Financial access: What has the crisis changed?

Penelope Hawkins

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Introduction

The global financial crisis and the recession have provided an opportunity to reflect on the role of firms, markets and central banks. As the crisis has shown, while access to inappropriate credit may undermine financial stability, the view put forward here is that provision of appropriate products to consumers in general is a necessary condition for successful implementation of financial stability measures. The paper identifies approaches that may promote appropriate access by central banks and highlights some African success stories.

Access lessons from the crisis

The financial crisis has become known as the sub-prime crisis. It can be viewed as a consequence of mortgage extension to low-income households and emerged as the core of a huge bubble of mis-selling, irresponsible credit granting and inappropriate re-bundling of assets. Incentives on both the demand and supply side contributed to the crisis.

While inappropriate inclusion was a characteristic of the sub-prime crisis, this does not invalidate the importance of appropriate access to financial services. Many developing countries have financial inclusion as an explicit objective, and it is argued here that this objective can and should withstand the fallout of the crisis. Moreover, while inappropriate financial access may impinge on stability of the system in unexpected ways, countries are likely to be vulnerable to poor market outcomes where households and small businesses lack appropriate financial inclusion. For example, individuals' educational and occupational choices are limited by accumulated wealth – and access to appropriate financial services can crucially facilitate such accumulation. Moreover, decisions relating to occupational choice - such as whether people become entrepreneurs or remain wage earners can determine their ability to save and invest, and can have long-run implications for growth and income distribution[1]. The case for access is not only a matter of equity, but also growth – and hence stability.[2]

Central banks can play a role in providing guidance for the market through appropriate regulation. Traditionally, banks have high unit costs, which has meant that - even although they have the advantages of incumbency - they have been slow to provide products with costs and services adapted to the needs of low-income individuals. In order to enhance both appropriate access and stability, a regulatory approach that is aware of and open to innovation is needed. In particular:

– Regulation and rules need to flow from the risk assessment of innovation and need to be proportionate. Rules of participation may need to change to allow for the possibility of a diversity of players and channels in delivering financial provision. One might describe this as risk-sensitive regulation.

– Regulatory processes need to facilitate innovation by being open to the need for, and possibility of, change. This may involve listening to and evaluating innovations that are beyond existing regulatory boundaries. One might describe this as enabling regulation.

– Regulation needs to promote responsible provision of financial services. This means that consumer protection needs to become the focus of regulator, provider and consumer alike. Aspects such as disclosure, transparency, education and redress need attention. But specific attention to the type of provision is also important. In particular, provision of saving facilities - where fees do not erode capital - is indicated. One might describe this as regulation for responsible provision.

The discussion below will explore each of these aspects. An overview of financial access in African countries is provided first.

Financial access in Africa

Financial access, also known as financial inclusion, goes substantively beyond access to credit, and includes access to appropriate savings products, payments services and insurance. Successful inclusion implies sustained usage and offers choice to consumers. So for example, a consumer with an appropriate savings product may be able to accumulate funds that limit the need to borrow when household shocks occur.

Since the first BIS meeting of African Governors in 2006, financial access has gained momentum in many developing countries. More than half of the 23 African countries shown here have an explicit financial inclusion policy[3]. However, these improvements come from a low base, and there is need for further improvement still.

The table below sets out access indicators as measured by the outreach of commercial bank branches per 100,000 adults, the number of ATMs per 100,000 adults and the geographic distribution of ATMs per 1000 square km. The focus here is on banking services, as many regard a bank account to be the first step in formal financial services provision. The emphasis on ATMs is pertinent given that customer evaluation of bank services is strongly

[1] Demirguc-Kunt, Beck and Honohan, 2008

[2] Mr. I Shiimi, 2010.

[3] CGAP, World Bank , 2010

associated with the bank's ATM services – in particular, the proximity and fees associated with ATM services[4].

