MANAGING THE RISKS IN FINANCIAL INCLUSION AND AGENCY BANKING

Emmanuel Moore Abolo, Dr.

Available at: https://works.bepress.com/emmanuel_abolo/6/
MANAGING RISKS IN FINANCIAL INCLUSION AND AGENCY BANKING

DR EMMANUEL MOORE ABOLO
CHIEF RISK & COMPLIANCE OFFICER
NIGERIAN EXPORT-IMPORT BANK

ABUJA.
JULY 15, 2014
"The Central Bank of Nigeria has expressed strong commitment to financial inclusion in the country by ensuring that the number of unbanked Nigerians is reduced drastically over the next few years. Specifically, the CBN said it would reduce the country’s unbanked population by 20 per cent before year 2020."
Outline

- Financial Exclusion
- What is Financial Inclusion?
- Why Are We Talking About Financial Inclusion?
- Twin Aspects of Financial Inclusion
- State of Financial Inclusion
- Financial Inclusion: Who Are These People?
- Obstacles to Financial Inclusion
- Risks in Financial Inclusion & Management
- What is Agency Banking?
- Rationale for Agency Banking
- Agency Banking SWOT
- Agency Banking Types
- Agency Banking: Some Examples
- Risks in Agency Banking
- Managing Agent Related Risks.
FINANCIAL EXCLUSION

- No Savings
- No assets
- No bank account
- No affordable credit
- No access to money advice
- No Insurance
**What is Financial Inclusion?**

a. Financial Inclusion is defined as “the process of ensuring access to appropriate financial products and services needed by vulnerable groups such as weaker sections and low income groups at an affordable cost in a fair and transparent manner by mainstream institutional players.” RBI CIRCULAR 12.08.2011

b. Approach is based on the fundamental principle of 5A’s of ensuring

   i. **Adequacy and**

   ii. **Availability** of financial services to all sections of the society through the formal financial system covering savings, credit, remittance, insurance, etc. and, at the same time,

   iii. increasing **Awareness** of such services and

   iv. ensuring **Affordability** ; and

   v. **Accessibility** of the appropriate financial products:

   - through a combination of conventional and alternative delivery channels; and technology enabled services and processes.
"The process of ensuring access to appropriate financial products and services needed by vulnerable groups such as weaker sections and low income groups at an affordable cost in a fair and transparent manner by mainstream Institutional players."

- The Committee on Financial Inclusion
  (Chairman: Dr. C. Rangarajan, 2008)
WHAT IS FINANCIAL INCLUSION? CONT
OBJECTIVES OF FINANCIAL INCLUSION

- **Economic:**
  - Equitable growth
  - FIIs can boost the development process

- **Mobilisation of Savings**
  - Capital formation and economic growth

- **Larger Market for the financial system**
  - Emergence for new players
  - Participation of retail investors

- **Social**
  - Poverty Eradication
  - Financial Literacy

- **Sustainability**
  - To improve income generation by low income groups

- **Institutional**
  - Effective implementation
Why are we talking of financial inclusion now?

- Focus on Inclusive Growth
- Banking Technology has arrived
- Realisation that Poor is bankable
TWIN ASPECTS OF FINANCIAL INCLUSION

- Financial Inclusion and Financial Literacy are twin pillars. While Financial Inclusion acts from supply side providing the financial market/services what people demand, Financial Literacy stimulates the demand side – making people aware of what they can demand.

Demand Side & Supply Side

Financial Literacy - Fair & Appropriateness

Financial Inclusion - Access

- Developing Economies face the problem of low level of literacy, poor accessibility and low demand. Therefore it is necessary for developing an Index for measuring both Access as well as the level of Literacy.
STATE OF FINANCIAL INCLUSION

More than half the world’s adult population lack access to credit, insurance, savings accounts, and other formal financial services.

