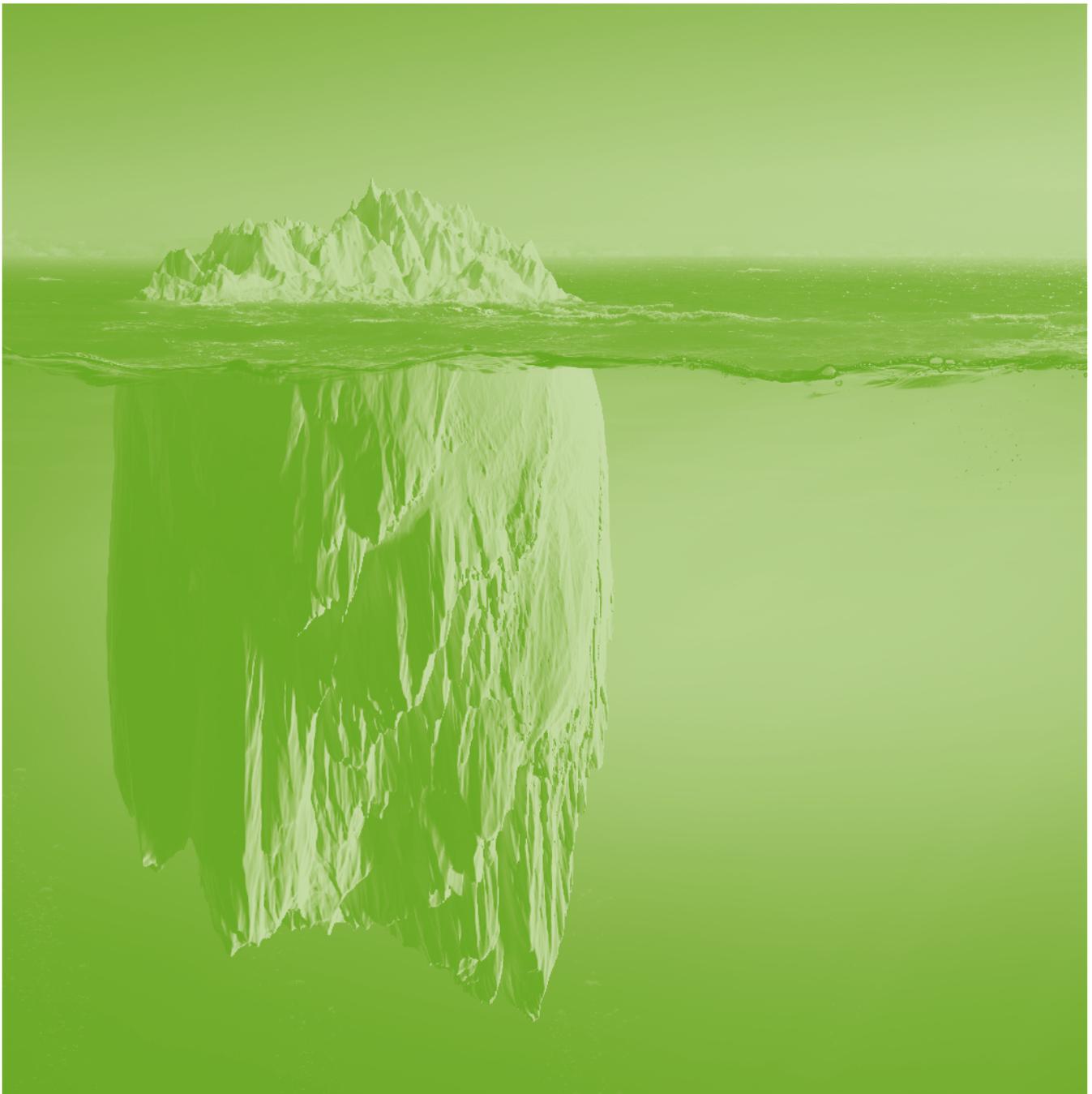




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PROPORTIONALITY IN PRACTICE CASE STUDIES (VOLUME 1)



CASE STUDY

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FOREWORD

INTRODUCTION

In an increasing number of countries around the world, National Financial Inclusion Strategies (NFIS) are being developed to increase access to, and usage of, quality financial services for underserved and unserved populations. In advancing these strategies, the implementation of appropriate regulatory frameworks, including adoption of appropriate global standards for financial stability and integrity, is of great importance to ensure that financial inclusion is pursued in tandem with a safe and sound financial system. However, application of global standards in an overly conservative manner that is not proportionate to the risks can have unintended consequences, with an adverse impact on financial inclusion.

In 2010, the G20 Principles for Innovative Financial Inclusion were developed with the aim of creating an enabling policy and regulatory environment for innovative financial inclusion. The eighth principle, which relates to ‘Proportionality’, calls for the building of a policy and regulatory framework that is proportionate to 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. In July 2014, the members of the Alliance for Financial Inclusion (AFI) created the Global Standards Proportionality (GSP) Working Group.¹ This serves as a platform to facilitate peer learning among policymakers and regulators in achieving a balance between financial inclusion, integrity and stability, as well as to examine the proportionate implementation of standards set by global Standard-Setting Bodies (SSBs).

In May 2015, the Global Symposium “Towards Proportionality in Practice: Financial Inclusion and Implementation of Global Standards” was held in Kuala Lumpur (KL), co-hosted by Bank Negara Malaysia, the Toronto Centre, and AFI. The adopted KL Resolution of Proportionality in Practice, calls for the gathering of data and evidence on the impact on implementing global financial stability standards in developing countries, highlighting the costs of unintended consequences and the benefits of proportionate approaches. It also calls for the documentation of successful regulatory and supervisory approaches to implementing proportionality, and the continuation of peer learning for successful approaches to implementing proportionality globally.

This publication is the first step towards building a knowledge repository to document AFI member institutions’ approaches and experiences in proportionately implementing global standards. This volume of case studies focuses on the proportionality in practice for more traditional forms of services for financial inclusion, such as agent banking and Mobile Financial Services (MFS). With the rapid pace of growth in technology-enabled innovation in financial services (including FinTech Innovations such as peer-to-peer lending and crypto-assets), a key challenge for policymakers now is to create an enabling regulatory

environment that promotes innovation and financial inclusion, without bringing about undue risks to the safety and soundness of the financial system. The GSP Working Group remains cognizant and will continue to look into proportionate approaches to regulate such innovative, technology-based financial services, which hold potential for financial inclusion.

KEY FINDINGS

- 1 A few countries articulated their general approach and interpretation of proportionality with regard to financial inclusion and global standards. For these countries (Bhutan, Malaysia, and Peru), proportionality is a regulatory approach that promotes stability and integrity, yet still encourages the development of innovative financial inclusion solutions.
- 2 Most case studies demonstrated the application of proportionality in the Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) regulations, towards advancing financial inclusion through the means of digital financial services and agent banking. Indeed, the Risk-Based Approach (RBA) as stated by the Financial Action Task Force (FATF) 40 Recommendations, is adopted for Know-Your-Customer (KYC) verification requirements. Specifically:
 - > In Bangladesh’s National Risk Assessment (NRA), financially inclusive products have been recognized as products with low money laundering and terrorism financing (ML-TF) risks. As such, banks and financial institutions adopt an RBA and apply a simplified KYC process for such products to support financial inclusion. For example, a simplified KYC process was introduced to promote MFS. Recognizing the gender gap in financial inclusion, this simplified process was applied on financially inclusive deposit products to encourage women’s easy access into the financial sector.
 - > Bank Indonesia has introduced a regulation to support digital financial services (DFS) and Laku Pandai (agent banking), which covers AML/CFT policies. The regulation states that a simplified KYC process can be applied when the ML-TF risk is low and for opening accounts associated with government programs that seek to improve welfare and alleviating poverty. Under the regulation, the various financial services (i.e. e-money unregistered, e-money registered and basic banking services) are subject to differentiated transaction limits and KYC requirements.
 - > In Malaysia, the Agent Banking Regulatory Framework was established in 2012 to govern the use of agents or third-party intermediaries by financial institutions in the provision of financial services. To mitigate risks that may arise in facilitating the opening of accounts at the agents: (i) the roles of agents in facilitating KYC functions are demarcated based on types of agents; and (ii) banking services offered at the agents are differentiated based on the outcome of KYC verification.

¹ Established as a successor to the Financial Integrity Working Group (FINTWG).

- > In Peru, three KYC regimes have been adopted, namely simplified, general and enhanced. The simplified regime is applied for clients and products with low ML-TF risks. There are two ways in which the simplified regime can be considered: (i) a financial service provider (FSP) can freely develop a product or service and seek the regulator's approval to use simplified regime if the ML-TF risk is low; and (ii) a FSP develops a product or service as defined in the regulation (which sets out clear thresholds to ensure low ML-TF risk), and hence, can use the simplified regime without the regulator's prior approval. Thus far, basic deposit accounts, simplified electronic money accounts and some insurance products have been defined in the regulations.
- > In promoting MFS, Tanzania has adopted a proportionate regime that allows mobile network operations (MNOs) to use agents to perform several critical functions and implement tiered consumer due diligence (CDD) process. Under this model, agents are responsible for facilitating cash withdrawals and deposits, registering users, and performing initial due diligence of new customers. They are required to comply with the MNOs' AML/CFT policies and are trained to follow specific procedures in case of suspected fraud or money laundering. A four-tiered CDD process is adopted, with transaction limits for each tier corresponding with risk mitigation measures, such as KYC verification requirements and controls for governance and management information system (MIS).

3 Proportionality is also applied in the prudential regulation on non-bank financial institutions, as observed in Malaysia and Russia.

- > In Malaysia, the regulatory and supervisory framework for development financial institutions (DFIs) is aimed at ensuring the institutions' financial and operational soundness, without impeding their ability to effectively achieve development mandates. In this regard, DFIs are not yet subject to the Basel II and III requirements that are applied to banks.
- > With the amendment to the legislation on consumer loan and microfinance activities, Bank of Russia (CBR) now regulates four categories of professional creditors (banks, credit co-operatives, microfinance organizations and pawnshops). These institutions are subject to different set of requirements and scope of activities, taking into consideration potential risks associated with deposit-taking activities. For e-money service providers, regulations applied to them (e.g. authorized capital) are less stringent in comparison to banking institutions.

4 Other forms of proportionality in practice include 'test and learn' and phased regulatory approaches.

- > Bhutan has adopted a phased approach in creating an enabling regulatory environment to improve financial access for the poor and low-income population. The regulation for microloans institutions was first introduced in 2014 to bring non-government organizations (NGOs) and entities engaged in lending activities into the formal financial system. Subsequently, Bhutan embarked on the formulation of regulations on agent banking in 2016. More recently, Bhutan implemented regulations on deposit-taking microfinance institutions and e-money issuers in 2017.

- > In Malaysia, the agent banking regulatory framework was first introduced in August 2012 to facilitate the implementation of agent banking in a reliable, safe and sustainable manner, while enhancing the access to basic banking services in unserved areas. The regulatory framework was subsequently enhanced in April 2015, with policy objectives expanded to include enhancement in convenience, accessibility and usage of banking services, as well as to increase customer satisfaction. Under the 2015 enhanced framework, agents can now facilitate financial institutions in opening savings accounts (previously, activities were limited to accepting deposits, facilitating withdrawals, fund transfers, bill payments and financing repayments).
- > In Russia, progressive steps have been taken to strengthen the regulatory and supervisory framework to deal with potential systemic risks, including from non-bank financial entities (shadow banks). In mid-2013, CBR became the mega regulator and was empowered with regulatory and supervisory mandate over non-bank financial entities. The National Financial Stability Council, a high level inter-agency body chaired by the First Deputy Prime Minister of the Russian Federation, was also set up. In 2014, the Financial Stability Committee was established within the CBR to, amongst others, monitor and assess risks of the financial system. Efforts are also underway to implement a unified data-reporting standard for non-credit financial institutions. This would enhance data quality and consistency, and promote transparency and data accessibility to market participants.
- > Tanzania adopts a 'test and learn' regulatory approach in promoting MFS. This approach has allowed the regulator to test the deployment of the service and monitor its developments. In this regard, the role of the regulator has been to support rather than stifle innovation, through understanding the risks inherent in such innovations and establishing the necessary risk controls.
- > In Uganda, biometric identification technology was adopted as a crucial first step towards promoting financial inclusion. Progressive financial inclusion initiatives have subsequently been undertaken, including the development of guidelines on consumer protection and mobile money services. The Bank of Uganda is also in the final stages of drafting regulations to support agent banking.

