

**Encouraging financial inclusion in a new nation
– The experience of the *Central Bank of Timor-Leste***

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Abstract

Financial inclusion is continuously underlined, in international *fora* and the academia, has essential for the promotion of social and economic progress of a country. Policymakers and regulators are well placed to be key players in shaping and developing an inclusive financial sector. In this context, having recognised the role that the continuous promotion of financial inclusion has in supporting the sustainability of Timor-Leste's growth, *Banco Central de Timor-Leste* ("the Bank") has been playing an instrumental role in measuring the level of financial inclusiveness of the Timorese economy and in fostering several initiatives to encourage and support evidence-based policies in this domain. In this presentation we explore the findings of the Bank's first ever report on financial inclusion – the *Financial Inclusion Report 2016* – and highlight how a new developing country is tackling this reality through the implementation of a set of comprehensive measures, which span from modernizing the payments systems to the promotion of financial literacy.

Keywords: financial services; financial literacy; payment systems; Timor-Leste

JEL classification: G20; O17

Introduction

We are all aware that in the recent years, more and more countries are introducing extensive measures to enhance access to financial services and improve usage of financial services. These comprehensive efforts illustrate each country's commitment to foster financial inclusion as a domestic agenda. Timor-Leste is a fairly new developing nation, and financial inclusion is especially vital to empower its citizens with the tools that allow them to meet their financial needs. The principle of inclusiveness is regarded with the utmost importance, and Banco Central de Timor-Leste (the Bank) is committed to ensure that no Timorese will be left behind as the financial sector develops and grows. The Bank has carried out various action plans to encourage inclusiveness, including ensuring facilitative regulation, modernizing payments systems, developing various financial products, building capacities and financial literacy. Moving forward, the Bank aspires to strengthen the financial inclusion strategies under a holistic national framework, to fill existing gaps and nurture innovation, towards achieving the vision of universal access to financial services in the country.

To promote financial inclusion in the Timor-Leste, the Bank started in 18 July 2016 the report on financial inclusion in Timor-Leste, which was officially released on 13 September 2016.

Financial Service Providers in Timor-Leste and the access point coverage

Despite being a new country, with a financial system under development, Timor-Leste has already 4 commercial banks: one local – BNCTL – and three branches of foreign banks –ANZ Bank (Australia and New Zealand), Mandiri Bank (Indonesia) and BNU/CGD (Portugal). There are also available microfinance institutions, credit unions, saving groups, insurance companies, and money transfer operators.

Access to financial services is a prerequisite for fostering inclusive finance. The Bank has placed significant emphasis on enhancing the outreach of financial services access points through various

channels by participating financial institutions. In fact, access point indicators, have been widely regarded as benchmarks to measure financial inclusion. A facilitative financial sector is pivotal to ensure the access to financial services, which has led to a notable progress in the growth of channels such as bank and nonbank access points, mobile banking vans, e-wallet and internet banking.

The abovementioned banking institutions in Timor-Leste play an important role in widening the outreach of financial services access points in the country to enable communities to transact, save and obtain credit.

Table 1. Financial Sector Access Points Coverage

Financial Service Providers	2016: Access Points					Total
	Branch/Field Office	ATM	EFTPOS	Meeting Centre	Other	
Banks	33	52	164	235	-	484
MFIs	37	-	-	634	-	671
Credit Unions	-	-	-	-	32	32
Insurance	2	-	-	-	-	2
Others (MTO, CEB)	16	-	-	-	-	16
Total	88	52	164	869	32	1,205

Source: Banco Central de Timor-Leste Financial Inclusion Report 2016

As at June 2016, a total of 484 access points was reached, including bank branches, automated teller machines (ATMs), electronic funds transfer point of sales (EFTPOS) and meeting centres. Of this total, 48% were related to meeting centres, 34% to EFTPOS, while ATMs and bank branches represented 11% and 7% respectively. This clearly illustrates the significance of the deployment of meeting centres and EFTPOS for outreach of financial services in the country.

Banks have shown a remarkable progress in widening outreach of financial services through the years: the total number of access points expanded from 198 in 2009 to 226 in 2013, an increase of 14%. Following that, the number of access points grew significantly from 2013 to June 2016, where the total access points recorded an increase of 114%. Of all the types of access points, EFTPOS displayed the highest percentage of increase from 2009 to 2016, recording a 254% growth, a leap from just 45 access points in 2009 to 164 by June 2016. ATM access points also recorded a substantial increase of 225%, from 16 access points in 2009 to 52 by June 2016.

Non-bank financial service providers have also been instrumental in shaping a more inclusive financial sector in Timor-Leste by complementing the role played by banks. In fact, non-banks promoted 711 access points, which corresponds to 59% of the 1,205 total access points in the country, while banks access points represents the remaining 41%. Non-banks bridge gaps in areas where banks are not able to serve, making it possible to reach more communities with financial products developed to satisfy their financial needs.

