Zamani Abdul Ghani: Scaling up financial inclusion through branchless banking

Remarks by Mr Zamani Abdul Ghani, Deputy Governor of the Central Bank of Malaysia, at the Microfinance Policymakers Forum "Scaling up Financial Inclusion through Branchless Banking", Kuala Lumpur, 2 December 2009.

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Introduction

Good afternoon and welcome to Malaysia. It is very encouraging to see so many senior policymakers gathered here today to participate in this Microfinance Policymakers Forum. Thank you for taking the time to be here and for contributing your knowledge. The motivation for today's event has its roots in the forum of the United Nations Advisory Group for Inclusive Financial Sectors which was held in May this year in Kuala Lumpur. As many of you may be aware, in recognition of the importance of financial inclusion, the United Nations established the United Nations Advisory Group on Financial Inclusion in 2006. The group advises the United Nations and member states on issues relating to the advancement of the financial inclusion agenda on a global scale. Since its establishment, many successes have been achieved. These include increasing the public awareness on the importance of financial inclusion, assisting governments in the design of regulatory systems that facilitate the creation of financial services for the poor, encouraging the use of holistic measures to gauge the progress of financial inclusion as well as collecting and disseminating best practices to further advance financial inclusion.

One of the topics that received considerable attention at the UNAG forum was branchless banking. Governor Dr. Zeti Akhtar Aziz had proposed a regional forum to exchange experiences and understanding amongst central bankers and financial policy makers on issues such as institutional structure, regulatory framework and supervision requirements and the application of technology for promoting access to financial services.

Branchless banking offers the means to provide the full range of financial services such as payments, deposits, credit and micro-insurance services without the use of physical bank branches, thus reducing significantly the cost structure. The financial services could be provided through mobile telecommunications networks or network of non-bank intermediaries, such as supermarket chains or post offices.

For the purposes of this Forum, I would like to focus my remarks on three key areas. Firstly, how payment systems technology is supporting branchless banking to improve access to financial services. Secondly, the policy and regulatory concerns pertaining to branchless banking. Thirdly, Malaysia's experience in developing a more inclusive financial sector and supporting branchless banking activities.

Payment systems technology for branchless banking

The most critical enabler of branchless banking relates to the role of payment systems technology, principally the use of mobile phone as a banking channel and payment device. The pervasive availability and use of mobile phone around the globe and familiarity amongst its users makes it a very cost-effective distribution channel to improve accessibility to financial services to the unbanked and underserved segment of the population. This is further complemented by the proliferation of payment cards, particularly electronic money, which enables banking and payment services to be conducted without a bank account or visits to traditional bank branches. According to data from the Consultative Group to Assist the Poor, or CGAP, there will be more than 120 mobile money schemes in developing countries by the end of 2009, more than double the number in 2008. CGAP estimates that by

2012 some 1.7 billion people will have mobile phones but no bank account, and 20 percent will be using mobile money.

A key challenge, to implement a commercially viable and workable mobile banking solution, especially where population density is low, is to achieve a critical mass of users required to reap economies of scale to keep transaction cost low. This is even more relevant if the aim is also to promote financial inclusion as financial services would have to be offered at affordable costs. Thus, a requirement for an open and interoperable mobile platform that facilitates the participation of many service providers and that offers a broad range of services is critical in developing a sustainable and efficient solution for both providers and users.

The other type of branchless banking is the use of non-bank financial service providers, also referred to as Business Correspondents in certain jurisdictions. This approach combines mobile banking solutions with person-to-person contact, except that the customer is not engaging with a bank, but rather with a supermarket counter staff, grocery shop owner, post office or village headman. The elements of trust, Know Your Customer and value-added advisory services can be more effectively met using this approach, without the corresponding high investment cost of establishing physical banking branches. Today's forum provides an excellent opportunity for all of us here to exchange ideas and experiences in these areas.

Policy and regulatory concerns pertaining to branchless banking

Let me now turn to my second point, which is about the policy concerns of regulators in relation to branchless banking services. The first concern is related to the need to continuously balance between prudential controls and allowing innovation to flourish within the financial sector. To site a recent well known example, the events in the US sub-prime markets and derivative products serve as a good lesson where innovation significantly outpaced the capacity of the regulatory environment to exercise prudential oversight, and prevent distress to the financial system.