5 A few countries indicated that the adoption of proportionality have yielded positive financial inclusion outcomes, as evidenced through quantitative and qualitative results. Some countries expressed difficulty in attributing progress within financial inclusion to proportionality, as the regulations are still new and too soon to yield outcomes.

- > In Tanzania, more than 58% of adults now use mobile money accounts and access to MFS has reached over 98%. In comparison, only 11% of adults used formal financial services when MFS first came into use in 2008.
- > For Malaysia, access to financial services has significantly increased since the introduction of agent banking in 2012. As at end-June 2015, there were five participating financial institutions with a combined network of 6,507

banking agents nationwide. Total number of transactions exceeded 45 million, with a total value of USD 1.1 billion. Malaysia has achieved numerous targets set under the Maya Declaration. As of end-2014, 95% of sub-districts, with a population of more than 2,000, have at least one financial access, exceeding the 90% target one year ahead (end-2011: 46%; end-June 2015: 96%). The 100% target for state legislative assemblies has also been achieved (end-2011: 73%).

- > Since the regulation on microloan institutions was implemented in Bhutan, to bring entities engaged in lending into the formal system, three entities have registered with the Royal Monetary Authority of Bhutan (RMA) as microloan institutions.
- > In Peru, AML/CFT regulations (including application of tiered KYC regime) was first introduced in 2011 and further fine-tuned in 2015. As such, it is still too early to see the impact. Volume wise, there is less than one million simplified e-money accounts, but the numbers are increasing. Informal evidence derived from the regulator's engagement with services providers suggests that simplified accounts have contributed towards attracting new clients. Encouraging results have been observed in the insurance market, with about 70% of existing insurance policies based on simplified regime.
- > In Bangladesh, women participation in MFS and agent banking is still comparatively low, but initiatives have been undertaken to address the financial inclusion gap. Of the 21 million registered MFS account holders, only 18% users are women. Less than 3% of banking agents are women. While the factors impacting women's access to financial services in Bangladesh are complex, it was recognized that resources and market players are available to bridge this gap.

6 Some countries highlighted several challenges in implementing proportionality in practice, including the need for operational enhancements for KYC verification. A few countries also indicated that there is scope for enhanced data collection to facilitate monitoring and to better regulate non-bank financial institutions (shadow banking).

- > For Indonesia, the pilot implementation of proportionate KYC rules in government aid disbursement revealed that individual registration for complete CDD procedures was a major hurdle, given the considerable amount of time required. For the reason that the social welfare ministry has already previously validated the identity of recipients, bulk registration can speed up the process while still keeping the risks low. Flexibility should also be implemented in the acceptance of valid ID documents for KYC verification. Other ID documents issued by government institutions, such as the social welfare ID, should also be recognized the same as the national ID.
- > In Peru, FSPs were unclear about using the RBA for KYC processes, with some firms highlighting difficulties in developing a rating system to score their clients. The FSPs also faced challenges in integrating analysis for KYC, especially when the assessment involved multiple risk factors for the same client.
- > In Cambodia and Mozambique, the lack of information on shadow banking is a major challenge. This affects the

ability of the regulator to assess the build-up of risks and deploy necessary regulatory measures, and thus, apply proportionality accordingly.

7 Sudan provided an interesting perspective from the de-risking phenomenon. Stringent KYC measures, when not applied in a manner that is proportionate to risks, may lead to the loss of correspondent account relationships and greatly undermine access to financial services.

8 To further support the adoption of proportionality in practice and ensure effectiveness, some countries highlighted the need for other complementary measures to be put in place.

- > Peru recognized the importance for effective communication and dialogue with FSPs. Such engagements should take place during the formulation of regulations, as well as throughout the implementation stage.
- > Malaysia and Bhutan highlighted the importance of on-going efforts to enhance financial literacy, to allow the public to make informed financial decisions.
- > Malaysia also recognized the need to continuously conduct surveillance (including mystery shopping) by financial institutions and the central bank, to support the effective implementation of the agent-banking framework.

CASE STUDIES ON THE APPLICATION OF PROPORTIONALITY IN PRACTICE

APPLICATION OF THE RISK-BASED APPROACH (RBA) IN AML/CFT POLICIES

BANGLADESH

Over the past few years, Bangladesh has seen a significant expansion in financial inclusion, driven by many Government initiatives to promote inclusive and sustainable finance for financial and social stability. In view that 50% of Bangladesh’s population are women, their participation in financial sector can have a great impact in economic development. However, women’s participation in the institutional economic sector is inadequate, and the rate of women entrepreneurs is very low, compared to male entrepreneurs. In fact, there are many obstacles affecting women participation in mainstream economy, although the degree of integrity, attention, creativity and expertise is very high (refer to Info Box 1 for further information on Women’s Participation in Micro Credit Programs and the Small and Medium Enterprises in Bangladesh, and Info Box 2 on Challenges to Women Participation in the Financial System in Bangladesh).

The strategic move for widespread financial inclusion initiatives have led to enhanced opportunities for a much-desired inclusive growth. The Government has taken initiatives to empower women by broadening the base of financial access through several types of financial institutions. Along with the formal banking sector, non-banking financial institutions (such as cooperatives, microfinance institutions and other government and non-government financial institutions) provide different financial services to women. Several types of products and services have been introduced in the last few years to encourage women’s easy access to the financial sector.

Proportionality In Mobile Financial Services (MFS) Regulations To Bridge The Gender Gap In Access To Finance

From an anti-money laundering and countering the financing of terrorism (AML-CFT) perspective, it is recognized that the target customer segment for financial inclusion (those with limited or no access to the formal financial system) has lower money laundering and terrorism financing (ML/RF) risks. Necessary guidelines and circulars have been published by the Bangladesh Bank for the special products introduced under this system. In the National Risk Assessment (NRA), financially inclusive products have been identified as low risk products. In line with the FATF Guidance on AML/CFT and financial inclusion, banks and financial Institutions are required to follow an RBA and apply simplified due diligence for low risk products to support financial inclusion. Simplified KYC is introduced to promote MFS for easy access to the financial sector. To promote MFS and women’s financial

inclusion, some financially inclusive deposit products have been launched, whereby simplified due diligence is applied (Table 1)

TABLE 1

NAME OF THE PRODUCT	CHARACTERISTICS
1 Account for the garments worker	<ul style="list-style-type: none"> > Account can be opened with BDT 100; > Required documents are National Identification Card (NID) and Employee ID.
2 Account for Hardcore poor women	<ul style="list-style-type: none"> > Account can be opened with BDT 10; > Required documents are NID, Birth Certificate or Food and Livelihood Security Card issued by Department of Women Affairs Bangladesh.
3 Account for Cleaning Staff	<ul style="list-style-type: none"> > Account can be opened with BDT 10; > Required documents are NID and ID issued by City Corporation.
4 Account for Leather Sector Worker	<ul style="list-style-type: none"> > Account can be opened with BDT 100; > Required document for this account should be NID and Employee ID.

Note: No charges applicable for the above accounts.

The Bangladesh Financial Intelligence Unit (FIU) has undertaken some background work on MFS, where a three-tiered KYC regime has been proposed, with transaction limits for each tier. The proposal contains the simplest type of KYC, where the mobile service provider can open an MFS account with Photo ID, NID, and verification. No forms are required to open an account. If the client is a female with no NID, NID of close relatives (such as parents, husband or children) can be used to open an account.

Outcomes

Women participation in MFS and Agent Banking are still comparatively low but initiatives are taken to address the inclusion gap.

Of the 59.65 million registered MFS account holders, only 18% of users are women. For agent banking, less than 3% of agents are women. Women tend to have lower mobility and cultural barriers prevent women from dealing with agents located in male-dominated markets.

While the relative simplicity in process and ID requirements provides opportunity and potential market for women to participate in digital finance, the following are some reasons for lower women participation in the sector:

- > Real and perceived security issues, whereby women are concerned about sharing phone numbers with men who may call after transactions and harass them.
- > Women do not have the government IDs and birth certificates required to open mobile accounts.

- > Phone ownership and usage is also a likely issue. Most low-income households tend to have one phone per household, often held by husbands or older children.
- > English-language phone menus may have a disproportionate impact on women. Literacy levels for women in Bangladesh are 55%. The use of Bangla text is difficult on a basic feature phone. It was reported that only 30% of adults have the ability to send SMS and use mobile phones that allow for USSD session-based menu.

Some leading providers are beginning to address the digital inclusion gap and market opportunity presented by women. The following are some of the initiatives taken by digital service providers:²

- > Dutch Bangla Bank Ltd. (DBBL) has signed up with several garment factories to disburse salaries to garment workers (80-90% women) with accounts that are mainly accessed via agents, ATMs and client-initiated mobile transactions. DBBL also has programs with donors and governments to promote payment transfers to women via dedicated women agents.
- > The Asia Foundation has launched new programs with Telco partners, Banglalink and UCash, to help women entrepreneurs utilize digital financial services and reach new markets through e-commerce. As a part of the program, UCash will hire 500 new women agents.
- > BRAC NGO, which primarily works with women, is integrating bKash mobile money into many programs. Since 2011, the Microfinance Program has offered mobile money as an option for deposit placements and loan repayment.

- > Swosti is a new company that seeks to create a “bridge between mobile banking and microloans” by offering a “mobile credit card” for emergency loans to existing Microcredit clients. Swosti allows Microcredit clients to register for a DBBL mobile account and apply for emergency loans. This allows clients to have faster access to emergency loans via mobile. It also provides the convenience for deposit placements, loan repayments and cash withdrawals across the large agent network. Pilot projects are ongoing, although microfinance institution (MFI) technology integration is still a challenge.
- > Micro insurance is another area where women may benefit from digital finance, although there is a lack in full data on women’s participation, which is still a challenge. MicroEnsure partnered with Grameenphone, Bangladesh’s leading mobile network operator (MNO), to provide life insurance as a loyalty service. Although the product has been offered for less than a year, 2.5 million airtime users have been registered for the service and product offerings are expected to expand.³

Women’s current participation in digital finance can be depicted in the following statistics on MFS and agent banking clients of Bkash and DBBL. These two players have the largest market share in MFS and agent banking (Table 2).

2 “Digital Finance in Bangladesh: Where are all the Women?” A publication of CGAP (Consultative Group to Assist the Poor).
3 CGAP interviews, December 2014.

TABLE 2

MOBILE BANKING ACCOUNT - BKASH

Year	2011	2012	2013	2014	2015	2016	2017
Bkash - Total number of registered customer	61,239	2,114,247	7,898,383	5,613,075	5,054,750	5,429,770	5,229,609
Registered Female customer	4,269	400,494	1,517,159	1,114,105	1,251,562	1,683,031	1,895,600
% of Women Customer	7%	19%	19%	20%	25%	31%	36%

MOBILE BANKING ACCOUNT - DBBL

Year	2011	2012	2013	2014	2015	2016	2017
DBBL - Total number of registered customer	57,542	855,184	1,152,022	1,674,257	3,139,489	3,545,291	3,816,061
Registered Female customer	4,758	85,171	149,020	286,954	995,258	886,039	1,086,390
% of Women Customer	8%	10%	13%	17%	32%	25%	28%

AGENT BANKING ACCOUNT - DBBL

Year	2015	2016	2017
DBBL - Total number of registered customer	36,870	326,949	420,634
Registered Female customer	5,934	84,305	108,308

The factors impacting women's access to financial services in Bangladesh are clearly complex, but resources and market players are available to bridge this gap. A first important step is for providers and other stakeholders to understand women's needs, preferences and usage of current products, services and channels.

An integrated effort by all policymakers and relevant stakeholders should be taken to address the financial inclusion gender gap. In addition to developing innovative and well-designed products and platforms that are carefully aligned with the needs and capabilities of women, there is also a need to ensure that the systematic gender barriers are alleviated.