Microfinance Institutions (MFIs)¹ in Timor-Leste are made up of 2 key institutions which enhance the financing access to microenterprises. In 2009, these 2 MFIs recorded 702 access points while in 2013, the number increased to 1,005 access points. As at June 2016, the number of access points for MFIs decreased to 671, as one of the MFIs, KIF, changed its strategy from group loans and meeting centers to individual clients.

¹ The abbreviation MFIs used throughout the text refers exclusively to “Microfinance Institutions” and should not be confused with the generalized use of this abbreviation for “Monetary and Financial Institutions”.

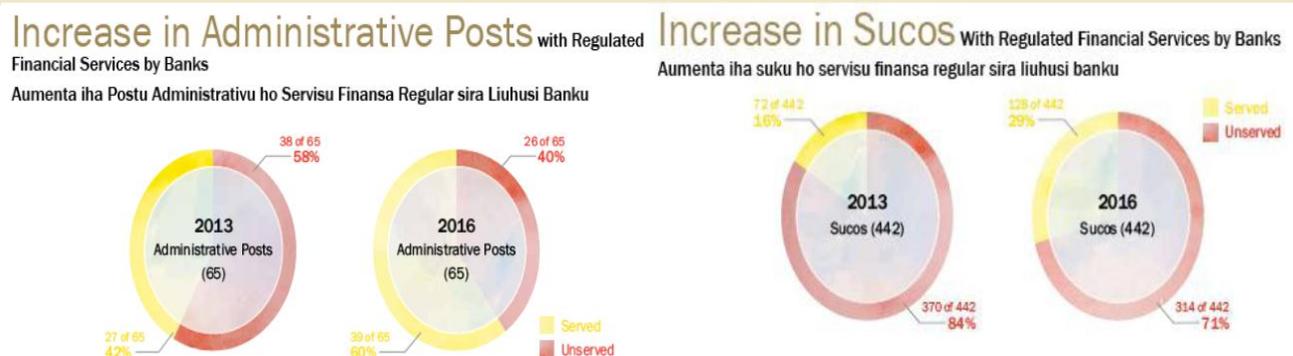
The landscape of the non-bank sector in Timor-Leste is complemented by other financial service providers as Credit Unions, Insurance providers, Currency Exchange Bureaus (CEB) and Money Transfer Operators (MTO). As at June 2016, the number of Credit Union stood at 32 while Insurance providers had 2 branches operating in the country. CEBs and MTOs provide their services via branches and, in June 2016, had a combined of 16 branches between them across the country.

Coverage at the administrative posts and sucos levels

The level of access to financial services in the country is fairly high, whereby all municipalities are served with financial services access points. The majority of administrative posts also benefit from the presence of financial services access points, and as at 2016, 88% of administrative posts were covered. However, there is a slight drop comparing with 2013 figures where 92% of administrative posts were covered. At the sucos level, 58% of them have the presence of financial services access points as at 2016, a number lower than the one recorded in 2013 where 63% of sucos were covered. The drop in financial access points from 2013 to 2016 was attributed to the drop in MFI access points due to the reduction of the usage of meeting centers after 2013.

At the administrative posts level, regulated financial services by banks were available in 60% (or 39) administrative posts in 2016, while 29% (or 127) sucos were covered.

Graph 1. Financial Services by Banks in Administrative post and Sucos



Source: Banco Central de Timor-Leste Financial Inclusion Report 2016

It is evident that gaps still exist, as there are administrative posts that are not yet covered by financial access. The numbers are more concerning at the sucos level. A large number of sucos continue to be unserved by access points and financial services in the country. 187 among a total of 442 sucos still do not have financial services access points, while 314 sucos remain unserved by banking regulated financial services.

The population density, based on the Census 2010, also highlights the varying densities of administrative posts: administrative posts with higher population densities, especially those which are still underserved, present higher potential for increasing access points in the future.

It was found that 81% of the population, or 858,731 of 1,066,409 people, are living in administrative posts covered by bank access points. From the adult population point a view, the same percentage was recorded, where 81% of adults are living in administrative posts covered by bank access points.

Limited coverage by branches

Due to the distance, there is some limited coverage by banks' branches. Within a radius of 5km, around one hour of walking, the bank branches cover 6.5% of the national territory, including most urban areas in the municipal cities. 10km radius from the bank branches covers 22.8% of the national territory, while 25km radius covers 80% of the national territory. Hence, people living in remote areas, (such as south Manatuto and west Lautem), may need to travel up to 25km or more to reach the nearest bank branch. They may also face adverse road conditions and transportation amenities to reach a bank branch.

