Financial Inclusion: Banking the Unbanked[1]

Chair of this program
Fellow Governors, Deputy Governors
Distinguished Delegates
Course Coordinator
Ladies and Gentlemen,

1. It is my great pleasure to present keynote speech for this 30th SEANZA Governors' symposium under the theme "**Financial Inclusion: Banking the Unbanked**". The financial sector has made tremendous development and expansion in the world, and has become the backbone of the economy. Still, despite growing financial expansion all over the world, financial inclusion is a matter of concerns for policy makers, especially central banks of developing countries while discharging the role of developmental finance. Thus, today's topic is pertinent for us to discuss and come up with concrete solutions to increase the access to finance.

2. Ten years ago, in 2006, the United Nations Committee on Building Inclusive Financial Sectors urged central banks and countries to incorporate the goal of universal "financial inclusion". Enunciating its pledge to financial inclusion, the G-20 set up the Global Partnership for Financial Inclusion in December 2010, a platform that also included interested non-G20 countries and relevant stakeholders, to carry forward work on financial inclusion.

3. Given clear links among access to finance, growth, income smoothing, and poverty reduction, many countries are now adopting the goal of universal financial access. Moving beyond the 'micro credit only' approach, financial inclusion has become recognized to include a variety of products and services as well as the cost effective provision of such services by a spectrum of financial service providers. Recognizing that 2.5 billion adults worldwide are 'unbanked' and that close to 200 million micro to medium enterprises in developing economies do not have access to affordable financial services and credit, the World Bank Group has laid out a vision for achieving universal financial access by 2020 (World Bank, 2015).

4. Likewise, governments around the world are perceiving financial inclusion as vital for economic development. Since 2011, over 90 developing countries, constituting more than 75 percent of the world's unbanked population, have signed the *Maya declaration*. The declaration is a set of measurable commitments that aim to improve social and economic conditions of the poorest in society through financial inclusion. This provides basic background for enhancing access to finance.

5. Because of some global efforts, gaps in access to finance are slowly narrowing down. For instance, the number of people worldwide having an account rose by 700 million between 2011 and 2014 with 62 percent of the world's adult population having an account, up from 51 percent in 2011 (World Bank, 2014). Still, the gender gap is not sharply narrowing, with 58 percent of women with an account compared to 65 percent of men. Likewise, more than half of adults in the poorest 40 percent of households in developing countries are still without accounts in 2014 (World Bank, 2014; Demirgüç-Kunt et al., 2015).

6. Asia-Pacific region is still home to an estimated 1.2 billion people who do not have access to a bank account or formal financial services (ADB, 2015). Only 84 percent of firms in developing Asia have a checking or savings account, which is comparable to Africa but lags behind Latin America's 89 percent and emerging Europe's 92 percent (ADB, 2015). Similarly, only 33 percent of firms in developing Asia have a line of credit or loan from a financial institution—much lower than Latin America's 54 percent and emerging Europe's 41 percent. This implies that firms in Asia still rely on informal sources, such as moneylenders, personal savings and funds from family and friends of credit for their business needs.

[1] Key Note Speech by Dr. Chiranjibi Nepal, Governor, Nepal Rastra Bank

7. Against this backdrop, today, I would like to highlight some major constraints in enhancing financial inclusion and the accompanying measures to reap the benefits of financial inclusion. I would also like to share briefly Nepal's experiences in enhancing financial inclusion.

8. Generally speaking, financial inclusion implies access to finance and financial services for all in a fair, transparent and equitable manner at an affordable cost (Sarma, 2008). According to Fuller and Mellor (2008), financial inclusion denotes the desire to develop 'alternative', welfare-oriented (rather than profit-driven), reliable, affordable and accessible financial services for all sections of the population. Others, however, regard inclusion as a market-driven remedy for poverty alleviation (Alpana, 2007).

9. No doubt, financial inclusion brings several benefits to the society and the economy, and a vital tool for poverty reduction and inclusive growth which is necessary for creating equitable society. Financial inclusion provides opportunities to better manage and increase savings, and borrow to satisfy emergency cash needs, a loan to fund education or health needs, and for productive investment. By borrowing, firms overcome cash constraints to establish and undertake new businesses, to meet the funds for working capital needs and also for business expansion. Formal financial institutions lower the reliance of individuals and firms on moneylenders and other sources of credit in the informal sector that often charge exorbitant rates of interest.

