

MicroNOTE

NO: 02 SEPTEMBER 2008

Regulated Playground for Branchless Banking in Pakistan

By SARA SAEED KHAN

INTRODUCTION

Development literature is a concoction of various paradigms and paradigm shifts. One of the recent swirls in this field has been the campaign on Information and Communication Technologies (ICTs), and their use in closing the gap between poverty driven polarizations within societies and regions, and on a broader scale, between the developed and developing faces of the globe.

For microfinance world-over, building inclusive financial spaces for the un-banked and financially under-served has been at the forefront of all progressive and forward looking institutions. Branchless Banking¹ is a term that has caught traction as the microfinance industry warms up to the idea of leveraging the outreach and cost advantages offered by various technologies and distribution models in targeting the double bottom line. A departure from regular brick and mortar banking, branchless banking offers a combination of virtual space and physical exchanges to extend and broaden the outreach of financial services.

Internationally, countries that have deployed branchless banking can be plotted along a maturity curve, each at a different stage, contending with traits and challenges specific to their respective contexts. This gives all interested players an opportunity to benchmark and benefit from experiences as they move into and explore untamed territory.

Pakistan has taken time to join this band wagon, and even today as awareness continues to build we foresee significant inroads to be made before we can claim critical mass. The regulatory framework that has recently been rolled out by the State Bank of Pakistan (SBP) is an important first step in formalising our contribution to ICT-enabled financial outreach. Regulating un-chartered space is a challenging task needless to say, but the newly promulgated framework seems to offer a carefully balanced mix between allowable models and activities, and their legal and regulatory mandates. For the moment however, this is true for the bank-led model only since non-bank and other models are expected to unroll in the future, based on the results of initial experimentation.

The author Sara Saeed Khan is the Technology and Communications Analyst at the Pakistan Microfinance Network. The PMN would like to acknowledge the comments and input by Ali Abbas Sikander of Tameer Microfinance Bank, and valuable input by Mark Pickens and Stefan Staschen at CGAP.

¹The definition in CGAP and DFID's Focus Note 43 is "the use of information and communication technologies (ICTs) and nonbank retail channels to reduce costs of delivering financial services to clients beyond the reach of traditional banking." Lyman, Timothy, Mark Pickens and David Porteous. "Regulating Transformational Branchless Banking: Mobile Phones and Other Technology to Increase Access to Finance." Focus Note 43. CGAP/DFID. Jan. 2008. http://www.cgap.org/gm/document-1.9.2583/FocusNote_43.pdf

KEY DRIVERS FOR SUCCESS

In its note on “Regulating Transformational Branchless Banking”, CGAP has identified a stream of critical elements that need close regulatory attention. Among these, the role of agents and AML/CFT controls has been specifically highlighted. One of the reasons that agent networks will facilitate the adoption of branchless banking in Pakistan is that they lend an amiable front to the institutions that keep low income and poorer populations from approaching formal financial services.

Moreover, outfitting local retailers with technologies such as POS terminals, biometric devices and mobile phones will quicken the spread of branchless banking activities because of the ubiquity of the mobile phone, the frequency of client visits to the local distributor, and the milieu of informal interactions that develops between retailers and client communities.

It is important to keep agent networks in check for a variety of risks that are associated with them. This is not always advisable however; in India for example, the narrow choice of entities permitted to operate as agents (essentially only NGOs and post offices), has led to an unenterprising uptake of transformational branchless banking when seen against the more flexible regulatory space and foray of agent networks in Brazil. In Pakistan, illiteracy, poor client redressal systems, risks of fraud, and several others factors have prompted the SBP to frame service level guidelines for the Agent Financial Institution (FI) combination, and requirements for agency due diligence (ADD). This is to ensure that potential agents have the infrastructure to comply with risk mitigations before they can enter into branchless banking transactions on behalf of a FI.

The current framework seems to have the tools necessary to get the initial increments of branchless banking off the ground in Pakistan. Building trust networks within the structure of agent assisted banking is critical to generate enough usage for making these models economically feasible (it is imperative that the FI/agent relationship is incentive driven, which is measurable for both parties) and attractive for financial institutions serving the un-banked. For those institutions hesitant to step in, there will soon be a host of pilot projects and similar cases to study as these begin snow-balling. There will also be networks of agents and retail outlets more experienced in handling technology enabled financial transfers and cash-handling. One of the critical factors in deploying banking through agent networks is location the ubiquity of agents is what is going to boost the factors of convenience, cost and usage, and get financial services to the un-banked.

Proportionality of regulation is another important element that resonates in this hype surrounding branchless banking. CGAP recommends that AML/CFT laws when adapted to models targeting the lower end of the pyramid should proportionally be shaped to the realities of the lower income segment, and reflect the risks associated with the number and value of transactions that will circulate in the system. These

²Agents can be described as third party entities / retailers willing to undertake cash transactions on behalf of a financial institution. Could refer readers who want more info to Focus Note 38 where CGAP coined the term “agent”. Lyman, Timothy, Gautam Ivatury, Stefan Staschen. “Use of Agents in Branchless Banking for the Poor.” Focus Note 38, CGAP. Oct. 2006.