INFO BOX 1: WOMEN'S PARTICIPATION IN MICRO CREDIT PROGRAMS AND SMALL-AND-MEDIUM ENTERPRISES (SMES) IN BANGLADESH

Women's participation in micro credit programs and the ready-made garment industry is a major contributor to Bangladesh's industrialization. Similarly, women's participation in the SME sector is vital for the prosperity of the country's economy. The statistics of the Microcredit Regulatory Authority (MRA) shows that this sector has created direct job opportunities for over 114,644 people as at June 2014. Of this, 81% were male and 19% were female. However, most of the members of microfinance institutions (MFIs) are women and the number is steadily increasing. As at 2015, 91.2% of members are women (23.6 million), which is 3.9% higher than the 2014 level. On the other hand, the number of male members (2.3 million) was 2% lower compared 2014.⁴

The sector has disbursed loans to 19.98 million borrowers, with outstanding loans totaling BDT 278 billion. Accumulated savings that mobilized savings from 25.17 million clients amounted to BDT 112 billion.⁵ In the meantime, Bangladesh Bank has taken some steps and formulated a guideline for the banks and financial institutions to ensure more institutional financial facilities are provided to women entrepreneurs for SME initiatives.⁶

- > To ensure balanced industrial development, a minimum 10% of total SME loans should be allocated for women entrepreneurs in the SME sector and it has to be increased up to 15% by 2021.
- > Applicable interest rate for credit extended to women entrepreneurs is the Bank rate (presently, 5%) plus maximum 4% (i.e. not more than 9%).
- > Banks and financial institutions have been instructed to give a grace period to women entrepreneurs. Grace period will be three months for short-term loans and three to six months for medium- and long-term loans. The grace period will not be considered within the loan period.
- > Banks and financial institutions will accept and settle all types of loan applications by women entrepreneurs in the SME sector with high priority.

- > Banks and financial institutions shall take initiatives to advertise all the facilities for women entrepreneurs in both electronic and print media.
- > Banks and financial Institutions can provide a maximum loan facility of Tk.2.5 million against personal guarantee to a woman without collateral.
- > Banks and financial Institutions have been instructed to establish a "Dedicated Women Desk" for women entrepreneurs in their branches. This is to ensure service-friendly approach towards women entrepreneurs.
- > Each branch of banks and financial institution is required to identify three women entrepreneurs who did not receive any credit from banks. Banks must then provide credit to at least one of such customer per branch, per year.
- > Each bank and financial institution shall follow a separate business strategy in SME lending, with minimum formalities in executing documentation to ensure easy and speedy loan disbursement process.
- > To encourage women entrepreneurs, priority shall be given to prospective women entrepreneurs in SME lending.
- > Training programs shall be arranged for the women entrepreneurs.

Based on the statistics of the SME and Special Programs Department of Bangladesh Bank, loans disbursed to women entrepreneurs accounted for about 3.5% of total SME loan disbursed over the past five years. Meanwhile, the number of women entrepreneur institutions has increased to 53,874 in 2017, when it was 41,675 in 2016, which is a positive sign for women's participation in the economy.⁷

4 Financial Stability Report 2015, Bangladesh Bank.

5 "Microcredit in Bangladesh" a Publication of Microcredit Regulatory Authority.

6 "Women Entrepreneurship Development" a Publication of Bangladesh Bank.

7 SME and Special Programs Department of Bangladesh Bank.

INFO BOX 1: WOMEN'S PARTICIPATION IN MICRO CREDIT PROGRAMS AND SMALL-AND-MEDIUM ENTERPRISES (SMES) IN BANGLADESH (CONTINUED)

Year	2010	2011	2012	2013	2014	2015	2016	2017
Total Disbursement (Billion) BDT	535.44	537.19	697.53	853.23	1009.10	1158.70	1419.35	1617.77
Disbursement for women entrepreneur (Billion) BDT	18.05	20.48	22.24	33.51	39.39	42.27	53.46	47.73
% of women loan disbursement	3.37%	3.81%	3.19%	3.93%	3.90%	3.65%	3.82%	2.73%
Women Entrepreneur Institution	13,233	16,697	17,362	41,719	42,730	188,233	41,657	53,874

Generally, financial institutions and banks extend credit to women under micro-credit programs for poverty reduction. The interest rates of these credits vary, based on the cost of the fund. To provide credit to women entrepreneurs at preferential interest, Bangladesh Bank has been implementing different refinance schemes. Funds disbursed only for women under the refinance scheme over the last eight years are depicted below:

Year	2010	2011	2012	2013	2014	2015	2016	2017
Women Fund Disbursement under refinance scheme (Billion) BDT	11.61	17.12	18.56	20.02	24.88	25.82	29.50	32.49

INFO BOX 2: CHALLENGES FOR WOMEN PARTICIPATION IN THE FINANCIAL SYSTEM BANGLADESH

- > Banks and non-bank financial institutions (NBFIs) are reluctant to finance women enterprises owned by unmarried girls. They are concerned that unmarried girls would eventually move to her husband's address, leaving the loan unpaid afterwards.
- > Female members that do not have their own property face difficulties to provide collaterals.
- > Banks lack the mindset of financing women entrepreneurs. They are more comfortable to deal with male entrepreneurs due Bangladesh's socio-economic context.
- > Families do not encourage female members to engage in business.
- > Banks and NBFIs are reluctant to provide services to women due to concerns that their husbands are the ultimate beneficiaries of the borrowed funds, and the financial institutions may face difficulties in recovering the funds.
- > Sometimes, due to socio-cultural norms, a woman is habituated to think of herself as a job holder/housewife rather than an entrepreneur.

INDONESIA

Indonesia has promulgated policy on digital financial services (DFS) as a key element of its national financial inclusion strategy (NFIS) to broaden financial access to those at the bottom of the pyramid. Efforts include providing payment system and financial services to the underbanked and unbanked people through cooperation with network agents using mobile- and web-based technology. Bank Indonesia has initiated DFS through registered electronic (e)money, based on chips and servers.

In 2015, Financial Services Authority (OJK) commenced the Laku Pandai program to allow the offering of a complete suite of products to the unbanked and underbanked through agents. Products offered under the program comprise: (i) savings that have similar characteristics of Basic Saving Account (BSA); (ii) loans or financing to micro business customers; and (iii) other financial products such as micro insurance.

Proportionality in Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) regime for DFS and Laku Pandai

One of the aspects that plays a significant role to support DFS and Laku Pandai is the implementation of Bank Indonesia's Regulation (PBI) No. 14/27/PBI/2012, which covers AML/CFT policies. The regulation states that simplified know your customer (KYC) can be applied when the risk of money laundering and financing of terrorism is low, and for opening accounts associated with government programs targeting at improving welfare and alleviating poverty.

The regulation allows the implementation of consumer due diligence (CDD) by third-party agents who represent the bank. The final responsibility for the identification and verification lies with the operator, and third-party agents have had cooperation with the bank in the form of a written agreement. The implementation of KYC in DFS and Laku Pandai are structured as per in Table 3.

TABLE 3

CUSTOMER CATEGORY	MAXIMUM MONTHLY TRANSACTION	DAILY MOBILE WALLET BALANCE	MAXIMUM TRANSFER SIZE (PER TRANSACTION)	RISK MITIGATION MEASURES: KYC VERIFICATION REQUIREMENTS
E-Money unregistered (Individuals newly registered)	IDR 20 mil. (\$1,500)	IDR 1 mil. (\$75)	-	Cash-in transactions: > Registered phone number and registered e Money account user
E-Money registered (Individuals who have been upgraded through verification of KYC)	IDR 20 mil. (\$1,500)	IDR 5 mil. (\$385)		> Prerequisites for upgrading: - Acceptable ID ⁸ - Registered phone number Transfer transactions: > Registered phone number and registered mobile money account user Cash-in transactions > Registered phone number and registered mobile money account user Cash-out transactions: > Acceptable ID
Basic savings account	-	IDR 20 mil. (\$1500)	IDR 5 mil. (\$385)	Simplified CDD. The information should include: > Name > Address as stated in ID and current residence address > Place and date of birth > Occupation

8 With information of name, ID number, Address as stated in ID and current residence address, Place and date of birth, nationality, occupation, gender, and marital status.

In addition, management information systems (MIS) and institutional governance also serve as risk mitigation measures. This includes the following:

1 MIS

- > Automatic system block on transactions that exceed limits;
- > Audit trail reports of each customer's transactions;
- > Alerts;
- > AML System.

2 Institutional governance

- > Segregation of duties and clear approval procedures that are documented;
- > Existence of a risk mitigation unit;
- > AML/CFT compliance officer and reporting.

Outcomes

Pilot implementation of proportionate KYC rules revealed scope for enhancements.

As part of the implementation of DFS, a pilot project was conducted for government aid disbursement. The pilot project revealed that individual registration for complete CDD procedure was a major hurdle, given the considerable amount of time required (Table 4). Given that the social welfare ministry previously validated the recipients, bulk registration can speed up the process, while keeping the risks low. This can contribute towards a more proportionate and balanced regulation. Bulk registration can also be implemented for the factory worker, as the company can provide data validation through a database.

Implementation of DFS in the government disbursement aid program also revealed the need for simplified KYC and supporting document ID to be clearly stated in the DFS regulation. Simplified KYC should be implemented, where risk mitigations have been put in place in the form of limits on maximum balance and transactions. Flexibility should also be implemented in the acceptance of valid document IDs. Other document IDs issued by government institutions, such as social welfare ID, should be recognized as the same as a national ID. The proposed simplified KYC in DFS will only require information such as name, place and date of birth, ID Number, and address.

TABLE 4: AML/CFT IMPLEMENTATION ISSUES

KEY ISSUES	UNINTENDED CONSEQUENCES FOR FINANCIAL INCLUSION	RECOMMENDATIONS
Individual registration with complete CDD procedure for group of customer (i.e. government aid recipients)	<ul style="list-style-type: none"> > Double validation process; > Longer registration process; > Recipients will experience complicated registration process. 	<ul style="list-style-type: none"> > Implementation of bulk registration in the case where data has been adequately validated; > Social ID Card or other ID Card issued by institution with sufficient validation process; > Simplified KYC.

MALAYSIA

Proportionate regulation promotes stability and integrity of the financial sector, and encourages innovative financial inclusion solutions. The proportionate application of global standards for financial regulation is a critical factor in enabling innovative financial inclusion solutions, ensuring its delivery in a safe and sound manner. Proportionate regulation ensures that the costs of regulation do not outweigh the benefits of regulation and that regulation is applied commensurately to risks.

Malaysia has been a practitioner of proportionate regulation. Examples of proportionality in practice include the following:

- 1 Agent Banking:** The Agent Banking Regulatory Framework was established in 2012 to align interdisciplinary stakeholders of agent banking to enable delivery of agent banking in a reliable, safe and sustainable manner. The regulatory framework also provides a basis for assessing risks, and implementing regulations that are proportionate to the risks identified; and
- 2 Development Financial Institutions (DFIs):** The Development Financial Institutions Act 2002 (DFIA), which empowers Bank Negara Malaysia to regulate and supervise DFIs,⁹ was enacted in 2002 to ensure the institutions perform their developmental mandate in a prudent, effective and financially sustainable manner. The DFIA provides a comprehensive regulatory and supervisory framework for DFIs to ensure financial and operational soundness of these institutions (please refer to Info Box 3 on Regulation of Development Financial Institutions (DFIs) in Malaysia).

With respect to agent banking, Malaysia has successfully implemented proportionate regulation on the adoption of a risk-based approach in addressing Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) risk.

The expansion in agent banking was put into effect through a phased approach with clear regulatory framework, as outlined in the policy document on agent banking. The policy document, which was first issued by Bank Negara Malaysia in August 2012 and subsequently revised in April 2015,¹⁰ governs the use of agents or third-party intermediaries by financial institutions¹¹ in the provision of financial services.

9 Specialised financial institutions established by the Government with specific mandate to develop and promote key sectors like agriculture, small and medium enterprises, infrastructure, maritime, export-oriented sector, capital-intensive and high-technology industries of strategic importance to the country.

10 Published in Bank Negara Malaysia's website (<http://www.bnm.gov.my>).

11 Financial institutions refer to licensed banks under the Financial Services Act 2013 (FSA); licensed Islamic banks under the Islamic Financial Services Act 2013 (IFSA); and prescribed institutions under the Development Financial Institutions Act 2002 (DFIA).

In developing the Policy Document on Agent Banking, the following key aspects were considered:

TABLE 5

APPLICATION OF GLOBAL STANDARDS

- > Generally, the regulatory framework is in line with the **FATF 40 Recommendations, particularly on the application of new technologies (Recommendation 15)**,¹² whereby financial institutions that leveraged on new technology in delivering agent banking services are required to identify, assess and effectively manage the risks associated with agent banking, including AML/CFT risk.
- > The regulatory framework is also in line with the **FATF Guidance on Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion**, specifically on the adoption of risk-based approach of AML/CFT as follows:
 - Financial institutions can engage agents to facilitate automated and real-time customer biometric identity verification, using chip-based national identity card;
 - In mitigating the potential risks which may arise when facilitating the opening of accounts at the agents, the following controls have been put in place:
 - Roles of agents in facilitating 'Know Your Customer' (KYC) functions are demarcated based on types of agents; and
 - Banking services offered at the agents are differentiated based on the outcome of KYC verification performed on the customer.
 - The rigorousness of Customer Due Diligence (CDD) measures are based on the risks associated with individual customers and delivery channels.