Ladies and Gentlemen,

10. However, despite several advantages, banking the unbanked is not easy task, and still a long way to go. We need to confront various obstacles, which require effective and innovative measures to tackle. Let me illustrate a few difficulties for expanding financial inclusion, although not exhaustive, particularly observed in developing countries.

Obstacles and Accompanying Measures

11. **First**, the geographic distance to a bank can be a huge deterrent for a poor individual. Consequently, transaction costs, both for banks and poor people, are a major barrier to financial inclusion. For banks, the cost of handling very small transactions is high and to operate in remote locations with little financial activity is costly and may not be feasible. **Second**, lack of financial literacy. The low level of financial literacy lowers the population's ability to understand financial products and services. **Third**, regulatory regime not conducive to poor people. The Global Findex data depicts that 18 percent of adults in the developing world cite 'lack of necessary documentation' as the reason for not having a formal account. Tough KYC documentation requirements imposed on banks in order to comply with guidelines for the prevention of money laundering and combating the financing of terrorism can prevent poor households from entering the financial system.

12. **Fourth**, absence of a sound and efficient payment system. In fact, it could be inferred that financial inclusion is a by-product of efficiency and soundness of the national payments system. **Fifth**, lack of appropriate financial products. Financial products have to be tailored to meet the requirements of the poor. Products need to be affordable and available within reasonable physical proximity and customers' friendly. **Sixth**, weak adoption of modern technology. Passing enabling regulation does not guarantee increased access if the users are not able to comprehend the product and services available with modern technology. **Seventh**, lack of data and information. Tracking progress and measuring outcomes of financial inclusion policy reforms are vital components of any financial inclusion initiative. To track progress in achieving more inclusive financial systems and measure their impact, reliable and comprehensive data that encapsulate various dimensions of financial inclusion are a prerequisite for evidence-based policymaking.

13. We need innovative ways to tackle these hurdles for expanding financial access in the countries like ours. Policy makers in developing countries need to formulate specific strategies to increase the use of financial services by rural populations or those living in areas with limited coverage. Mandating banks to open in unbanked rural locations and the development of community-based savings groups are a few strategies

that have been adopted in different countries with varying levels of success. Use of Information and Communication technology (ICT) with expansion of financial literacy seems to be a better way to overcome geographical and informational barrier to get access to formal financial services through development of modern payment systems. Overcoming the governance problems and enhancing the efficiency of public sector financial institutions with more responsibility to reach remote and unbanked areas could also enhance financial access in the economy.

14. To enhance financial inclusion, we also need to think on relaxing KYC requirement at least for the poor. Many low and middle-income countries do not have universal identification system and poor people may not possess documents such as utility bills or pay slips that are taken for granted in developed countries. Moreover, developing special financial institutions is required to cater the needs of the poor people and those living in remote areas, where mainstream financial institutions hesitate to go. Since costs of getting financial service are also major concerns for financial inclusion, government needs to think about subsidizing the micro-finance activities to enhance the outreach to the poor at affordable costs. Use of ICT helps reduce operating costs to reach unbanked areas. Need assessment is also necessary to devise appropriate financial products to meet the demand of people of the unbanked areas.

15. Mobile money has taken an upsurge in countries where branch banking has been constrained due to transportation and infrastructure hurdles. Moving from cash-based to digital payments has the potential benefits of providing a first entry point into the formal financial system and making payments more efficient by lowering the cost of disbursing and receiving payments. More importantly, a wide range of financial education initiatives should be developed and delivered through various channels to enhance financial literacy among general people. Further, adequate and reliable data are crucial for detecting policy gaps, comprehending both served and underserved populations, and monitoring progress of financial inclusion initiatives. In this light, it appears important for governments to implement nationally-led surveys of financial inclusion on a larger scale.

Financial Inclusion in Nepal

Ladies and Gentlemen,

16. Let me now allow me to present the status of financial inclusion and attempts done and current policies for expanding financial access. However, we have yet to move a long way to achieve universal access to finance in Nepal.