³ GPRS based or dial-up

⁴ Could refer readers who want more info to Lauer, Kate, Mark Pickens, Stefan Staschen. “Notes on Regulation of Branchless Banking in India.” CGAP. Jan. 2008. <http://www.cgap.org/p/site/c/template.rc/1.26.1482>

should also accommodate the implications of conducting transactions through relatively unsophisticated agents. Overly prudential AML/CFT will limit the access and convenience of branchless banking accounts. In Pakistan, a risk-based approach has been structured by leveling branchless banking accounts around transactional and documentary limits. However, even a level one account (*please see table 1*) that appears to permit the lowest transactional flexibility in terms of number and value, requires that the client provide a photocopy of his/her CNIC before such an account can be opened. The drawback is that in order to cut across to the mid and lower levels of the pyramid and reach out to remote areas, such requirements serve to limit the uptake by clients. It is recommended that there be significant risk-based adjustments in the pre-requisites to account opening (i.e. expanding the list of acceptable proof of identity beyond the CNIC, to include other sources such as letters from government officials or IDs from other KYCed clients) - Only then will the convenience of this form of banking translate into value for its demographic.

Table 1. Transactional Requirements by Account Level Adapted from the SBP Regulations on Branchless Banking

Account Level	Level 1	Level 2	Level 3
Description	Entry level: for low income individuals.	Top level offering all branchless banking transactions, subject to full KYC req. (as applicable to full-service banking account.	Account for merchants, businesses, banking agents or third party providers.
KYC requirements	Fill and sign an application form; Photocopy of CNIC; Verification of CNIC by NADRA; At least one face to face interaction with a designated employee of the FI or biometric fingerprint, and digital photo taken by the agent must reach the FI.	Fill and sign an application form; All KYC requirements as laid down under Prudential Regulations issued by the SBP apply; Verification of CNIC by NADRA;	Fulfillment of all requirements of level 3 account; Fulfillment of additional requirements as specified by the FI.
Max. Bal. allowed Debit/Credit)	PKR. 60,000	FI must set limits according to each customer profile.	FI must set limits according to each customer profile.
Max throughput allowed (Debit/Credit)	PKR. 10,000 per day PKR. 20,000 per month PKR. 1,20,000 per year	FI must set limits according to each customer profile.	FI must set limits according to each customer profile.

Currently, under allowable activities agents are permitted to open a level one account for a client on behalf of their financial partners. For convenience and value to cultivate to potential, these rules will need to be further stretched in order to allow additional facilitatory activities to fall under the agent. Whether the regulations on branchless banking are meeting these calls for proportionality, is yet to be determined.

Overall, the branchless banking regulations are an important first step into an area that has the potential to grow exponentially, showing appreciable and prompt action taken by the national regulatory authority to get things moving. However, against all the hype that has taken a steep route in microfinance, we too need proportionality in our excitement around this tide of enabling technologies.

BENEFITS AND CHALLENGES:

If business models are developed correctly and tailored commercially, the benefits for the industry can be seen in terms of:

- ▶ Additional liquidity for the MF sector;
- ▶ Greater outreach of basic financial services like savings accounts and remittances, and greater fee income via transactional fees and utility bill commissions;
- ▶ Reaching new market segments and/or increasing the profitability of serving current customers;
- ▶ Access of banking services for first time users;
- ▶ Better quality of service;
- ▶ Policy makers meeting greater numbers for access to finance, which will have a bearing on economic development as well as health, nutrition and education outcomes;
- ▶ Introducing increased competition and efficiency in the financial sector.

Benefits aside, there remain a fair amount of challenges for the industry en route to new branchless banking initiatives:

- ▶ Finding the right kind of agent networks;
- ▶ Ensuring that agents comply with the legalities and moral codes of the business, and creating appropriate incentives for them;
- ▶ Cash theft;
- ▶ Fraud management;
- ▶ Customer service benchmarks and monitoring;
- ▶ Agent trainings and development;
- ▶ Customer education;
- ▶ Building trust networks,
- ▶ Information system streamlining and integration, and
- ▶ Regulatory reporting.

MicroNOTE (Issue No 2): Regulated Playground for Branchless Banking in Pakistan

Published in Pakistan in September 2008 by **Pakistan Microfinance Network** with support from the Department for International Development (DFID)

Authored by Sara Khan

Design and Layout by Sumaira Sagheer

Printed at PanGraphics (Pvt.) Limited, Pakistan

Copyright © 2008 Pakistan Microfinance Network. 38-B, Street 33, F 8/1, Islamabad, Pakistan
Tel: +92 (51) 2816139-41, Fax: +92 (51) 2854702, Email: info@pmn.org.pk, www.pmn.org.pk
All rights reserved. For further information, contact Sara Khan at skhan@pmn.org.pk

The views expressed in this document are those of the author and do not necessarily reflect the views and policies of Pakistan Microfinance Network (PMN) or the donors who have funded the study.

PMN does not guarantee the accuracy of the data and information included in this document and accepts no responsibility for any outcome of their use.