REGULATORY OBJECTIVES

- > The regulatory framework was introduced in August 2012 to facilitate the implementation of agent banking in a reliable, safe and sustainable manner, whilst enhancing the access to basic banking services in unserved areas.¹³
- > With the enhancement of the regulatory framework in April 2015, the policy objectives have been expanded to further enhance convenience, accessibility and usage of banking services, as well as to increase the satisfaction level of customers.

RISK ASSESSMENT UNDERTAKEN

- > Potential risks that may arise from agent banking in the Malaysian context include operational, technological, compliance, financial, legal and reputational risks, as well as user awareness risk and financial inclusion risks (access, usage and quality).
- > These risks are dealt within the agent banking regulatory framework that outlines the minimum expectation to be observed by financial institutions, which amongst others, include the following:
 - i. Financial institutions must retain the ultimate responsibility and accountability of all agent banking activities;
 - ii. An oversight mechanism must be established to monitor agents' conduct and ensure that associated risks are managed effectively;
 - iii. All transactions by agents, including verification of customer's identity, must be conducted on an online, real-time basis and within the business premise of the agent;
 - iv. A robust, reliable and secure infrastructure/system must be put in place to support agent banking activities, including a minimum two-factor authentication¹⁴ system for agent banking transactions; and
 - v. Appropriate deposit and withdrawal limit must be established so that more customers can benefit from agent banking and reduce risk exposures.
- > Since the implementation of the agent banking regulatory framework in 2012, the inherent risks of agent banking have been well managed with zero fraud incidences.

DATA USED TO INFORM POLICY IMPLEMENTATION

- > The data used in formulating policy/regulation, as well as monitoring and measuring the impact of the agent banking implementation in the country includes the following:
 - i. Percentage of sub-district with population of more than 2,000 or state assembly areas in Sabah having at least one access point;¹⁵
 - ii. Volume and types of transactions, such as deposits, withdrawals, loan payments, fund transfers, bill payments, cashless payments, pre-paid top-up; and
 - iii. Total number and type of agents.

12 Recommendation 15 stipulates that "Countries and financial institutions should identify and assess the money laundering or terrorist financing risks that may arise in relation to (a) the development of new products and new business practices, including new and pre-existing products. In the case of financial institutions, such a risk assessment should take place prior to the launch of the new products, business practices or the use of new or developing technologies. They should take appropriate measures to manage and mitigate those risks".

13 Unserved areas defined as sub-districts (*mukims*) with >2,000 population without any access point to both deposit and withdrawal services.

14 The two-factor authentication may include verification via MyKad and Personal Identification Number (PIN) of ATM/debit card.

15 An access point is a place of banking business that provides minimum services of accepting deposit and facilitating withdrawal of funds by customers, which include bank branches, mobile units of the financial institutions, electronic terminals and bank agents.

In April 2012, the Financial Sector Assessment Program (FSAP) conducted an assessment on the concept paper of agent banking guidelines¹⁶ (the Concept Paper). FSAP viewed that the Concept Paper generally applied the international best practices for agent banking. FSAP also recommended Malaysia to review certain aspects of the guidelines towards ensuring a sustainable adoption of agent banking by financial institutions, which includes: (i) lifting the limitation on locations where agents can be deployed; and (ii) permit low-value account opening at agents, on behalf of banks. The policy document on agent banking, issued in April 2015, has incorporated FSAP's recommendations, whilst the liberalization of agent location was implemented in phases, in line with the policy objectives of serving the underserved areas.

Recognizing the need to focus on enhancing the usage and satisfaction of the customers, the agent-banking framework has been expanded¹⁷ in 2015 as follows:

1 Agent banking services

In addition to existing services, namely accepting deposits, facilitating withdrawals, fund transfers, bill payments and financing repayments, agents are now allowed to facilitate financial institutions in the opening of saving accounts via online real-time system and through biometric identity verification.

2 Location of agent banking

Extended from the unserved to underserved areas. Underserved areas are sub-districts (*mukims*) with more than 2,000 populations or *State Assembly Area (DUN)* for Sabah¹⁸ having access points of five and below.

3 Daily cash withdrawal limit

Increased from USD120 to USD240 at sole proprietor agents to better facilitate the needs of the community.

Additional requirements to mitigate the risk of allowing agents to facilitate the opening of savings accounts are as follows:

- i. Risk-based approach of AML/CFT;
- ii. Key functions of opening accounts and AML/CFT obligations remained with financial institutions;
 - > Decision to approve the customer's application for opening savings accounts and issuance of ATM/debit card;
 - > On-going AML/CFT surveillance, which includes profiling of customer and reporting of suspicious transactions; and
 - > Conducting due diligence on customers immediately upon opening accounts.
- iii. Enhance infrastructure and capability of AML/CFT system;
- iv. Intensify customer awareness and education programs; and
- v. Expand training module on AML/CFT, data privacy and secrecy rules for agents.

Outcomes

Access to financial services has significantly increased since the introduction of agent banking in 2012.

At national level, the rollout of agent banking has a significant contribution in elevating the level of financial inclusion. Key outcomes are as follows:

- 1 Malaysia has achieved numerous targets on access to financial services, as set under the Maya Declaration;
 - > **Sub-districts:** 95% of sub-districts with a population of more than 2,000 have at least one financial access point as at end 2014, exceeding the 90% target one year ahead (end 2011: 46%; end-June 2015: 96%); and
 - > **State legislative assemblies:** 100% achieved (end 2011: 73%).
- 2 There are five participating financial institutions with a combined agent network of 6,507 banking agents nationwide (as at end-June 2015);
- 3 Total number of transactions exceeded 45 million, with a total value of USD 1.1 billion (as at end-June 2015);
- 4 Agent banks are the only financial services provider in 53% of total sub-mukims/State Assembly Areas in Malaysia; and
- 5 Convenient access to banking services.
 - > **99% of the population in Malaysia** has access to formal banking services, through agent banks or financial institution branches; and
 - > **Access to remote sub-districts/state legislative assemblies** (up to 120km away from the nearest access points) and areas with less than 2,000 populations.

The three-prong benefits as set out in Table 6 have been observed.

16 The Guidelines on Agent Banking were subsequently issued on 15 August 2012.

17 Revised regulatory framework formulated based on feedback from stakeholders, including the underserved communities, financial institutions and various relevant departments in the Bank Negara Malaysia.

18 Sabah is located in the East Malaysia, one of two Malaysian states on the island of Borneo and is the second largest state in Malaysia.

Implementation of 2012 agent banking framework surfaced several challenges, which led to the revision of the agent banking regulatory framework in 2015.

The following areas of enhancements were identified in the 2012 agent-banking framework:

1 Accessibility could be further improved:

- > 43 sub-districts in Malaysia remain unserved; and
- > 128 sub-districts/State Assembly Areas have only one access point.

2 Limited services for customers

- > Unable to facilitate opening of saving accounts
 - Transactions mainly for payments.
 - Impacting income for financial institutions with small customer base.
- > Low withdrawal limit at sole proprietary agent (USD120).
 - Customers had to make few visits.
 - Increase cash holding/transit risk for agents.

The above challenges were addressed in the revised policy document in 2015.

A key lesson learnt: Proportionality in practice should be undertaken in a balanced and safe manner, which is contextualized to the enabling infrastructure and advancement of the financial sector and economy.

In Malaysia's agent banking experience, the following are adopted:

- 1** Financial institutions can engage agents to facilitate customer identity verification on its behalf using national identity card (MyKad) and biometric authentication through online real-time system. For opening of account, the customers' information must be screened against relevant databases.

2 Pending completion of KYC, the accounts opened at agents have the following limitations:

- > Access to the accounts through agent banking channel is valid up to two months and shall be blocked automatically if KYC verification is not completed within the stipulated period;
- > Inter-bank fund transfers are not allowed, except for Government to Person (G2P) payments; and
- > Lower cash withdrawal limit at USD717 per month.

3 There should be continuous and on-going efforts to manage the inherent risks and surveillance of the agent banking implementation in Malaysia. Currently, there are a myriad of initiatives and efforts in place, as follows:

- > Continuous surveillance and mystery shopping by financial institutions and Bank Negara Malaysia; and
- > On-going efforts by financial institutions and Bank Negara Malaysia to increase awareness and consumer education.

PERU

The core mission of the Peruvian regulatory and supervisory body, the *Superintendencia de Banca, Seguros y Administradoras Privadas de Pensiones* (SBS) is to protect depositors' interests, by ensuring the soundness and stability of the financial system. An additional responsibility, since 2007, is to prevent the abuse and misuse of supervised financial services. Thus, the Peruvian regulator faces the challenge in harmonizing three objectives - stability, integrity and financial inclusion. The housing of diverse functions under the same roof, however, accords the SBS with coordination advantage.

The earliest application of proportionality in Peru was possibly in 1997, when the microcredit regulation was first issued. This regulation defines microcredit and boundaries for risk exposure. Regulatory requirements were reduced to ease credit management for services providers and enable financial access to micro and small firms.

TABLE 6

CUSTOMERS	AGENTS	FINANCIAL INSTITUTIONS
<ul style="list-style-type: none"> > Able to undertake basic banking transactions. > More convenient access and longer operating hours (i.e. similar to business hours of agents). > Lower transaction costs. For e.g. customers would save on transportation/fuel given the shorter distance to retail agents/post offices. 	<ul style="list-style-type: none"> > Additional revenue in the form of commission income (up to USD480 per month). > Increased business sales due to higher inflow of customers who wish to conduct basic banking transactions and open accounts with selected financial institutions. > Enhanced image and promote business visibility due to affiliation with financial institutions. 	<ul style="list-style-type: none"> > Increased outreach to unserved areas in a cost-efficient manner. In comparison to branches, financial institutions reported that agent banking channels delivered cost savings in terms of set-up costs of more than 80%. > Reduce queue at branches, as customers will now have options to undertake banking transactions at retail agents and post offices. > Value proposition to attract new customers, while serving as a platform for the development and delivery of new products.

In pursuing the stability and integrity objectives, the SBS adopts international standards, including the principles and recommendations of the Basel Committee of Banking Supervision (BCBS) and Financial Action Task Force (FATF). The global standards are implemented in a customized way, taking into consideration Peru's context and the characteristics of its financial sector.

In developing regulatory framework for stability and anti-money laundering and combating the financing of terrorism (AML/CFT), proportionality promotes the harmonization of stability, integrity and financial inclusion objectives.

The approach is aimed at ensuring measures that commensurate with the risk level of activities performed and the complexity of the operations of a specific supervised entity. This is in line with the recommendations by the BCBS in its 2012 *Revised Basel Core Principles for Banking Supervision*, and by the *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation*, *The FATF Recommendations*.

SBS adopts proportionality in the due diligence process for Know Your Customer (KYC), which is aimed at ensuring regulations are effective without being an obstacle to financial inclusion. The approach taken by the SBS is described in the Regulation for Risk Management of Money Laundering and Terrorism Financing, issued by Resolution SBS N° 2660-2015.¹⁹ Various aspects, as set out in Table 7, were considered in developing the Regulation.

INFO BOX 3: REGULATION OF DEVELOPMENT FINANCIAL INSTITUTIONS (DFIS) IN MALAYSIA

The Development Financial Institutions Act 2002 (DFIA) takes into consideration the diverse characteristics and unique roles, functions and objective of each DFI, and the relevant provisions in the existing statutes. Recognizing the unique characteristics of DFIs, policies have been formulated and developed to suit these different roles. The issuance of policies and standards have also been prioritized based on criticality and stages of development, whereby DFIs continue to strengthen their capacity and capabilities to improve their overall performance. The prudential requirements would not impede the DFIs' ability to effectively achieve their developmental mandates.

While the Basel II and III standards have been issued to banking institutions, these policy requirements have yet to be extended to the DFIs. Notwithstanding, the capacity and capabilities of DFIs have been continuously strengthened to adopt the international standards and best practices.

DFIs have improved their overall performance and continued to play instrumental role in the respective mandated sectors, whilst leading the financial inclusion initiatives such as agent banking, micro financing, micro savings and SME financing.