The environment within which branchless banking will flourish requires a great deal of innovation in terms of executing transactions, maintaining proper audit controls and ensuring fraudsters do not take advantage of unsuspecting customers. As regulators we are particularly concerned where deposits are accepted by non-bank entities, acting in the capacity of an agent to a financial institution. This is because while financial institutions need to comply with minimum prudential regulations, such as capital, liquidity and submission of financial data on a regular basis to the supervisory authorities, non-bank financial service providers are typically not subject to such requirements, and in the event of financial distress, depositors may be at risk. In order to address this concern, the regulators need to ensure a sound regulatory regime which is sufficiently accommodative to balance prudence and innovation. This not a simple issue, and this Forum has been designed to explore critical aspects of achieving this fine balance.

A second key policy concern relates to undermining confidence in the payment systems. As different intermediaries get involved, there is an increase in the risk of losing transaction integrity, corruption of data or breach of payment settlement terms. The loss of faith in the safety and security of transactions, in particular payment transactions, can result in widespread loss of consumer confidence. Another area relates to policies governing competition as different players position themselves in the branchless banking arena? Issues such as licensing, pricing, alliances with different financial institutions and compliance with prudential regulations need to be considered carefully. The public and consumers may lose confidence if there is no sense of order in how the payment system is evolving, or there is wide disparity in charges and fess.

There is a need for the major stakeholders to align with some form of regulatory approach or framework which would provide a basis for assessing risks, and to implement regulations that are proportionate to the risks identified. In this Forum, some of the key elements of such a regulatory framework will be dealt with, such as Know Your Customer, compliance with Anti-money Laundering regulations, Consumer Protection and achieving greater levels of system interoperability amongst service providers. As such, branchless banking will require an inter-disciplinary approach given the different types of expertise needed to drive this important agenda.

The third area of policy concern I would like to touch on relates to the issue of accountability with cross-sector regulatory requirements. There must be clarity over the accountability for the integrity of transactions, security of information transmitted, adherence to a consistent set of regulations and proper maintenance of the system. And it is important to note that higher standards of control will also result in higher costs to the service providers. Cross-sector policy issues must be resolved, and clear accountability with respect to the operations of the system must be established. Systems of governance to engage with different legislative requirements, from capital requirements to anti-money laundering regulations, must be in place. Players need to have the requisite skills and knowledge to address issues promptly with different stakeholders, such as customs, immigration, police and international agencies like Interpol. Even if the non-bank players do not need to directly engage with these issues, they must have high degree of awareness in order to work effectively with their partner financial institutions.

Measures taken in Malaysia to develop a more inclusive financial sector

Allow me to now share Malaysia's experience in addressing financial inclusion and branchless banking. In Malaysia financial inclusion has been a high priority in our national agenda for many decades. Since the establishment of the Central Bank, there has been a conscious policy to have an extensive commercial banking branch network across the country, to ensure the outreach, in particular, to cover the non-urban areas. Malaysia now has 10.2 branches for every 100,000 individuals as opposed to the global median of 8.4 branches for every 100,000 individuals. In Malaysia, more than 80% of the population also have some form of savings account. This has also contributed to the financialisation of savings in the country. Deposits as a percentage of gross domestic product is 180%. This means that savings is mobilised even from small savers into the formal financial system. This allows the savings to be channelled to productive economic activity.

To further drive the provision of basic financial services to the underserved, the National Savings Bank in Malaysia has been mandated in 2006 to enhance the outreach of deposit services and micro-financing. Their efforts, together with those of commercial banking institutions and government mandated micro-financing agencies, have resulted in a significant expansion of micro-financing. Micro-financing has increased from RM151 million in 2000 to RM2.2 billion in September 2009, representing an annual average growth rate of 34%.

The Bank also reviewed its existing legislation, and this year the new Central Bank Act of Malaysia 2009 came into effect a week ago, on 25 November 2009. One of the changes introduced as part of clarifying the mandate of the Bank was to explicitly articulate the Bank's developmental role in having a more inclusive financial sector.