The problem goes further if focused on the poor people living on less than USD 2 per day, as their income is not only low but also irregular and are therefore more vulnerable to external shocks and uncertainties of their cash flows.

Less than 10% of the people who live with under USD 2 a day have access to formal financial services.

The number of unbanked adults is estimated to be 2.7 billion (72 percent of adults) in developing countries and 160 million (19 percent of adults) in developed countries.

It is estimated that 1.4 billion people, or one quarter of the population of the developing world, lived below an absolute poverty level of $1.25 a day in 2005.

More than 215 million people (or 3% of the world's population) live outside their countries of birth and sent an estimated $325 billion to developing countries in 2010.
Financial Inclusion: Who Are These People?

- Underprivileged section in rural and urban areas like, Farmers, small vendors, etc.;
- Agricultural and Industrial Laborers;
- People engaged in un-organized sectors;
- Unemployed;
- Women;
- Children;
- Old people; and
- Physically challenged people.
The main obstacles to financial inclusion can be summarized as follows:

**Supply side**

* Outreach: low density areas and low income populations are not attractive for the provision of financial services and are not financially sustainable under traditional banking business models and corresponding regulatory requirements
* Regulation: frameworks are not always adapted to local contexts
* Business models: mostly with high fixed costs
* Providers: limited number and types of financial service providers
* Services: non-adapted products and services for low income populations and the informal economy

**Demand side**

* Irregular income
* Frequent micro-transactions
* Lack of trust in formal banking institutions
* Literacy level, lack of awareness and/or knowledge/understanding of financial products
* Cultural obstacles (e.g., gender and cultural values).
RISKS IN FINANCIAL INCLUSION & MANAGEMENT

- Large numbers of low-value transactions
- Lack of collateral for lending
- High levels of dormancy Customers / Products
- Developing pro-poor products, appropriately priced, for the chosen market segments
- Avoiding “contamination” of existing customers/products Delivery model
- Managing a remote network
- Reaching the remote poor at low cost
- Harnessing technology
- IT and staff capacity to cope with increased volumes
- Physical security, especially for cash transportation
- Poor infrastructure – power and communications
- Staff with negative attitude to the poor and to micro segment
- Banking the poor still often seen as largely a CSR activity
- Financial literacy improving but not perfect
- Difficulty of customer identification
- Inflexible AML/CFT rules
  - Manage the risks in an enterprise-wide framework.
Policies that enable banks to contract with nonbank retail agents as outlets for financial services have proven highly successful in advancing financial inclusion where bank branches are not economically viable.

Such policies leverage existing retail infrastructure as delivery channels, and turn pharmacies, post offices, or supermarkets not only into agents of banks but agents of financial inclusion.

Collaboration among banks and agents has become possible as technology has reduced the costs and risks of the remote exchange of information to carry out financial transactions.

Coupled with simplified account opening procedures and other incentives to use this channel, such as the delivery of cash transfers, financial system outreach and numbers of users can increase explosively.
What is Agency Banking?

- A **banking agent** is a retail or postal outlet contracted by a financial institution or a mobile network operator to process clients’ transactions. Rather than a branch teller, it is the owner or an employee of the retail outlet who conducts the transaction and lets clients deposit, withdraw, and transfer funds, pay their bills, inquire about an account balance, or receive government benefits or a direct deposit from their employer. Banking agents can be pharmacies, supermarkets, convenience stores, lottery outlets, post offices, and many more.

- Globally, these retailers and post offices are increasingly utilized as important distribution channels for financial institutions. The points of service range from post offices in the Outback of Australia where clients from all banks can conduct their transactions, to rural France where the bank Credit Agricole uses corner stores to provide financial services, to small lottery outlets in Brazil at which clients can receive their social payments and access their bank accounts.
RATIONALE FOR AGENT BANKING

- Banking agents help financial institutions to divert existing customers from crowded branches providing a “complementary”, often more convenient channel. Other financial institutions, especially in developing markets, use agents to reach an “additional” client segment or geography.