Making the regulation proportional to risk increases the efficiency in the allocation of resources for both the supervisor and the supervised entities. This avoids overburdening financial institutions with requirements when they are not needed. Increased efficiency promotes financial inclusion, as it implies lower costs for all FSPs, especially those targeting low-income people as potential customers.

The AML/CFT Regulation is a comprehensive document that has evolved over time, in response to the need of fine-tuning the overall financial regulatory framework. This is critical to ensure that the regulation is conducive to financial inclusion.

Three regimes for KYC due diligence - simplified, general and enhanced

In determining which regime to adopt, an assessment of money laundering and terrorism financing (ML-TF) risk is made, based on risk factors that are explicitly set out in the Regulation.²⁰ As such, the KYC regime can be applied to diverse risks, allowing financial institutions to freely design products and services, and a regime that best fits the characteristics and risk of clients and products. This provides sufficient room and flexibility for innovation. The regimes mostly differ by the minimum information required to identify a client, with the subsequent verification and by the intensity of monitoring.

Simplified Regime, which applies to clients and products with proven low ML-TF risk, has the least requirements. General Regime is applicable to most clients and products, with standardized identification, verification and monitoring. Reinforced Regime²¹ entails more exhaustive and detailed KYC due diligence process.

As shown in Table 8, the Simplified Regime allows financial services providers to reduce the minimum information required for customer identification. Under this regime, clients are required to provide reliable document of identification - typically the National ID, which is used on a widespread basis in Peru.

¹⁹ First version of the approach was issued in 2011.

²⁰ the client, the products and services, together with the delivery channels, and the relevant geographic region.

²¹ and applies to all non-resident persons, trusts, politically exposed persons, persons involved in LA-TF related investigations or judicial processes, transfer recipients from countries not cooperating with FATF, among others.

TABLE 7

APPLICATION OF GLOBAL STANDARDS
> The regulation is consistent with 2012 FATF Recommendations, mainly Recommendation 1, where FATF advises the use of a Risk Based Approach (RBA). ²²
REGULATORY OBJECTIVES
> The objectives are twofold: <ol style="list-style-type: none"> 1 To increase the efficacy and efficiency of the AML/CFT system, abiding by international standards and best practices. 2 To ease the access to financial services, especially for low-income segments of the population, without affecting the integrity of the financial system.
> The regulation does not target specific sectors. It affects the relationship and interaction between diverse financial services providers (banking and non-banking institutions, cooperatives, insurance brokers and private pension funds) and their clients.
DATA USED TO INFORM IMPLEMENTATION
> To define regulatory thresholds in the Simplified Regime (described further below), data on per-capita income and expenses for different quintiles of income were useful to make inferences about the reasonable volume of transactions that are associated with diverse accounts.
> A survey was also extended to the insurance industry and the results were used to inform policies for the Simplified Regime.
> For monitoring purposes, firms report the number of basic deposit account holders and simplified e-money accounts.
CONSULTATIVE ARRANGEMENTS
> The views of standard setters were indirectly taken into account through the revision of published documents. In this regard, the KYC regime is aligned with international standards and best practices. In particular, the development of the regime benefited from FATF Recommendation 10.
> SBS also engaged supervised entities to clearly identify sources of inefficiencies and barriers of the AML/CFT regulation to their activities, especially those serving the small and low-income customers.

TABLE 8: MINIMUM INFORMATION REQUIRED FOR CLIENTS THAT ARE NATURAL PERSONS²³

SIMPLIFIED REGIME	GENERAL REGIME	REINFORCED REGIME
> Full name	> Full Name	> The requirements are larger than those contemplated in the General Regime.
> Type and number of ID	> Type and number of ID	> Information collected goes beyond the client, including the spouse (or partner) and relatives, up to the second degree of consanguinity and second of affinity.
> Address	> Address > Nationality and Residence > Phone number and/or email address > Purpose of relationship with the firm > Occupation and name of the employer > Identification of legal representative, if applicable	

TABLE 9: SIMPLIFIED REGIME: PRODUCTS DEFINED BY REGULATION

	MAXIMUM BALANCE	MAXIMUM DAILY DEPOSITS	MAXIMUM ACCUMULATED DEPOSITS AND WITHDRAWALS	OTHER CHARACTERISTICS
Basic deposit accounts	S/. 2000	S/. 1000	S/. 4000	Only one account per person
Simplified e-money accounts ²⁴	S/. 2000	S/. 1000 (limit per transaction)	S/. 4000	

Note: Client: Resident natural persons, Geographical: For contracting in the national territory only.

22 “to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified”. The recommendation is strong and it is suggested that a RBA “should be an essential foundation to efficient allocation of resources across the anti-money laundering and countering the financing of terrorism (AML/CFT) regime...”

23 Requirements for legal persons are also contemplated in the Regulation.

24 Can be opened remotely, with minimum requirements and subsequent automated verification.

The Simplified Regime can also be applied to low ML-TF legal persons. Minimum information required are:
(i) corporate name; (ii) tax payer registration number;
(iii) identification of legal representatives; and iv) business address.

There are two ways in which a product or service can be considered under the Simplified Regime:

- 1 Financial service providers can freely design and develop any product or service, and request SBS' approval to use the simplified regime, if the product has low ML-TF risk.
- > Financial service providers are required to provide information on the product characteristics, commercial and operative design, distribution channels, and the ML-TF risk management plan. The SBS may deny or grant approval with specific requirements.
- 2 Products or services may be defined by regulation, with established thresholds to ensure a low ML-TF risk.
- > Based on the limits specified, financial service providers may develop a suite of products and offer them without SBS' prior approval. Thus far, basic deposit accounts, simplified electronic money accounts and some insurance products have been defined by regulation, in 2011, 2013 and 2015, respectively.
- > Deposit and simplified e-money accounts are defined with specific characteristics and limits (Table 9).

In addition, after a thorough evaluation, SBS included a list of insurance products (Circular N° S-661-2016 of July 20th 2016) in the Simplified Regime. This includes mandatory and massive insurance products, micro-insurance, group insurance, credit insurance, life insurance (with some constraints), personal accident and health insurance, insurance contracted by employers in favor of their employees.

Outcomes

It is still early to trace the financial inclusion progress of implementing the due diligence regime scheme for KYC. Thus far, encouraging results have been observed in the insurance market.

The KYC regime scheme, which was first issued in 2011, has undergone fine-tunings. The most recent version came into force in July 2015. To some extent, it is still early to see full results of the regulation. The number of financial accounts contracted under the Simplified Regime remains small, albeit growing. Informal evidence derived from SBS' engagement with services providers suggests that simplified accounts have contributed towards attracting new clients. This is in view of reduced acquisition costs and increased products that have become more accessible.

E-money activity is in the early stages of development. To date, there is less than half a million of simplified e-money accounts but the numbers are increasing. However, real numbers will be observed as the e-market reaches more scale.

Although the KYC regime was only recently adopted for some insurance products, the industry's response was almost immediate. It is estimated that about 70% of existing insurance policies are based on Simplified Regime.

Industry response for basic deposit account, which was defined in 2011, is less desirable. This is mainly due to high implementation costs and difficulty in controlling the parameters that characterize the product. Furthermore, expectation of the development of simplified e-money activity may have contributed to the incipient use of the basic deposit accounts.

Key lessons learnt: Effective application of proportionality requires careful balancing by the regulator and effective dialogue with financial service providers.

Three key challenges have been identified in the implementation of the policy.

- 1 Many supervised entities are not clear about the risk-based approach. They encounter difficulties in developing the rating system required by regulation to score their clients, based on clear criteria that are consistent with the KYC regimes.
- 2 Different ML-TF risk factors need to be evaluated and risk levels may differ across the factors for the same clients. This creates complications for firms to integrate the analysis.
- 3 Firms are still struggling to engage all the areas of the firm in the ML-TF prevention. The sharing of information that are relevant to ML-TF risks across areas can be improved.

The regulator needs to evaluate cases where flexibility in the regulatory requirements would be needed to increase financial inclusion and at the same time, ensure that the flexibility would not compromise the stability or integrity of the financial system.

Before designing the policy, it is important to identify barriers that the regulation may be posing to market development and extension of financial services to low-income segments, while ensuring that AML/CFT objectives are met. In this regard, communication with financial services providers is crucial. Such dialogues allow the regulator to compare the information gathered with assumptions and to conduct evaluations to define realistic thresholds. Publication of draft regulation to obtain the public's feedback is critical to ensure smooth implementation and intended objectives are met.

The interaction between regulators and supervised entities should continue at the implementation stage. This is to ensure that all parties involved understand the objectives and approach of the regulation and take necessary actions for effective implementation. Moreover, it is possible that lessons from specific practices in the field may lead to further fine-tuning of the regulation.

TANZANIA

'Test and Learn' Regulatory Approach in Promoting Mobile Financial Services (MFS)

Tanzania has witnessed an unprecedented level of uptake of MFS, since such services came into use in 2008. These encouraging results have emerged, among others, from a conducive regulatory environment. The 'test and learn' approach allows the regulator to test the deployment of the service and monitor its developments. In this regard, the role of the regulator has been to support rather than stifle innovation, through understanding the risks that are inherent in such innovations and establishing the necessary risk controls.

Proportionality in Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) Regime in MFS

Tanzania has adopted a proportionate regime that allows mobile network operators (MNOs) to use agents to perform several critical functions and implement tiered consumer due diligence (CDD). Under this model, agents are responsible for facilitating cash withdrawals and deposits, registering users, and performing initial due diligence of new customers. They are required to comply with the MNOs' AML/CFT policies and are trained to follow specific procedures in the case of suspected fraud or money laundering. In the absence of national ID system in Tanzania, customers often use voter registration cards to validate their identity. Other valid forms of ID include pension cards, passports, employee cards, and a ward executive officer's letter.

The following are key considerations in practicing proportionality:

- 1 Role and potentiality of MFS in advancing financial inclusion:** MFS is considered a fundamental way to reduce financial services exclusion and informal payments. This, in turn, minimizes risks of money laundering and terrorist financing that may result from exclusion.
- 2 Simplicity and ease of adoption of the service by the unbanked masses:** The rural and urban underserved population has easily adopted the use of mobile phones, based on the use of feature and the Unstructured Supplementary Service Data (USSD) technology. Such technology can be used to deliver MFS.
- 3 Legal requirements for registration of subscriber identification module (SIM) card:** The Government passed a law that made it compulsory to register all SIM cards before use and those already in use had to be registered. Anonymous callers are also prohibited.
- 4 Audit trail that the technology provides:** Audit trails for all transactions are required and such data must be retained for more than seven years. This provides a healthy ground for law enforcement in AML/CFT intelligence and other operational risk mitigation.
- 5 Technologically imposed transaction limits and tiered customer base:** Platform-based transaction limits and structuring of customers are imposed based on the transaction limits from the system. This also allows for enforcements of such limits on a real-time basis.
- 6 The implementation of risk mitigation measures:** All transaction limits must be based on internal risk

mitigation measures of the service provider. This includes the adoption of governance and MIS controls to monitor and report suspicious transactions for AML/CFT compliance.

- 7 Reporting institutions:** MNOs must institute AML/CFT mechanisms and report suspicious transactions to the Financial Intelligence Unit (FIU), in accordance with the Anti-Money Laundering Act 2006 (AMLA).

In addition, management information systems (MIS) and institutional governance also serve as risk mitigation measures. This includes the following:

1 MIS

- > Automatic system block for transactions that exceed limits;
- > Audit trail reports of each customer's transaction;
- > Alerts;
- > AML System.

2 Institutional governance

- > Segregation of duties and clear approval procedures that are documented;
- > Existence of a risk mitigation unit;
- > AML/CFT compliance officer and reporting.

Outcomes

More than half of the adult populations are now users of mobile money accounts.

When mobile financial services came into use in 2008, only 11%²⁵ of the adult populations were users of formal financial services. This was less than the regional average of 24%. In comparison, more than 60% of adults had mobile phones and the global system for mobile communications (GSM) network coverage had then reached 80% of the land mass.

Following the exponential growth, more than 58% of adults in Tanzania now use mobile money accounts and access to MFS has reached over 98%.

Implementation of tiered know your customer (KYC) requirements

Transaction limits must commensurate with the risk mitigation measures deployed by MNOs. The applicable transaction limits and corresponding KYC verification requirements are set out in Table 10.