Let me briefly summarise the initiatives taken by Bank Negara Malaysia which are supportive of branchless banking activities. Given the extensive network of physical branches and ATMs in the country, branchless banking has not yet experienced significant take up. Nonetheless, the use of e-money for tolls and parking bays has increased significantly, and a number of operators are seeking to expand the market.

In terms of addressing the policy concerns, measures were taken to put in place the payment infrastructure, promote a broad product range to cater for the different payment needs of consumers and business sectors and the formulation of a transparent and cost-effective pricing framework to provide the incentive structure that would spur the adoption of electronic means of payments. Another important measure relates to the setting of common standards to address the interoperability of systems including standardising the payment messaging format to enable the wider acceptance of electronic payments. Finally is the need to ensure the security and integrity of the payment system which requires the supporting regulatory and legal framework to be in place. The Payment Systems Act, the E-money Guideline issued by Bank Negara Malaysia and the Exchange Control Act rules for cross-border remittances serve as the main regulation in this area.

In addition to e-payment channels and e-money as a mode for pursuing the financial inclusion agenda, there holds much promise in the usage of agents or non-bank intermediaries to extend the outreach of financial services to the underserved in the Asian region. In Malaysia, we have facilitated the utilisation of post offices as a delivery channel for banks to provide simple banking services, including opening of accounts, cheque and cash deposits, cash withdrawals, funds transfers and remittances, and loan repayments. By engaging the services of post offices, the banks are able to leverage on the wide dispersion of post office branches in non-urban areas as well as the communities' familiarity and trust associated with services offered by post offices. Malaysia's approach in the regulatory framework for such arrangements places the responsibility the banks to put in place the necessary safeguards and controls. Such controls include requirements to set transaction limits, establish sound reporting and monitoring mechanisms, and conduct periodic assessments towards ensuring that the integrity and quality of financial services provided is maintained at all times.

In addition, substantive consumer education and protection measures have been implemented, which would also be applicable broadly to branchless banking related issues. A specific department known as Consumer and Market Conduct Department was established in 2006 to spearhead the initiatives. These initiatives included financial education at schools and for the general public; greater disclosure requirements about the features of financial products and the associated risks; the Financial Mediation Bureau to provide an avenue for redress; the Credit Counselling and Debt Management Agency to assist individuals in financial distress; and a public service centre at the Central Bank and all its branches to provide information and advice. The market conduct regulations also give the regulator powers to oversee fees and charges to ensure the quantum is reasonable for the services provided. These measures are broad enough to provide consumer protection in relation to branchless banking in general terms. However, they may be less effective in addressing some of the unique aspects of branchless banking, such as disputes with non-bank agents located in remote or rural locations. Perhaps this forum could consider some of these aspects.

Collaboration in terms of sharing best practices, standards and regulations would reduce the cost as well as expedite the development of more inclusive financial sectors. We need to be mindful of the fact that for effective collaboration to take place, we must have common goals to bind our work. In this case, that common goal is the development of more inclusive financial sectors, by making available a broad range of financial services to the poor and micro enterprise segments of society and the economy, as well as those living in remote areas.

Before I conclude, let me again stress that the development of more inclusive financial sectors is an important objective, and as policymakers we need to pursue this without compromising on the prudential standards that sustain confidence in the financial system. Branchless banking has tremendous potential to increase the outreach of financial services provided the different players and regulators are able to work within common regulatory framework. And finally that we must adopt a collaborative stance in pursuing this important global agenda which can make a real difference for the millions of people that remain caught in poverty.

On behalf of Bank Negara Malaysia I would also like to thank our principal facilitators for the workshop from the Consultative Group to Assist the Poor, the subject matter experts from World Bank, the representatives from Maxis Communications Malaysia and Global Exchange of Philippines, and the representative from Group Speciale Mobile Association who joins us from London. I also welcome the participation of the Alliance for Financial Inclusion in this Forum, and we look forward to working with all of you on developing more inclusive financial sectors in the Asian region. Finally, I would like to thank all the participants who have come in from all over Asia to support this Forum. I wish you a fruitful forum and hope that you will form valuable professional relationships during this event.