17. There are four types of financial institutions licensed by the Nepal Rastra Bank (NRB), the central bank of the country, namely commercial banks (A class), development banks (B class), finance companies (C class) and micro finance institutions (D class). As at mid-June 2016, the number of commercial banks, development banks, finance companies and micro finance institutions (MFIs) stood at 29, 68, 44 and 41 respectively. There has been substantial expansion of financial institutions in Nepal since the beginning of financial liberalization in the mid-1980s. Before that, there were just state-owned two commercial banks and two development banks in Nepal.

18. Financial access has been growing with the expansion of network of financial institutions. As of mid-June 2016, the branch network of commercial banks stood at 1851, followed by 1330 branches of micro finance institutions (MFI)s, 848 branches of development banks and 190 branches of finance companies. With the total number of branches of BFIs standing at 4219, the population per branch of financial institution was 6,647 at mid-June 2016.[2] Access to finance is quite uneven, however, mostly concentrated in urban and semi-urban areas. In some remote districts population per branch remain as high as 72026.

19. A recent FinScope Consumer survey undertaken by the UNCDF in 2014 showed that 61 percent of Nepalese adults have access to formal financial services which also includes financial service from saving

[2]This excludes the FINGOs and cooperatives.

and credit cooperatives as well and 18 percent remain totally excluded.[3] Moreover, only 57 percent of adults claim to save and 45 percent claim to borrow money.

20. Supply side survey released recently in 2016 showed that lack of appropriate financial products to cater the need of the poor people contributed to low level of financial access despite the expansion of financial institutions. Financial products available in the market are unsuitable for the poor, and the people like farmers and irregular earners.

21. Acknowledging the significance of financial inclusion policy for Nepal, the NRB has taken a number of policy measures to ensure reliable and affordable financial services to the poor people in the country since the 1970s. Likewise, some policy models were introduced in the past for advancing financial inclusion. These included the Grameen Bank Model, the Wholesale Micro Finance Model, the Directed Lending Model, Project-Based Micro Credit Model, and the FINGOs and the SACCOs Model.

22. Under the **Grameen Bank Model**, based on group solidarity mechanism where credit is linked to savings and focus exclusively on women, MFIs licensed by the NRB employ this model to cater financial services to the deprived women, especially in rural areas. The **Wholesale Micro Finance Model** was introduced in Nepal with the setting up of the Rural Self-Reliance Fund (RSRF) in 1991 to provide wholesale credit to other institutions involving in micro finance activities.[4] With respect to **Directed Lending Model**, NRB introduced the Deprived Sector Credit Program in 1991 under which the BFIs (A, B and C class) were required to lend a specified portion of total outstanding loan to deprived sector. Currently, commercial banks, development banks and finance companies are required to lend at least 5.0 percent, 4.5 percent and 4.0 percent of their outstanding loans respectively to deprived sector either directly or through any other MFIs.

23. In terms of the **Project-based Micro-credit Model**, a number of external donor agencies have been rendering technical and financial assistance to enhance the rural financing activities in Nepal.[5] Projects such as Raising Income of Small and Medium Farmers Project (RISMFP), UNNATI Access to Finance Project (UNNATI-A2F), Mobile Money for the Poor (MM4P) and Making Access Possible (MAP) are currently ongoing projects and have focused on poverty alleviation and access to finance in rural areas.

24. With respect to both the **FINGOs Model and the SACCOs Model**, the NRB had issued licenses to financial NGOs (FINGOs) and Savings and Credit Cooperatives (SACCOs) to undertake limited banking activities aiming to expand financial services basically for the members. Even outside the NRB's preview, there are about 14000 saving and credit cooperatives operating in different parts of the country.

25. Besides introducing the different models for providing affordable financial services, to the poor, a number of other policy measures have also been initiated by the NRB for enhancing financial inclusion in recent years. These include liberal licensing policy for MFIs, requirements for BFIs (A, B. and C Class) to allocate certain percentage of their credit for investment in the productive sector, special refinance facility to cottage and small industries, interest free loan to extend bank branches in remote and rural areas, directives on consumer protection, and directives on branchless banking and mobile banking services, among others.