25 Of which, 9% and 2% of adults were using banking services and formal non-bank financial services, respectively.

TABLE 10

CUSTOMER CATEGORY	TRANSACTIONAL LIMITS			RISK MITIGATION MEASURES: KYC VERIFICATION REQUIREMENTS
	MAXIMUM TRANSFER SIZE (PER TRANSACTION)	MAXIMUM DAILY TRANSFER LIMIT	DAILY MOBILE WALLET BALANCE	
Tier I (Individuals) ²⁶	TZS 1 mil.	TZS 1 mil.	TZS 2 mil.	<p>Mobile money (e-money) transfers:</p> <ul style="list-style-type: none"> > Registered phone number and registered mobile money account user <p>Cash-in transactions:</p> <ul style="list-style-type: none"> > Registered phone number and registered mobile money account user > Acceptable photo ID <p>Cash-out transactions:</p> <ul style="list-style-type: none"> > Acceptable photo ID²⁷
Tier II (Individuals) ²⁸	TZS 3 mil.	TZS 3 mil.	TZS 5 mil.	<ul style="list-style-type: none"> > Pre-requisite for upgrading: MNO to verify KYC of the customer on the MNO systems. > Documents should include: <ul style="list-style-type: none"> - Acceptable photo IDs²⁹ - Registered phone number and registered mobile money account user
Tier III (Business entities, firms and institutions)	TZS 10 mil.	TZS 50 mil.	TZS 500 mil.	<ul style="list-style-type: none"> > Pre-requisite for upgrading: MNO to verify the KYC of the customer on the MNO system. > Documents should include: <ul style="list-style-type: none"> - Tax Identification Number - Business License Number - Acceptable photo IDs³⁰ - Registered phone number and registered mobile money account user
Tier IV (Individuals) ³¹	TZS 10 mil.	TZS 500 mil.	TZS 500 mil.	Same requirements as for tier III customers, and full business KYC (similar to compliance by banks)

26 Individuals who are either newly registered or transfer of funds to unregistered customer.

27 National ID; Voter's registration card; Employment ID; Social Security ID; or Letter from ward/village executive.

28 Individuals who have been upgraded through verification of KYC by MNO through internal AML/CFT controls including micro agents.

29 More than one of: National ID; Passport; Voter's registration card; Employment ID; Social Security ID; Letter from ward/village executive; Any other documentation that will assist in verification.

30 More than one of: National ID; Passport; Voter's registration card; Employment ID; Social Security ID; Letter from ward/village executive.

31 Collection and disburseable accounts transactions of business entities and customers.

UGANDA

The absence of a national identification card has been recognized as a key challenge for Government agencies to implement necessary intervention strategies to bring in the unbanked population into the formal financial system. Similarly, providers of formal financial services faced difficulty in serving customers with varying identification documents.

Against this background, biometric technology was adopted as a more secure and reliable means of identification, prior to accessing financial services. This technology utilizes specific physiological features of individuals (such as fingerprints, face and iris scans) and behavioral characteristics to determine authenticity. The technology is increasingly supporting financial inclusion, making it economically viable for financial institutions to reach poorer people.

Biometric identification system was a crucial first step to support financial inclusion

Government and the Bank of Uganda undertook the following reforms:

- 1 The Credit Reference Bureau (CRB) was established under the Financial Institutions Act 2004 to facilitate the sharing of credit information across financial institutions. Due to the lack of a unique national identification system at the time, the CRB service provider was mandated to develop a Financial Card System. The Financial Card System is an online, real-time system that captures biometric and other identification information on a financial card with built-in chip. It uniquely identifies individuals and companies for purposes of cross matching borrowers' credit profiles across supervised financial institutions.

As at end-June 2016, the Financial Card System was installed in 615 branches of supervised financial institutions and over 1 million financial cards have been issued to borrowers. Credit extension grew by 51% between 2012 and 2014, with groups previously excluded from the financial system (such as women and the youth) benefitting from greater access to credit facilities and other financial services within the country. For instance, between 2013 and 2014, loans granted to women aged between 18 to 25 years increased by 300%. During the same period, loans granted to women aged between 18 to 35 years increased by 86%. For the youth, credit issued to individuals aged below 25 years increased by 525%.

- 2 The National Identification and Registration Authority (NIRA) established a national identification register and issued national identity cards. In this regard, Bank of Uganda and NIRA are discussing the prospect of utilizing the biometric identification data in the National ID system for financial sector purposes. It is expected that going forward, the National ID biometric system will ultimately be the key identifier in accessing financial services and improving KYC processes. Additionally, it is envisaged that customers will be able to link their National IDs to electronic payments and receive salaries payments automatically, especially in remote areas of the country. This will in turn, further improve access to finance for good borrowers and enhance financial inclusion. As at end-June 2016, over 17 million Ugandans had registered and accessed the national identity cards.

Various initiatives undertaken to promote financial inclusion and financial literacy

Efforts include the following:

- 1 Between 2012 and 2015, Bank of Uganda initiated projects on Financial Inclusion and Financial Literacy that were aimed at increasing access to financial services and empowering users of financial services to make rational decisions in their personal finances. Provision of financial services in a sustainable manner remains a big challenge due to poor communications infrastructure and low levels of financial literacy. In addition, low population density renders the unbanked areas unattractive to the financial service providers, despite the evidence that the poor can also save, borrow and promptly pay their loans.
- 2 The Bank of Uganda Consumer Protection Guidelines 2011 and the Key Facts Document were issued to the financial sector in various local languages to further enhance financial literacy and increase transparency in disseminating information to consumers.
- 3 To avoid stifling innovations, Bank of Uganda further introduced guidelines to provide clarity to stakeholders on mobile money services. This was aimed at creating a flexible environment for low cost and convenient innovations to thrive. New delivery channels, such as mobile money transfers initiated by telecommunications operators, have been fully embraced and encouraged as mechanisms to enhance financial inclusion. Bank of Uganda interacts closely and regularly with external partners, such as the Ministry of Finance, Planning and Economic Development and the Uganda Communications Commission (UCC), financial institutions, mobile network operators and other relevant actors from the public and the private sector.
- 4 Bank of Uganda is also in its final stages of drafting regulations to support agent banking, which is a low-cost platform that promotes proximity and customers' access to financial services.

In conclusion, while biometric identification system is not the only method that will address all the issues that impede financial inclusion, it is indeed a crucial first step. By making it easier to document one's identity and financial track record, biometric identification improves Know Your Customer (KYC) processes and empowers wide segments of the population that were previously excluded from participating in formal financial transactions. In this regard, biometric identification is not only a starting point for innovations that will enhance financial inclusion, but also one of the biggest social experiments of our time.

REGULATIONS ON MICROLOAN INSTITUTIONS

BHUTAN

One of the primary development objectives as enunciated in the Royal Government's vision document, "Bhutan 2020: A Vision for Peace, Prosperity and Happiness", is to ensure that "the benefits of development are shared equitably between different income groups and regions, in ways that promote social harmony, stability and unity and contribute to the development of a just and compassionate society." Consistent with this vision, the **goal of financial inclusion** in Bhutan is to ensure that the poor, the vulnerable and the marginalized segments of the population increase their financial literacy and capability; and gain access to financial services that are tailored to their specific needs. Access to financial services can, in turn, contribute towards improving their livelihoods, raising income levels, reducing vulnerability, and bringing them into the mainstream of the economy and society as economically productive citizens.

This has resulted in the adoption of proportionate regulation and the creation of an enabling legal and regulatory environment to improve the access to the poor and low-income people. The Royal Monetary Authority of Bhutan (RMA) has actively worked to foster the development of an **inclusive financial system** that contributes to the country's goal of poverty alleviation through sustainable and equitable regional development. RMA has taken or is in the process of undertaking the following measures:

- 1 RMA has, in 2014, put in place the **Regulation for Microloan Institutions**. Under the regulation, RMA could bring Non-Governmental Organization (NGO) and entities engaged in lending activities into the formal financial system, by allowing them to register with the RMA for onward lending purposes.
- 2 **Agent-Banking Regulation**, focusing on agent banking by the licensed banks, came into force in November 2016.
- 3 **Regulation for Deposit-Taking Microfinance Institution** was implemented with effect from January 2017.
- 4 **E-Money Issuers Rules and Regulations** was implemented in 2017.
- 5 **Priority Sector Lending Guidelines** was implemented with effect from January 2018. This guideline is an integrated platform that will coordinate interventions from several Government agencies to stimulate the cottage and small industries (CSI) sector as an important driver of Bhutan's economic transformation, through improved access to finance.

Regulation for Microloan Institutions is an example where proportionality is applied.

Bhutan's financial sector has grown significantly over the last few years and has made substantial progress in terms of financial viability, profitability and competitiveness. However, there are concerns that it has overlooked a large segment of the population comprising of the poorer and weaker sections - especially those living in the rural areas.

Proportionality refers to an approach where regulation is proportional to the benefits and costs of the regulatory intervention, which implies that different

risks are regulated differently. It is typically based on an understanding of the gaps and barriers in the existing regulation. In the case of microloan institutions, the requirements as set out in Table 11 apply proportionality in practice.

Outcomes

The Regulation for Microloan institutions is relatively new and impact assessment is set for a later stage.

Microloan institutions have been registered as civil society organizations (Non-Governmental Organizations), which are not under RMA's purview. With the implementation of the regulation, RMA envisages to bring such institutions into the formal financial system. Thus far, three entities have registered with the RMA as microloan institutions.

Very little is known about the current micro clients and the number of potential future clients. This information gap is one of the bottlenecks to serve the target market well. A credit reference system, which is required under the regulation, to collect positive and negative information about microfinance clients at appropriate cost to the providers, is a positive development. This would not only reduce the risk of over indebtedness, but also allow clients to build a track record and thus, improve their creditworthiness.

Since this regulation came into force only in 2014 and players coming into existence in 2015, the RMA is yet to conduct an impact assessment. The RMA has developed a reporting template for microloan institutions to facilitate impact assessment at a later stage.

As the crucial financial policy maker of Bhutan, RMA has recognized two key barriers to financial inclusion:

- 1 Supply-side barriers, such as transaction costs, inadequate regulatory frameworks and other factors hindering the quality and quantity of financial services and products; and
- 2 Demand-side barriers that restrain the capacity of individuals to access available services and products.

RMA expects that these barriers would, to some extent, be addressed with the implementation of Regulation for Microloan institution. However, given the low level of financial literacy, RMA anticipates that a key challenge will be to develop the process of a financial literacy program to educate people in making sound financial decisions, and selecting products that best fit their needs.

TABLE 11

REPORTING

- > Every quarter, microloan institutions shall submit to RMA, details of its loan portfolio and donors with detail of funds received. The information shall be submitted in the manner prescribed by RMA.
- > The accounts of the microloan institutions shall be audited at the end of each financial year.
- > Microloan institution should seek RMA's approval in the event that there is a change in management and significant owners.

CONSUMER PROTECTION

- > Microloan institutions shall make adequate efforts to educate their clients on important terms and conditions of all their loan products.
- > While making a complete disclosure of the lending rates of all their loans and any other charges in the contract/documents signed with their clients, relationship officers of the microloan institutions shall also read out these terms before their clients.

COMPLAINT PROCEDURES

- > Microloan institutions shall set up effective procedures that allow microloan clients to submit complaints.

INSPECTIONS

- > Continuous surveillance shall be carried out by the RMA through inspection/examinations on the microloan institutions.
- > Whenever the circumstances warrant, such inspections shall be extended to agents, partners, and service providers or outsourced entities of the microloan institution, in view of their participation in the micro-lending business.

In developing the Regulation for Microloan institution, the following key aspects were considered:

APPLICATION OF GLOBAL STANDARDS

- > In developing the regulation, RMA has incorporated certain minimum standards set out in the core principles for Effective Supervision and other standards published by the Basel Committee for Banking Supervision (BIS).
- > RMA expects that the regulation will facilitate the implementation of prudent practices and effective risk management techniques by micro-finance institutions.
- > The regulation will also promote a level playing field for all market players, including transparency, accountability, corporate governance and fair competition.

REGULATORY OBJECTIVES

- > The regulation specifically targets the poor and people with low income, who are excluded from the mainstream formal financial system, namely - smallholder farmers; unemployed youth; self-employed artisans; those engaged in small scale production, processing and marketing of agricultural products; and micro and small enterprise operators.
- > This allows for the weaker sections of society to gain access to basic financial services. Thus far, only micro lending is covered under this regulation.