Usage Indicators

The number of people who uses financial services, either provided by banks or non-bank, is central to usage indicators. This measurement of financial services acceptance gives an overview of the penetration of financial products and services in the country.

Financial Institution	Total Clients
Banks	388,018
MFIs	26,873
Credit Unions	8,059
Total	422,941

Source: Banco Central de Timor-Leste Financial Inclusion Report 2016

In Timor-Leste, the data collected in June 2016 found that there were 422,941 clients with accounts in banks, MFIs and credit unions. Given this figure, it is estimated that about 42% of the population (or 68% of adult population) use financial products and services.

The largest share of clients in the financial system is held by banking institutions, with a total of 388,018 customers. 96.5% of this total clients are individuals, while the remaining 3.5% are corporate clients. A look into the breakdown by gender of the individual clients shows that a slightly higher percentage of males are using financial services by banks (52% of total banking clients) compared to 48% of females clients.

Credit Market

Using Timor-Leste 2010 population census information we can conclude that only 6% of adult population has an outstanding loan, of which 55% borrowed from the banking system and 45% borrowed from MFIs. Loan products offered by banks are granted in a higher proportion to male clients (13,354 men, corresponding to 63% of the total costumers compared to 7,642 female clients, which corresponds to the remaining 37%). However, MFIs loan products are more demanded by female clients, with a total of 16,257 clients (96%) against just 678 male clients (4%).

Graph 2. Credit Markets



Source: Banco Central de Timor-Leste Financial Inclusion Report 2016

The higher number of female borrowers in MFIs, has been contributing to increase the number of female clientele for loan products, which corresponds to 63% of total loan clients in the overall financial sector.

Just to share some similar observations with regard to the penetration of loan accounts by municipalities in the country, Dili (the capital of the country) records the highest usage in loan accounts offered by both banks and MFIs. The number of bank loan account holders in Dili reaches more than 35% of the total bank loan account holders, while for MFIs, the number lower to 18.6% of the total MFI loan account holders.

Other Financial Products Usage Still Limited

Usage indicators also examine other important features, particularly on how financial accounts are being used. The Bank has evaluated the usage of deposit accounts in banking institutions, including the penetration of the usage of debit cards and the collection of outstanding deposits.

It was found that only 7% (28,177) of the clients are using debit cards, out of the total 387,063 deposit accounts registered in banks. It was also observed that there are 297,630 clients with deposit balances below USD100.00, including a sizable number of 244,332 clients with deposit balances below USD10.00. Clients with deposits below USD10.00 are made up of both corporates (2,860 accounts) and individuals (241,471 accounts). The low account balances indicates that some of these accounts may not be actively used, resulting in a lower savings rate. Another reason behind the low balances is due to the primary usage of a portion of these individual accounts: to receive financial aid from the government.

E-wallet is another new approach adopted to increase outreach of financial products and services for consumers in Timor-Leste. This product is currently offered by CGD/BNU which was officially released in March 2015, after the start of pilot run in November 2014. This product offers a set of services such as transfers between CGD/BNU accounts, including e-wallet to e-wallet or current to e-wallet, purchase of Pulsa prepaid top-up for phone credit, check account balances, transactions status and International Bank Account Numbers (IBAN) for current accounts. There are currently 1,573 clients registered for this product and, on average, 2,000 of monthly transactions were performed using this product. The e-wallet product is a promising strategy to enhance financial inclusion as there are about 1.5 million registered mobile account subscriptions in the country, a number which is higher than the total population, signifying a wide penetration of mobile phone accounts.

In line with the development in the financial sector, internet banking services were also introduced in Timor-Leste, with the first initiative rolled out in January 2013 by ANZ Bank. ANZ Bank has 2,500 registered users and the volume of transactions ranges from 600 to 800 per month. CGD/BNU launched, in February 2016, their internet banking initiative called BNUdireto, through a platform that

is serving 700 individuals and 33 enterprises with an estimated volume of transactions up to 1,500-2,000 per month.

In the recent years, insurance providers in the country have been striving to expand their product range to help all segments of society manage their risks. To date, insurance providers have expanded their product range to more than 7 types of insurance policy types, and currently, there are a total of 1,052 individual insurance policy holders in the country and 212 collective insurance policy holders.

Timorese mostly use MTOs to conduct international transfers, being the majority of transactions outbound. International outbound transfers make up 70.5% of total transactions valued at over USD48,900.00, in the first half of 2016. However, international inbound transfers account for 29.45%, of total transactions valued at over USD19,400.00.

The usage of financial products by regions show that Dili has the largest share of deposit account holders, which is consistent with the population of Dili, and with the fact that it is the municipality with highest population density in the country. Totalising 119,119 clients, Dili has 233% more clients than the next highest municipality, Baucau, which has 35,802 clients. The municipalities with the lowest numbers of individual deposit clients are Ailieu (13,753), Manatuto (16,327), Manufahi (16,568) and Ainaro (16,772).

