.

### III. WHAT ARE THE NEXT CHALLENGES THAT THE COUNTRY NEEDS TO RESOLVE TO INCREASE THE ACCEPTANCE AND USAGE OF FINANCIAL SERVICES IN THE NON-BANKING POPULATION DURING THE NEXT 5 YEARS?

The main challenge of the future is how to accelerate the penetration of the regulated system among the excluded sector of the population and the penetration of the mobile accounts must be greatly boosted in this excluded sector in order to achieve this.

An additional relevant challenge that complements the previous one is to develop the electronic wallet as a means of payment, to allow the excluded population to interact more with the regulated financial system.

The abovementioned is key, because the greater use of the Digital Financial Services means a lower amount of cash circulating in the economy, which in turn, allows an accelerated regulation of the entire supply operating in the non-regulated financial market.

As a result, more regulation of the Financial System accompanied by lower cash in circulation means less operating risk for the laundering of assets, which is currently one of the more important threats to the Honduras financial system.

Finally, an additional important challenge ahead that needs focus is reducing the existing gender gap in our country. Currently, this gap is very strong in both banking and digital services, as can be seen through different data sources.



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