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[3] Undertaken in late 2014, the survey was based on 4,014 samples of the adult population in Nepal, aged 18 years and above, across 70 districts covering the terai, hills and mountain. Details are presented in UNCDF (2015).

[4] The other wholesale lending institutions include Rural Micro Finance Development Center, Small Farmer Development Bank Ltd., First Micro Finance Development Bank and RSDC Micro Finance Development Bank that manage their funds from other BFIs (A, B or C class) with respect to deprived sector lending or take loan from other institutions and then provide wholesale credit to MFIs and/or cooperatives for further lending to individual clients as micro credit.

[5] These include IDA, ADB, UNDP, UNICEF, UNIFEM, EU, IFAD, USAID, CIDA, GIZ, DFID, and UNCDF.

26. The government through the Budget for 2016/17 has outlined some policy directions. These included expansion of banking and financial services in the rural areas, promotion of mobile banking and branchless banking, continuation of government led programs such as Rural Self Reliance Fund (RSRF), Poverty Alleviation Fund (PAF), Youth and Small Entrepreneur Self-employment Fund, and the implementation of subsidized agricultural lending program.

27. NRB has been implementing its second five-year Strategic Plan (2012-2016), in which financial inclusion has been identified as a strategic priority. This Plan is formulated on seven strategic pillars, financial sector stability being one of them under which enhancing financial inclusion is a strategic priority. Likewise, the Monetary Policy of 2016/17 is also directed towards deepening financial inclusion through enhancing financial literacy and access to finance. It has also made commitment to support government's initiation of opening 'at least one bank account for each household' and the arrangement of distributing social security allowances through the bank account.

28. Moreover, final draft of the National Financial Literacy Policy is waiting for Government's approval. Likewise the NRB, along with other stakeholders, has formulated a draft of the Financial Sector Development Strategy (FSDS) 2015-2020, in which financial access and inclusion serves as a pillar of the banking system.[6] The FSDS accords emphasis on some mechanisms for increasing access to finance: such as a) formulating appropriate policies for expanding financial access and inclusion; b) improving institutional arrangements for expanding financial access; c) strengthening the regulatory and supervisory framework for MFIs; d) enhancing public awareness through financial literacy and education; and e) promoting consumer protection with regard to utilizing financial services and products.

29. Finally, for providing a direction for financial inclusion in Nepal, a roadmap is essential. In this respect the *Nepal Financial Inclusion Roadmap (2017–2022)* has been released last month. The Roadmap proposes a policy target of increasing formal financial inclusion in Nepal from 60 percent to 75 percent by 2022, and reducing the excluded proportion from 18 percent to 3 percent. To attain this target, the Roadmap proposes six initiatives including the following: "1) unlock constrained credit and savings markets; 2) improve the payments system; 3) bolster risk-mitigation capabilities; 4) enhance and leverage locally based financial service providers; 5) enhance financial inclusion support in the national governance; and 6) strengthen consumer empowerment, protection and education." (UNCDF, 2016, p. 20).

Conclusion

30. At last, I would like to conclude my speech by saying that in the majority of developing economies, access to and use of financial services lags behind the developed world. The gains from increasing financial inclusion can be substantial so that governments and central banks need to actively seek reforms to improve the legal and regulatory environment as well as institutional infrastructure to speed up the adoption of new and more attractive financial products and digital technology, which should help reduce transaction costs and overcome obstacles to enhance financial inclusion. We should also realize that though financial inclusion has become a general phenomenon, it cannot be addressed by a single product or "one size fit all" approach. For this reason, financial inclusion plans, policies, institutions, measures and models should be tailored appropriately to suit the country specific context.

Thank You

[6] The FSDS encompasses all the players of the financial sector, such as the Securities Board of Nepal (SEBON), Insurance Board of Nepal, Department of Cooperatives, and Ministry of Finance. The FSDS was one of the four commitments made by NRB to the Maya Declaration in 2013. The other commitments include promotion of financial literacy; conducting of rural credit survey and introduction of mobile money service. The draft of the FSDS has been submitted to the Government for approval.