RISK ASSESSMENT UNDERTAKEN

- > The main risks considered for the implementation of this regulation include operational and credit risks.
- > Risk mitigation mechanisms include the following:
 - 1 Transparency and public disclosure by the microloan institutions are important to monitor their behaviors and affordability.
 - 2 Accurate disclosure and comparable information on the products and services would help consumers to make informed choices.
 - 3 Standardized information on financial and social performance of microloan institutions would help regulators to assess potential risks and the level of affordability, in line with the objective to meet financial sustainability.

DATA USED TO INFORM IMPLEMENTATION

- > Data submitted by the financial institutions (banks and insurance companies) were used for the implementation of this regulation.
- > While the available data is patchy, there was some evidence that only a minority of the population in rural areas has access to formal financial services. For example, while the agriculture sector (mostly rural) accounts for more than 17% of GDP as at end-June 2015, loans to the sector was less than 5% of the total loan portfolio of the financial sector.

CONSULTATIVE ARRANGEMENTS

- > Technical assistance was sought from the Asian Development Bank in developing the regulation.
- > The draft regulation was also posted on the RMA's website for one month for public consultation.

REGULATIONS AND SUPERVISION ON NON-BANK FINANCIAL INSTITUTIONS (SHADOW BANKING)

RUSSIA

Shadow banking (or the more preferred term, “parallel banking” or “parallel banking system”) in Russia makes financial markets more mobile but it needs supervision to maintain stability. The Bank of Russia (CBR) estimates that the size of this sector in Russia is not more than 5% of Gross Domestic Product (GDP) (i.e. 6 times lower than in developed countries) and 4.7% of the banking system.

The total amount of parallel banking institutions in 28 most developed jurisdictions in 2014 totaled \$36 trillion, or nearly 60% of consolidated GDP of these jurisdictions. The parallel banking segment mainly comprises non-banking financial credit intermediaries, and stock market institutions (brokers, dealers, microfinance institutions, credit cooperatives, and pawn shops).

Proportionate regulatory and supervisory approach taken to address systemic risks from parallel banking institutions

Several steps have been undertaken to improve systemic risk monitoring.

- 1 In mid-2013, the CBR became a mega regulator and was empowered with regulatory and supervisory mandate over non-bank financial entities. The integration of the Federal Financial Markets Service (FFMS) into the CBR led to improved data availability for systemic risk surveillance.
- 2 A Division for Analysis of Systemic Risks of Non-Credit Financial Institutions was newly created in the Financial Stability Department.
- 3 The National Financial Stability Council, a high level inter-agency body, was set up in 2013. The First Deputy Prime Minister of the Russian Federation chairs the council and its membership includes representatives of CBR, Ministry of Finance, Deposit Insurance Agency, Ministry of Economic Development and the Presidential Administration.
- 4 In November 2014, the Financial Stability Committee was established in the CBR. The Governor chairs the Financial Stability Committee and its function, amongst others, is to monitor and assess risks of the financial system.

Currently, CBR supervises the following financial institutions that fall under the broad definition of shadow banking:

- > Investment funds;
- > Microfinance organizations;
- > Consumer credit co-operatives;
- > Agricultural consumer credit cooperatives;
- > Pawnshops;
- > Professional market participants.

The following are some examples of the Proportional Regulation and Supervision in Russia:

1 Amendments of the legislation on consumer loan and microfinance activity

The CBR now regulates four categories of the professional creditors (banks, credit co-operatives, microfinance organizations and pawnshops). These institutions are subject to different set of requirements and scope of activities, taking into account risks related to the acceptance of deposits.

2 e-Money

The requirements are less stringent than banks. The authorized capital requirement is RUR300 million for a credit institution, and RUR 18 million for non-credit institutions.³² In addition, the balance thresholds for corporate and personified/personalized electronic payment instruments were increased, and the simplified identification was introduced.

Further efforts underway to enhance data collection on non-bank financial institutions

Information collection for the purposes of identifying and monitoring systemic risks is carried out within the framework of mandatory reporting and supervision on non-bank financial institutions. In addition, CBR also conducts ad hoc and regular surveys of non-bank institutions and cooperates with self-regulated organizations (e.g. cooperates with National Securities Market Association to obtain information on brokers and dealers).

CBR also cooperates with financial market infrastructures to identify and monitor systemic risks. The central bank has the right to request information on organized trading from the trading organizers. In this regard, CBR and the Moscow Stock Exchange have entered into an agreement, which allows CBR to have online access to the datamarts relating to trading activities on the Moscow Stock Exchange.

CBR also aims to increase the depth and scope of the data on non-credit financial institutions. Several projects have been implemented to improve the reporting system:

- 1 **Unified reporting form.** Non-credit financial institutions will migrate into a unified reporting form that will be common to all financial institutions. Broker-dealers, non-governmental pension funds and insurance companies were expected to migrate into the unified reporting form by 2017, and microfinance institutions by 2018.
- 2 **Unified accounting standards based on International Financial Reporting Standards (IFRS).** It is expected that the unified supervisory requirements be harmonized with IFRS and the integral package of accounting, supervisory and statistical reporting requirements (including audit and actuarial report).

³² who can carry out funds transfers without opening the account and transactions related to it.

3 Unified international standards for financial, supervisory and digital business data transmission. Non-credit financial institutions can rely on the data model that includes reporting form description, help and infrastructure libraries, matching rules and data validation (xbrl code).

The implementation of a unified data-reporting standard for non-credit financial institutions seeks to achieve the following objectives:

- > Eliminate double-counting and redundancy in data reporting;
- > Enhance data quality and consistency through harmonization and process automation;
- > Promote transparency and accessibility of financial data for all market participants; and
- > Harmonization of data sharing standards to facilitate domestic and international data dissemination.

CAMBODIA

The Financial Stability Board (FSB) defines shadow banking as “credit intermediation involving entities and activities (fully or partially) outside the regular banking system.” These non-bank financial institutions range from the sophisticated, such as insurance, private equity, leasing and finance companies, to the less sophisticated, such as financial cooperatives, microfinance and pawn shops. Similarly, the financial activities and products offered range from sophisticated derivatives to basic loans. Following the 2007 financial crisis, shadow banking has risen to \$71 trillion globally, as at end-2012, representing half of total global banking assets.

Shadow banking in Cambodia is not significantly different from global developments. More than 200 non-government organizations (NGOs) provide microloan to rural people and they register with the National Bank of Cambodia (NBC), as required under the law. Their loan portfolio is estimated at \$2 billion or 20% of the total loan portfolio of the banking system.

While regulations have been put in place for formal banking sector, not as much have been done for the shadow banking sector. One of the main reasons for the increase in shadow banking activities is regulatory arbitrage. Increased regulations for the formal banking sector creates incentives for financial institutions to undertake in shadow banking activities, which is lightly regulated or unregulated.

Drivers and extent of shadow banking in Cambodia

The increase in shadow banking is driven by the following factors:

- 1 Lenders respond to tighter rules and regulations by seeking alternative sources of funding and channeling lending outside the purview of the central bank.
- 2 Difficulties faced by small borrowers in obtaining loans from formal banking and financial institutions create niche markets for shadow banking lenders.
- 3 Some NGOs, who have been operating under the umbrella of social charity, have advantage over regulated entities and borrowers.

Benefits and risks of shadow banking

Shadow banking can provide benefits to the real economy by extending credit to specialized sectors (such as agriculture and micro financing) and providing large investors with alternatives to bank deposits. However, shadow banking activities are not subject to the same degree of regulation and supervision as the formal sector and hence, can potentially pose systemic risks to the financial system. These risks can arise through direct and indirect linkages between shadow banking and the banking system. Direct linkages can take the form of funding interdependence, whereby banks provide credit facilities to shadow banks or take deposits from shadow banks. Banks and shadow banks can be indirectly linked when they invest in similar assets, lend to the same set of clients, or are exposed to the same counterparties. A default in one sector can result in contagious effects. Finally, shadow banking activities can undermine the effectiveness of macro-economic management and monetary policies. In an ample liquidity environment, NBC may face challenges in controlling monetary policies by changing interest rates or managing money supply.

At present, shadow banking activities in Cambodia account for 15% to 20% of total loan portfolio. Shadow banking institutions and products tend to be more traditional and simpler, and their inter-linkages with other parts of the financial system are less complex. The main challenge is to gather reliable data and bring them under better regulation and to reduce the fragmentation of oversight by different regulatory authorities. While these shadow banking activities are not, or less supervised and regulated by the NBC, there is a need for more effective supervision and regulation, and better coordination among all stakeholders.

Next steps

The NBC and policymakers are cognizant of the growing significance of shadow banking and are looking at implementing measures to better monitor such activities by encouraging them to be operationally regulated and supervised.

MOZAMBIQUE

Shadow banking refers to all the non-bank financial intermediaries that provide services similar to traditional commercial banks. Generally, they generally carry out traditional banking functions, but do so outside the traditional system of regulated depository institutions. Shadow banking may complement traditional banking in different ways, such as expand access to credit in supporting economic activity, risk sharing, supporting market liquidity or maturity transformation. Despite the potential benefits to the real economy, shadow banking may pose risks to financial system stability, as revealed during the global financial crisis (please refer to Info Box 4 on International Regulatory Initiatives on Shadow banking).

Typology of Financial Institutions in Mozambique

Based on the Banking Law (Law 15/99 amended by Law 9/2004,) there are two types of institutions in Mozambique, namely, credit institutions and finance companies (Table 12).

TABLE 12: TYPOLOGY OF FINANCIAL INSTITUTIONS IN MOZAMBIQUE

CREDIT INSTITUTIONS	FINANCE COMPANIES
> Banks	> Finance brokerage companies
> Finance leasing companies	> Brokering firms
> Credit cooperatives	> Investment fund managers
> Factoring companies	> Property management companies
> Investment companies	> Venture capital companies
> Micro banks in different forms permitted under applicable legislation	> Group purchase managers
> Electronic currency institutions	> Credit card issuers or managers
> Money lenders	> Foreign exchange bureau
> Save and loans organizations	> Discount houses
> Other firms	> Other firms

The Mozambican financial system is simple and less sophisticated. The amendment to the Banking Law in 2004 has allowed for the establishment of several entities that are considered in many literatures as shadow banking, such as: (i) finance leasing companies, (ii) factoring companies; (iii) investment companies; and (iv) investment fund managers. However, such entities have not yet operated in Mozambique.

Up until 2005, finance leasing was undertaken outside bank activities due to regulatory constraints. As a result, many banks created their own finance leasing companies. Following the amendment of the Banking Law, all finance leasing companies operating in Mozambique have merged with the banks.

Shadow banking in Mozambique falls within two categories - formal entities and underground entities:

Due to data limitations, the aggregate estimate on the size of shadow banking in Mozambique is presently not available, but it is likely to be small compared to the size of the financial system. The scanning and mapping of shadow banking in Mozambique, based on the Financial Stability Board (FSB) framework, also indicates that entities operating in Mozambique are not involved in the economic functions identified within the FSB shadow banking framework (please refer to Info Box 5 on Scanning and Mapping of the Overall Shadow Banking System in Mozambique based on Financial Stability Board framework).

In Mozambique, entities that are considered as shadow banking are set out in Table 13 below:

TABLE 13

FORMAL ENTITIES	UNDERGROUND ENTITIES
> Money Lenders	> Accumulating Saving and Credit Associations (ASCAS)
> Save and Loans Organizations	> Associations of Rural Finance (RFAs)
	> Rotative Saving and Credit Association (ROSCA)
	> Rotating Credit Groups (PCRs)
	> Some Ponzi Schemes (recently closed by the authorities)

Formal Entities

Central Bank of Mozambique does not prudentially regulate Money Lenders, and Save and Loans Organizations. These entities report a few data items (such as, total of loans, number of beneficiaries and charged interest rate) once a semester. Some operators, however, have not provided this information. For those that reported, most data were inaccurate or not regular. Based on available data from the formal entities, the total outstanding loans of this sector are about 0.14% of the total assets of banking system.³³

The following entities are not classified as shadow banks:

- 1 GAP, an Investment Company, is licensed and supervised by Central Bank of Mozambique as a bank. The entity is subject to Basel II prudential regulation due to the nature of its main operations (loans).
- 2 Some government agencies are also involved in lending activities. Loans are disbursed through these agencies as part of the sectorial development strategies sponsored by the Government. The sectors include energy (National Energy Fund - FUNAE), Agriculture (Agriculture Development Fund), local development (Local Development Fund), and real state promotion fund. Although these funds are involved in lending, they are not considered shadow banking, as they do not represent credit intermediation.