Table 1
Financial access measures across African countries

Country	Number of commercial bank branches per 100,000 adults		ATMs per 100,000 adults		ATMs per 1000 km^2	
	2005	2009	2005	2009	2005	2009
Algeria	4.8	5.4	1.5	5.8	0.1	0.6
Angola	0.8	0.6	1.7	9.6	0.1	0.8
Botswana	6.4	8.8	9*	21.5^	0.3	0.5^
Democratic rep of Congo	1.8	2.4	0.2	1.3	0.0	0.1
Egypt	3.6		1.8	..	1.2	..
Ghana	3.0	5.1	..	4.8^	..	3.0
Kenya	2.6	2.5	1.6	7.5	0.6	2.9
Lesotho	2.4	2.3	3.7	6.6	1.4	2.7
Madagascar	1.2	1.6	0.7	1.4	0.1	0.3
Malawi	1.8^^	2.2^	..	2.7^	..	2.2^
Mauritius	20.5	23.2	33.4	39.1	154.2	187.7
Morocco	10.5	15.8	15.8*	18.6^	..	9.3^
Mozambique	2.0	2.9	..	4.9	..	0.8
Namibia	7.3	7.5	12.1*	30.3	0.3	0.5
Nigeria	1.6	6.4	..	..	..	..
Rwanda	1.0	2.3	0.2	0.8	0.5	1.9
Seychelles	30.2	34.5	25.3	34.5	45.7	65.2
South Africa	7.2	8.1	25.4	52.4	6.7	14.5
Swaziland	5.8	5.7	11.5	18.7	4.4	7.6
Tanzania	1.2	1.9	0.6	3.4	0.1	0.9
Tunisia	12.4	15.5	9.8	17.7	4.7	9.0
Uganda	0.5	2.3	1.4	3.3	0.9*	2.7^
Zambia	1.5	3.6	0.7	6.4	0.1*	0.6^
Average	5.84	7.54	7.46	14.33	13.77	18.66

Source: (Unless otherwise indicated) IMF Financial Access Survey. www.fas.imf.org

* Beck,T, Demirguc-Kunt, A and Martinez Peria, M S, 2006

^ CGAP, World bank Financial access 2010

^^ CGAP World Bank, Financial access 2009

Table 1 shows that in every country, access to financial services in terms of both demographic and geographic measures has improved. In some cases, the improvement has been very marked. For example, in eleven of the 23 countries, the number of ATMs per 100,000 people has more than doubled over the five year period. In the Congo and Zambia, the increase has been more than fivefold (albeit from a low base).

[4] Competition Commission of South Africa, 2008; Feasibility, 2009

These data only provide part of the picture, however. In the first instance, they provide information about the supply of services, rather than the up-take or use of financial services. Data for the number of deposit accounts at commercial banks per 1,000 adults provide a better indicator of actual usage (shown in Table 2), and this is supplemented with an estimate of the percentage of consumers who use financial services, sometimes referred to as the Honohan index[5].

Data for numbers of bank accounts per 1,000 adults range from a low of 21 per 1,000 for Congo and 28 for Zambia (no data for Egypt), to 2,109 for Mauritius. The high value reported by Mauritius emphasises that the data tell us about number of accounts, not unique depositors. Moreover, as an off-shore financial centre, Mauritius has also attracted many foreign deposits.

Once again, this is not the whole story, as commercial banks are only one source of deposit accounts for example. For example, in some countries, where the number of banks accounts per 1,000 adults is very low, other providers, such as cooperative banks and state institutions may boost the level of formal financial inclusion. For example, Kenya, Mauritius, Seychelles and Uganda all have robust co-operative banking sectors that serve more than 5% of the population. In other countries, specialised state financial institutions provide accounts with deposit and saving services, if not credit. Countries in this category include Botswana, Morocco and Tunisia.