- Reaching poor clients in rural areas is often prohibitively expensive for financial institutions since transaction numbers and volumes do not cover the cost of a branch. In such environments banking agents that piggy back on existing retail infrastructure – and lower set up and running cost - can play a vital role in offering many low-income people their first-time access to a range of financial services. Also, low-income clients often feel more comfortable banking at their local store than walking into a marble branch.

- Banking agents are the backbone of mobile banking, i.e., performing transactions over a mobile device, most often a mobile phone. To enable clients to convert cash into electronic money and vice versa which can send be sent over their mobile phone, clients will have to visit a branch, automated teller machine (ATM), or banking agent. Especially in remote and rural locations, where cash is still the most important way to pay and transact, a mobile banking service is dependent on banking agents to enable clients to effectively use the service.
Agency Banking: SWOT

**Strengths**
- Lower cost than building traditional bank branches, hiring fixed employees
- Commission-based costs supports scaling Agency network, variable financial case
- Helps lower queues in bank halls
- Can support retailer / SME banking business line
- Can be used to sell business accounts, allowing salary disbursal for employees

**Opportunities**
- Tendency to leave money in bank account, with easier access / more locations
- Combined behaviour (banking & agency location activity) can increase number of banking moments, joint activities
- Support card usage (if using POS)
- Can generate new bill payment revenues (incl. taxes, school fees) in some markets
- Can increase customer base (more locations)

**Weaknesses**
- Lack of real control of agent behaviour, cash control
- Less chance of real interaction with customers, up-sell/cross-sell
- Requires a “partner management” programme / systems / people
- Requires careful management of float, collection accounts, etc.

**Threats**
- Bank reputational risk if things go wrong
- Partner management / CIT key to Agency Banking success, often requires branch support to ensure Agencies are supported correctly
- Will consumers accept this in some countries?
Agency Banking Types

- Retailers (chain, independent)
- Insurance Outlets
- Post Offices
- Lottery Outlets
- Mobile Network Dealers
- Pharmacies
Agency Banking: Some Examples

Brazil

- Brazil is probably the most developed market where banking agents have significantly increased financial system infrastructure.
- 74 institutions are currently managing around 105,000 points of sale that reach all 5,561 municipalities. The Brazilian correspondent banking locations are over 60% of all points of sale in the Brazilian financial system.
- Financial institutions in other Latin-American markets such as Peru, Colombia, and Mexico have started to learn from the Brazilian experience, adjusted their regulation and established their own banking agent networks.
Agency Banking: Some Examples—continued

**Australian Post**

- Provides banking services on behalf of 70+ banks/financial institutions at 3,200 outlets.
- Deposits, withdrawals, account balance inquiries, bill payments, etc. No fees for any of these services.
- “Bank@Post” partnership with Rural Bank for account opening.
- All-services payment concept with remittances, prepaid VISA, PostPay online e-commerce product (pay on delivery) & Pay it @ Post (accepting cash for online payments) in combination with SecurePay (online payment product).
Agency Banking: Some Examples—Continued

Banks & Post Offices in Supermarkets (US)

- The US has been working with these collaborative models for years.
- Primarily "shop-in-shop" models for services, leveraging large retailers (Walmart, K Mart) or super markets.
- Some examples:
  - Post Office (⬆)
  - Banks (⬆)
  - Mobile Network Operators (⬆)
  - Health Care / Medical Check-Ups (⬆)
  - Opticians (←→)
  - Coffee / Food Services (⬆) – however, often "retailer-owned"
  - Pharmacy (⬆) – could be "retailer-owned", depending on the U.S. state
- Some services (like post office) in retailers are being phased out based on lack of traffic/customers.
Risks in Agency Banking

The level and kinds of risk to which a bank will be exposed as a result of its use of agents will depend on:

- the extent of such use—the picture is quite different if a bank uses agents minimally or for 100 percent of its business;
- the activities in which its agents are engaged; and
- the bank’s management of the agent business, including not only proper oversight and monitoring of agent activities but also the process by which agents are selected and trained.