³³ Total assets of Mozambican Bank System was 625.888.014.290.00 mozambican meticals in February 2016 (Source Banco de Moçambique).

Underground Entities

Underground entities provide credit to many people and economic activities. Information on the assets of underground entities is scarce due to the informal nature of their operations. It is believed that the assets of these operators are sizeable in comparison to the formal entities.

Quantifying risks to financial stability emanating from shadow banking is a major challenge due to lack of data.

Overall risk to financial stability emanating from formal entities (money lenders, and save and loans organization) is assessed to be low. Available data on formal entities suggests that the scale of their operations is small and they are not highly interconnected with the regular banking system. However, inaccurate and irregular data reporting pose challenges. For underground entities, quantitative information is largely unavailable. Another key point is that many entities prescribed in the Banking Law (and classified as shadow banking globally) have not operated in Mozambique. This currently mitigates risks.

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INFO BOX 4: INTERNATIONAL REGULATORY INITIATIVES ON SHADOW BANKING

Paul McCulley in 2007 coined the term “Shadow banking” with specific reference to American non-bank financial institutions that used short-term deposits to finance long-term loans. Later, the Financial Stability Board defined shadow banking as the ‘credit intermediation involving entities and activities (fully or partially) outside the regular banking system’.

The following are some international regulatory initiatives on shadow banking:

- 1 Financial Stability Board (FSB), published in 2011, recommendations to strengthen oversight and regulation of shadow banking.
- 2 Basel Committee on Banking Supervision (BCBS), published three years later, a revised supervisory framework for measuring and controlling large exposures, which includes exposures to shadow banking entities.
- 3 European Banking Authority (EBA), published in December 2015, guidelines to monitor the limits on exposures to shadow banking entities, which carry out banking activities outside a regulated framework under Article 395(2) of Regulation (EU) No 575/2013.

In view that the shadow banking system varies across jurisdictions and evolves over time, the FSB highlighted that there are many ways to monitor this system. In 2011, the FSB developed high-level principles for monitoring shadow banking. The proposed monitoring approach comprises the following stylized steps:

Step 1: Scanning and mapping of the overall shadow banking system;

Step 2: Identification of the aspects of shadow banking system that poses risks or regulatory arbitrage concerns; and

Step 3: Detailed assessment of systemic risk and/or regulatory arbitrage concerns.

In 2015, the FSB introduced a new, more risk-based framework for shadow banking. This framework limits the inclusion of institutions without shadow banking risk.

INFO BOX 5: SCANNING AND MAPPING OF THE OVERALL SHADOW BANKING SYSTEM IN MOZAMBIQUE BASED ON THE FINANCIAL STABILITY BOARD FRAMEWORK.

The Financial Stability Board (FSB) broadly defines shadow banking as a system of credit intermediation involving entities and activities outside the regular banking system. Based on this broad definition, non-banks (with exception of insurers and pensions) are considered part of the shadow banking system only if they

- (i) are part of a credit intermediation chain;
 - (ii) are not subject to bank or comparable financial supervision; and
 - (iii) perform activities entailing bank-like risks, such as liquidity and maturity transformation risks, and leverage.
- Financial institutions that meet these criteria are then subdivided in five functions.

Other Financial Intermediaries (OFIs) sector can be used as a starting point to analyze shadow banking. OFIs comprise all financial institutions, except banks, insurers and pension funds. Table 14 maps out shadow banking in Mozambique using this approach.

TABLE 14: ECONOMIC FUNCTIONS WITHIN FSB SHADOW BANKING FRAMEWORK

ECONOMIC FUNCTION (EF)	DEFINITION	TYPICAL ENTITY TYPES	ENTITIES OPERATING IN MOZAMBIQUE
EF1	Management of collective investment vehicles with features that make them susceptible.	Fixed income funds, mortgage funds, money market funds, and hedge funds.	None
EF2	Loan provision that is dependent on short-term funding.	Finance companies, leasing companies, and credit unions.	None
EF3	Intermediation of market activities that are dependent on short-term funding or on secured funding of client's assets.	Brokers dealers.	None
EF4	Facilitation of credit creation.	Financial guarantors.	None
EF5	Securitization-based credit intermediation and funding of financial entities.	Securitizations vehicles.	None

Based on the above, the Mozambican financial system appears to be simple and less complex. The amendment to the Banking Law in 2004 has allowed for the establishment of several entities that are considered in many literatures as shadow banking, such as:

- (i) finance leasing companies,
- (ii) factoring companies;
- (iii) investment companies; and
- (iv) investment fund managers.

However, such entities have not yet operated in Mozambique. Up until 2005, finance leasing was undertaken outside bank activities due to regulatory constraints. As a result, many banks created their own finance leasing companies. Following the amendment of the Banking Law, all finance leasing companies operating in Mozambique have merged with the banks.

DE-RISKING AND SUDAN'S OBSERVATIONS

The de-risking phenomena can have profound adverse consequences and seriously slow down financial inclusion efforts and advancement, especially in developing countries, such as Sudan. While formal data on the breadth and magnitude of de-risking may not be available, anecdotal evidence points to a somber situation on multiple accounts.

Domestically, banks have a view that specific financial services, such as personal remittances, are rather expensive to operate. Banks are subject to Know Your Customer (KYC), Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) and other international standards and requirements. Such transactions are voluminous, typically small, and generate low income. For small banks, as those in Sudan, such transactions can eat into their slim profit margin, hence creating the tendency for banks to forego such businesses.

On the other hand, customers may find banks' processes not attractive, in terms of money and time spent. They may seek less cumbersome and more convenient alternatives. Ultimately, those who already have official bank accounts may cease using them and others may be discouraged to open an account. In this regard, financial inclusion may not live up to its potential but instead, reduce it. Fortunately, this has not been observed thus far. However, the likelihood remains, at least theoretically.

The rate of smart cell phone penetration in Sudan is high and the coverage is impressive. However, the same telecommunication medium is often used as a means for money transfer. Cell phone money transfers are mostly done via telecommunication agents that are not currently regulated. The Central Bank is looking into developing appropriate frameworks for regulating this emerging industry. In the meantime, de-risking is driving gradual growth in the informal financial sector.

At the international level, the impact is more evident. As banks and financial institutions implement international standards and conform to global requirements, they tend to be more risk-averse. As such, appropriate correspondent bank relationships are sometimes terminated on the pretext of weak AML/CFT controls in the respondent bank.

There are various key drivers of de-risking, such as:

- (i) considerations on overall profitability;
- (ii) implementation of unilateral and bilateral regulations, such as the United States of America's Office of Foreign Assets Control (OFAC) and Foreign Account Tax Compliance Act (FATCA) laws;
- (iii) avoidance of reputational risks, such as AML/CFT and tax, and
- (iv) increase in compliance costs.

These key drivers of de-risking, which are affecting Sudan, often leads to loss of correspondent account relationships and impedes payments for imported goods and services.

Some financial displacements are taking place as de-risking continues, including foreign currency markets' move abroad. In addition, domestic payment transactions are shifting towards the informal sector, such as travelers carrying cash by hand and the use of informal money remitters.

Given that most drivers of de-risking are exogenous, policy response and maneuvering at the national level is understandably limited.

ANNEX

ANNEX 1: KL RESOLUTION ON PROPORTIONALITY IN PRACTICE

Participants to the Symposium:

- > **Reinforced** the importance of the principle of proportionality in advancing a balanced approach to financial inclusion, stability and integrity;
- > **Welcomed** the progress that has been made by the global standard-setting bodies (SSBs) to incorporate the principle of proportionality into their work;
- > **Commended** the efforts that have been initiated by some countries to implement proportionality in practice, which has improved the wellbeing of the poorest, by widening access to basic financial services, strengthening financial stability and integrity;
- > **Recognized** that challenges in achieving proportionality in practice remain and therefore, that the number of countries, which have effectively implemented proportionate approaches, is relatively low;
- > **Noted** that a common challenge is the lack of capacity by regulators, supervisors, and financial institutions to implement proportionate approaches; and
- > **Expressed concern** that the acceleration of de-risking by international banks could have potentially harmful consequences for financial inclusion and practical solutions should be sought through dialogue between the public and private sectors, and between regulators.

The Symposium Accordingly Calls for:

- 1 **Gathering** of data and evidence on the impact of implementing global financial stability standards in developing countries, highlighting the costs of unintended consequences and the benefits from proportionate approaches;
- 2 **Documentation** of successful regulatory and supervisory approaches to implementing proportionality (e.g. tiered KYC requirements, internal rating based approach to accurately define risk weights for SMEs);
- 3 **Communication** of such practices to stakeholders, including regulators, supervisors, SSBs, international organizations and financial institutions;
- 4 **Support** from international organizations and donors to build the capacity of regulators, supervisors, assessors and financial institutions to implement proportionate approaches;
- 5 **Public-private cooperation** at a national, as well as global level, to advance the implementation of proportionate approaches;
- 6 **Leveraging** on technology as a driver for achieving financial inclusion in a safe and sound manner, and complementing proportionate regulation;
- 7 **Continuation** of peer learning for successful approaches to implementing proportionality globally; and
- 8 **Encouragement** to SSBs to continue integrating proportionality in practice into their work.

ANNEX 2: POLICY AND REGULATORY CHANGES ON GLOBAL STANDARDS PROPORTIONALITY

In 2017, 11 regulatory reforms were reported from 8 countries (Table 15). These reforms were mainly around developing proportionate AML/CFT frameworks and simplified KYC rules.

With regards to identification, Afghanistan set up a biometrics identity system, while Mexico established rules to apply biometric identification procedures when opening accounts, in order to address identity theft. Jordan on the other hand reported setting up a KYC regime for Forcibly Displaced Persons (FDPs).

A number of reforms reported were on aspects that relate to rules and guidelines for setting up basic bank accounts, which targeted low-income individuals. This was the case in São Tomé e Príncipe, Mozambique, Philippines and Thailand. In the Philippines, Bangko Sentral ng Pilipinas (BSP) issued a circular for a no-frills deposit account with low opening fees and no dormancy charges, and in Mozambique regulations were reviewed to revise the minimum age of opening a bank account. These measures were intended to remove account-opening barriers for the un-banked and underbanked, and increase the number of people with access to financial services.

TABLE 15

	COUNTRY	POLICY AND REGULATORY CHANGE
1	Afghanistan	Set up a biometrics ID system.
2	Bangladesh	Issued instructions to be followed by institutions engaged in mobile financial services for the prevention of money laundering, terrorist financing and proliferation financing.
3	Jordan	Set up KYC regime for FDPs.
4	Mexico	Identity theft: This regulation sets the rules to apply biometric identification procedures when opening accounts or credits.
5	Mozambique	Regulation that include minimum age of opening bank account to increase the level of people with bank accounts.
6	Philippines	Basic Deposit Account is an affordable savings product with low opening amount and maintaining balance, and no dormancy charges. The reserve requirement for this type of deposit is 0% so that banks will also be encouraged to offer it to broader markets. This no-frills deposit account will allow every Filipino to not only save and manage their finances but also serve as a gateway for everyone to transact in the digital finance ecosystem.
7	Philippines	Branch-lite (BSP Circular No. 987) - Branch-lite units can provide a wide range of products and services suited for servicing the needs of the market. With simplified and more flexible provisions, banks will be better able to expand in areas that are unbanked and underserved.
8	Philippines	Risk-based and technology-enabled KYC (BSP Circular No. 950) - This allows covered institutions to implement reduced KYC rules for certain low-risk accounts and use technology for face-to-face contact requirements. These amendments will facilitate frictionless customer onboarding, which is currently a major pain point for those serving the low-income segment.
9	Philippines	Enhanced regulatory framework for money service business (BSP Circular No. 942) - Recognizing the role of remittance and transfer companies in the provision of basic financial services, especially to the unbanked, the BSP enhanced existing regulations to ensure that MSBs are properly supervised for their effective compliance with AML and internal control rules and guidelines.
10	São Tomé e Príncipe	Developed regulations to incentivize financial institutions to ease the process of account opening by customers (Nr 20/2017 - Procedimento para Troca da Dobra nas Instituições Financeiras).
11	Thailand	Bank of Thailand together with the Thai Bankers Association is working on the implementation of a Basic Banking Account (BBA) policy, which aims to improve financial access and promote the savings behavior of those with low incomes. As a result, financial institutions will offer fundamental financial products and services at more reasonable prices, and at a reduced cost for targeted segments.

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