The data on levels of inclusion (data missing for Seychelles) show a high degree of variability across the countries in the sample. Twelve countries have more than the Sub-Saharan average of 20% of their adult population making use of formal financial services. This includes Malawi with 21% and Tunisia with 42%. Only three countries, namely Botswana, Mauritius and South Africa have financial inclusion levels that exceed the world average of 46%[6].

In general, the data in the table and figure suggest improvement in levels of financial inclusion in many African countries, but that there is much still to do. A starting point for a number of countries has been commitment to an explicit financial inclusion strategy. Some 13 of the countries (56%) listed here have an explicit strategy to address access (World Bank, 2010). The next section highlights some general principles and some success stories.

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[5] Patrick Honohan's estimate of the % of adults using financial services is incorporated in the IMF's Financial Access data.

[6] Thresholds for sub-Saharan Africa and the World are from the World Bank 2010.

Table 2 Indicators of financial usage (2009)

Country	Number of depositors with commercial banks per 1,000 adults	Financial inclusion (use of financial services)
Algeria	385.3	31.0%
Angola	132.20	25.0%
Botswana	506.3	47.0%
Dem. Rep of Congo	20.9	1%*
Egypt	..	41.0%
Ghana	332.3	19%*
Kenya	379.3	29%*
Lesotho	254.4	17.0%
Madagascar	45.2	21.0%
Malawi	163.4	21.0%
Mauritius	2,109.0	54.0%
Morocco	265.28	39.0%
Mozambique	140.5	12.0%
Namibia	752	28.0%
Nigeria	461.02^	15.0%
Rwanda	226.2	23%*
Seychelles	330.2	
South Africa	839.1	49%*
Swaziland	463.9	35.0%
Tanzania	134.7	16%*
Tunisia	639.7	42.0%
Uganda	173.2	21%*
Zambia	27.6^	15.0%
Average for sub Saharan Africa		20%
Average for world		46%

Source: (for number of accounts): IMF Financial Access Survey www.fas.imf.org and ^CGAP, World bank Financial access 2010

Source: (for number of accounts): Financial access initiative, 2009 and *Gallup surveys, 2010 www.gallup.com

Central banks and financial inclusion

Central banks are traditionally charged with ensuring financial soundness and stability. However, given that appropriate access and stability can be mutually reinforcing, many central banks are looking for ways to promote improved access within their primary objective of a safe, stable and efficient system. The discussion below highlights regulation that is risk-sensitive, enabling and that promotes responsible provision.

(a) Risk-sensitive regulation

Technology (and demand for its services) continually drives innovation – witness, for example, the revolution in mobile phone banking. There are two key elements that central banks need to be aware of - the risks that an innovation may pose to the soundness of the system - compared to its potential access benefits - and the risks of regulation compared to leaving the innovation unregulated. This last may involve extending the regulatory margins of central bank authority.

Central banks that seek to promote financial inclusion have to consider how innovation might impinge on the soundness of the system at the same time as evaluating the potential benefits of the innovation to extending financial services to more consumers. Based on this evaluation, proportionate regulation needs to be designed and implemented.

Governor Fundanga of Zambia, for example, has said:

> *Nevertheless, regulation should facilitate and not impede development and must create an optimal, dynamic and agile banking environment. As Regulators we must therefore be open minded to new market solutions while the developers need to constantly engage the regulator in their product development.*[7]

Of course, central banks may choose to turn a blind eye to innovations and hope that if there is failure in the unregulated segment of the sector, there will be no reputational risk to the broader financial sector and only minimal losses to citizens. Extending the regulatory margins to providers and products that offer near-substitutes for banking products may be justified if it is likely that the product offerings meet a consumer need and will be taken-up anyway. In this case, regulation may allow for better consumer outcomes than one that leaves the process exclusively to the market.