Identified Barriers for Financial Inclusion

The procedure of opening a bank account appears to be a straightforward process. The steps involve going to one of the four commercial banks' branches, presenting an identification document with a photo (electoral card, which is the most common document among adult Timorese, national identity card or passport), filling bank forms and, within the same day, the account application is approved for accepting deposits.

Timor-Leste adopted Tetum and Portuguese as official languages, and English and Bahasa Indonesia as working languages. In addition to Tetum, there are other 15 dialects used in specific areas across the country, making it challenging for financial services providers to select languages for an effective communication. According to the Census 2010, Tetum is the most widely used language, but only 56.1% of the adult population are able to speak, read and write it. Therefore, there is still a need to use language alternatives to cater for the remaining population.

The network of bank branches is still limited to the main city of each municipality. While it covers 29.6% of the population (people living in urban areas), the remaining 70.4% (population living in rural areas) are required to travel a significant distance to reach the nearest bank branch. Public transport connecting main cities to other villages, when existing, is precarious and unreliable. For many, the only alternative is to rely on informal arrangements or walk long distances, at times up to 25 km or more, to the nearest branch.

Identified Gaps & Challenges for Inclusive Finance

The challenges for access to financial services are mainly related with the deployment of access points to areas outside the urban centres, especially to administrative posts and sucos with large land areas and lower population density. Currently, there are 8 administrative posts unserved by any financial service providers, regulated or not, and 26 administrative posts unserved by banks. The numbers are even more concerning at the sucos levels. The lack of access points in these unserved and underserved areas give the residing communities no choice, but to travel a long distance to reach a financial access point. The features of financial products and services available in the market also play a key role in either driving or hindering financial inclusion. If financial services are complicated and expensive to use, it would be natural for people to reject these products. In fact, all four banks in Timor-Leste are charging a range of different fees for monthly maintenance, debit cards, and a range of different minimum initial deposit and bank account balance. The logical next step would be to improve the product availability, the pricing and processes in the financial sector to serve the requirements and needs of those without access to banks so they can also benefit from the financial system. The actual

state of financial sector also suggests that there is a need for supporting the infrastructures to improve information asymmetry and manage emerging risks.

Financial literacy, Consumer protection & Capacity building are important challenges for inclusive finance. The lack of awareness and knowledge about financial products and services, especially amongst the poor and rural communities, also pose as a hindrance towards fostering financial inclusion. There are still many people within the unbanked and underserved segments who simply do not comprehend what financial services are available, why they are important, how to use and what are the benefits of using them.

BCTL Key Initiatives to Promote Financial Inclusion

- E-Wallet: on September 2014, the Bank authorised the BNU/CGD to start a pilot program that allows a set of banking transactions to be carried out by mobile phone.
- Banking agent: During 2015, the Bank worked with the ADB and the University of New South Wales (UNSW) on a branchless banking agents network project. As a result, a Circular Letter 14/2015: Guidelines on the Use of Agents in Branchless Banking was introduced. In addition, the Bank, ADB and the UNSW team produced a policy paper on supervision and protection of float in branchless banking, and also produced a policy paper on consumer protection in branchless banking.
- Small and Medium Enterprises' (SME) access to credit: the Bank initiated in 2013 a feasibility study on options for agricultural finance and a loan guarantee schemes granted by Government to support the private sector in Timor-Leste.
- Financial literacy and consumer protection: the Bank spearheaded its first awareness program of Financial Education on 29 November 2014, which was launched officially by the President of RDTL (Democratic Republic of Timor-Leste) H.E. Mr Taur Matan Ruak. This was a nationwide awareness program aimed at improving financial literacy. The theme for the program, "Save now for a better future" was developed in consultation with community groups, and its main objective is to raise awareness about personal and small business finances and thereby change spending behaviour to inculcate savings habits.

Financial Literacy Program

The program of "Save now for a better future" has the purpose of improve basic financial literacy levels of the Timor-Leste people through a nationally coordinated network of financial education programs and awareness campaigns. Its mission is to convey the Timorese the idea that they can use products and services provided by the finance sector to enhance their wellbeing thus contributing to the economic growth of the nation. The expected outcomes include a recognition of target groups with improved financial knowledge, skills and attitudes that will foster economic growth in the country.

Conclusion

The Bank has carried out a lot of initiatives in the last few years, in collaboration with the government, financial service providers and other partners, as an important effort to build the foundations for inclusiveness in the financial sector in Timor-Leste. However, the Bank still needs to strive to make this real. To enhance financial inclusion, the Bank is concentrating its efforts on identifying opportunities to through coordinated strategies in the coming future.

References:

- BCTL (2016); BCTL Financial Inclusion Report 2016