The use of agents can trigger operational, technological, legal/compliance, reputational, and other risks.
The use of a nonemployee—i.e., an agent—to service bank customers introduces new operational risks that may stem from lack of capacity, poor training, and lack of necessary tools and systems. These risks include the following:

- Agent fraud or theft
- Unauthorized fees
- Abusive service by agent of customers (in particular, tying—i.e., requiring clients to purchase certain goods and services to obtain other services) or misrepresentations regarding the agent’s role as acting on behalf of a bank
- Loss of customer assets and records
- Data entry errors
- Poor cash management resulting in an agent not having sufficient cash on hand to enable the customer to make a withdrawal
- Agent failure to resolve or forward consumer complaints to the bank.

Agents may themselves be subjected to theft and third party fraud.
Technological risks. Utility disruptions or software or hardware failures can cause a lack of service availability and information loss.
Risks in Agency Banking: Legal/Compliance

- Customers may sue a bank as a result of agent theft or an agent’s violation of privacy laws/bank secrecy laws or other misuse of confidential customer data. Agents may sue the bank for breach of contract or for broader claims.

- Uncertainty in the applicability of agent-related laws or regulations and the interpretation of contracts give rise to the risk of lawsuit.

- For instance, in Brazil, agents are suing banks, claiming that they are the functional equivalent of bank staff and should receive the same benefits, including salary and leave. Compliance risks include risks of fines or other civil actions due to an agent’s noncompliance with law or regulation, such as anti-money laundering and combating the financing of terrorism (AML/CFT) regulations, bank reporting requirements, or applicable consumer protection rules (e.g., transparency of pricing and other disclosure).
Risks in Agency Banking: Reputational

Underperformance by agents or agent fraud, robbery, agent liquidity shortfalls, loss of customer records, leakage of confidential customer data, and violation of consumer protection rules regarding price disclosure.

There may also be negative media due to systems failures. Agent-related AML/CFT lapses that result in a bank being used for financial crimes may result in the public’s association of the bank with criminals. Even if it is derivative, reputational risks can be the most damaging.
Risks in Agency Banking: Credit Risk

- Credit risks are tied primarily to operational risk: the bank may not receive the money owed by the agent (if, e.g., an agent has a credit line to help manage its liquidity) due to robbery of the agent or agent theft.

- To reduce the risk of loss of cash in Brazil, for instance, agents are required by regulation to go to the bank every other business day to deposit funds. In Mexico, each agent is required to have an account with the contracting bank.
MANAGING AGENT RELATED RISKS

Banks manage and mitigate risks triggered by the use of agents through various policies and procedures, internal audits, and review processes. Regulations may specify the required policies and procedures and corporate governance arrangements or the supervisor may impose them. Even in the absence of regulatory or supervisory requirements, a bank would typically have such policies and procedures in place to manage the risks of its agent business.

A bank’s approach to risk management in relation to its agent business will depend on the services performed by its agents, the aggregate value of the transactions they handle, as well as the number of agents and their geographic spread. There will be only minor agent-related risks to manage if a bank has only a small number of agents or uses agents for very limited services. In addition, independent and internal audits serve to determine the bank’s level of compliance with its own policies and procedures and with applicable regulation, including minimum technology standards. A bank’s approach to agents will, in many ways, be similar to its approach to outsourcing more generally.

In addition to policies and procedures regarding the selection, training, and monitoring of agents, a bank often will have other risk management policies and processes for its branchless banking operations, including periodic review, internal controls and audits, and contingency planning. In addition, while not common, banks may also seek insurance coverage and risk-sharing arrangements.
DISCUSSION POINT – Q & A

CONTACT DETAILS

mail@drabolomoore.com

www.drabolomoore.com

THANK YOU