A prime example of non-banks offering near-substitutes for banking services is in the payments area. This has led to central banks re-thinking how they should approach participation in the payments system. Zambia provides an example of this. The National Payment Systems Act was enacted in 2007 and since then the Bank of Zambia has successfully designated four payment systems, seventeen payment system participants and thirty payment system businesses.[8] The Bank of Zambia (BoZ) thus designates players wishing to provide services such as money transfer services, mobile banking and other payments services. In doing so, the BoZ is able to monitor transactions and ensure that only safe and efficient institutions are allowed to provide payments services[9]. By creating different tiers in the payments system regulatory structure, explicit criteria for regulation that is proportionate to the risk brought into the system can be established and monitored.

Other examples include licensing agent banks, which makes use of the distribution channels of merchants, post offices and pharmacies to deliver financial services[10] and having tiered banking licences which tailor regulation to the permissible type of banking services offered – without exacerbating instability[11] .

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[7] Fundanga, 2009

[8] Bank of Zamiba, 2010.

[9] Tukiya Kankasa-Mabula. 2009.
[10] Hannig and Jansen, 2010

[11] Hawkins, 2006

Box 1

General principles for access – from remittances to saving and insurance

Central banks are charged with ensuring stability of the financial system, while promoting appropriate access. A useful point of departure is the General principles for international remittances, published by the Committee on Payments and Settlements Services (CPSS) in 2007. The key principles highlighted in that document can be easily translated into General principles for Access. They have been adapted here for this purpose.

Transparency and consumer protection

General Principle 1. The market for financial services should be transparent and have adequate consumer protection.

Payment system infrastructure

General Principle 2. Improvements to the payments system infrastructure that have the potential to increase the efficiency of financial services should be encouraged.

Legal and regulatory environment

General Principle 3. Financial services should be supported by a sound, predictable, non-discriminatory and proportionate legal and regulatory framework in relevant jurisdictions.

Market structure and competition

General Principle 4. Competitive market conditions, including appropriate access to domestic payment infrastructures, should be fostered in the financial services industry.

Governance and risk management

General Principle 5. Financial services should be supported by appropriate governance and risk management practices.

These high-level principles are a useful reminder that just as international remittances can be promoted, at the same time as ensuring a sound a safe financial system, so too, can financial access be promoted while ensuing stability.

(b) Enabling regulation

It is something of a truism that technological innovation may run ahead of appropriate regulation, but it is also true that highly effective regulation can stifle innovation. In particular, licensing requirements for banks may form a significant barrier to both deposit-taking and payments services. This presents a significant challenge to central banks wanting to promote access while ensuring stability.

An example of how the central bank may allow innovation to run ahead while monitoring its outcomes on the market and consumers is the case of M-PESA in Kenya (See Box 2). This is a case where the regulatory processes were adaptable enough to permit the innovation to be piloted while being monitored. In this example, the Central Bank of Kenya (CBK) dealt with non-banks in reaching its objective of improved financial regulation.

Box 2

Kenya: Enabling regulation for mobile banking

The success of M-PESA in enhancing access to money transmission through mobile telephony, and in ultimately allowing for access to a number of essential financial services, has received widespread acclaim (eg The *Economist*, 2009). It is a story of harnessing technology successfully for the benefit of previously excluded individuals. But it is also a story of engaged and adaptable regulation.

The Central Bank of Kenya (CBK) has played a pivotal and enabling role in the success of financial inclusion through mobile technology. Underpinning its approach, is the acknowledgement that appropriate legislation may lag technological innovation[1], but empowered with its mandate "to formulate and implement such policies as best to promote the establishment, regulation and supervision of efficient, effective payment, clearing and settlement system"[2], the CBK chose to permit innovation to run ahead of legislative change. At the same time it was mindful of the need for stability and of the need to monitor the developments.

