

State Bank of Pakistan

Comments on Consultative Document- Guidance on the application of the Core Principles for Effective Banking Supervision to the regulation and supervision of institutions relevant to Financial Inclusion-Consultative Document

State Bank of Pakistan likes to offer following comments on the subject consultative document:

1. The document provides reference to other BCBS documents which form basis of various proposed principles in reference section. However, it would be appropriate, if reference of the document is specifically mentioned under the relevant principle as has been done in the case of Core Principles for Effective Banking Supervision.
2. Sustainability of the financial inclusion related institutions is a key to development of this sector. Sustainability, particularly in case of microfinance, depends on the rate of retention of the borrowers i.e. borrowers that once avail a loan facility and graduate into next loan cycle. Repeated borrowing enhances the sustainability as it lowers risks, reduces administrative costs, transaction costs etc of the banks/MFBs. The retention of the borrowers reflects the portfolio quality, institutional viability, risk assessment framework and the socio economic impact of the financing on the consumer. In order to sustain long term relationship with the customer, in most cases, progressively increasing the loan size, training of the borrowers for usage of the loans, maintaining an active oversight by board and senior management, careful loan structuring, close monitoring, simplification of loan documentation, quality customer services and complaint redressal are useful stepping stones for financial sustainability and risk management of the institution. Above aspects may be appropriately covered for supervisory guidance in the document.
3. Establishment of third party agent networks allows the agent to offer services to multiple banks. Particularly, same agent can provide the services for multiple bank and multiple products, which carry the risk of compromising the data security and confidentiality. Particularly, the agent can use data for promoting his own business and risk the confidentiality of customer data. Therefore, the document needs to provide guidance on coverage of this risk.
4. Keeping in view the fact that Consumer Protection or Responsible Banking Conduct is one of the key prerequisites of Financial Inclusion, it is suggested that the annexure A of the subject document which includes the OECD's high level principles on Consumer Protection, may explicitly and appropriately be incorporated in the identified Core principles for supervision and regulation of institutions relevant to Financial Inclusion. For that matter, principle 1, 2, 8,9,10,11,28 etc shall ideally include specific guidance on "conduct supervision" of institutions responsible for Financial Inclusion.
5. Along with the guidance on other types of risks like credit, liquidity and operational risks, the subject document may also include "conduct risk" as it is one of the most crucial and risingly relevant risks to entities responsible for financial inclusion as they deal with most vulnerable segment of market both in terms of financial capability as well as literacy.
6. Though documents have considered the size of the institutions for guidance, it is important to highlight that the final principles/guidance should not add supervisory burden on this sector. Specifically, the Basel guidance is considered best international practice and assessors sometime take strict view on implementation of the standards that may overburden the sector with

additional supervisory requirements. This issue needs to be given due weight, while finalizing BCP principles.

7. A new area of supervisory concern has emerged due to offering of innovative services like branchless banking through telecommunication channel. As highlighted in the consultative document, telecommunication companies have become parent/associate of the financial institutions. In some cases, major part of the revenue of financial institution is now being generated from the payment services provided through parent/associated telecommunication companies. In such a case, any failure of the telecommunication company will lead to the failure of the financial institution. The BIS document may provide guidance on dealing with the highlighted risk.