This meant that when the CBK was approached in 2007 with the innovation by Safricom in conjunction with Vodafone[3], it allowed for a monitored pilot phase, during which time the CBK assessed the risks of the product and determined that the product did not involve deposit-taking, as no intermediation was involved. Moreover, the amounts transferred were ring-fenced and not available for the operations of the firms involved. After a successful pilot, the CBK set out its reporting requirements and provided Safricom with a letter of no objection. The reporting requirements included monthly reporting of pre-determined metrics, but also regular meetings with key stakeholders[4]. While the risks of mobile phone banking include "fraudulent movement of funds, network hitches and mismatch of cash balances at the pay points"[5], the CBK was confident that the risks did not outweigh the benefits of the innovation under its oversight.

As the take-up of M-PESA showed significant demand from consumers – for both transfers and short-term storage of money - the CBK evaluated each product extension on a case-by-case basis[6]. Subsequently, the CBK has made legislative amendments to bring mobile payments within the purview of the regulatory framework and to allow agents to take deposits on behalf of banks. It has also recently published e-money regulations[7]. Meanwhile M-PESA now offers an enhanced suite of financial services through its joint venture with Equity Bank and its M-KESHO offering. In this way, the M-PESA offering "evolved from the initial concept of transferring money from one individual to another to include other functions, such as payment of utility bills, loans, salaries and deposit mobiliation"[8].

1 Kimenyi, M S and N S Nhung'u, 2009.

2 Section 4(A) (1) (d) of The *Central Bank of Kenya Act*

3 Business call to action, 2011.

4 Nyaoma, G, 2009.

5 Kimenyi, M S and N S Nhung'u, *ibid,* p 7

6 Nyaoma, G, *ibid*.

7 Ndung'u, N. 2011.

8 Ndung'u, N. ibid

Another example is the approach of the authorities to address financial infrastructure and personal identification inadequacies in Uganda through partnering with a non-bank technology company. In this case, biometric national identification cards (approved by the central bank) provide individuals access to debit and credit facilities, mobile banking and electronic funds transfer facilities[12]. In this example, the challenges of allowing access by a remote rural population required new technologies.

(c) Promoting responsible provision

Regulators need to be aware of the incentives on both the supply and demand sides of the market. While the regulator can do little to influence demand side incentives, it can try to ensure that the supply-side offering is responsible in terms of disclosure, transparency, education and redress. While some of these may not fall directly under the purview of the central bank, (for example ombudsmen schemes may exist), the central bank may need to form part of a national dialogue to ensure responsible provision is promoted[13].

Where central bankers may play a more active role is in ensuring that there are sufficient supply-side incentives for essential financial services – such as saving accounts. The rationale here is that while providers will have incentives to provide highly profitable products, such as credit, there may be fewer incentives to offer savings facilities.

A saving facility is important not only because it is a useful financial service, but because it allows for the building of trust in financial institutions - which is important for stability - and because it provides the consumer with choice regarding appropriate use of other financial services. For example, a person who is able to accumulate savings may not be obliged to go into debt to manage a personal financial shock, moreover such a person may choose to self-insure. Without a facility to save, where fees do not erode funds, the consumer loses these options.

Mechanisms to encourage savings facilities include allowing tiered banking, including cooperative banks and credit unions, and banking, and include allowing savings of small amounts through e-money directives. Tiered banking provides scope for the emergence of cooperative banks and credit unions.

Conclusion

The promotion of financial inclusion by regulators needs to take into account the fact that inappropriate access may increase the risk of instability. The emergence of the recent global economic crisis is associated with the sub-prime crisis, which can in turn be viewed as arising because of unbridled access to mortgages. Much depends in such a discussion on how access is defined.

What is increasingly clear is that technology is being used to increase access, and the central bank can play a role in ensuring that this access is appropriate and not at odds with its stability mandate.

In order to do so, central banks are likely to have to extend their regulatory oversight beyond existing margins and play a risk-sensitive and enabling role. This, together with promotion of responsible provision, will place additional burdens on central banks and may require additional resourcing. Moreover, central banks will need to strengthen both internal departmental communication and external communication with policymakers and other stakeholders. Moreover it is clear that there is much to learn from each other.

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[12] MAP International, 2009

[13] Pandit, V. S. 2011.

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