

INNOVATIVE MSE-FINANCING PRODUCTS AND DELIVERY CHANNELS IN BANGLADESH:

OPPORTUNITIES & CHALLENGES

Sajjad Zohir
Shafiun Shimul
Asad Priyo
Tariq Ali
K M Masnun Hossain

December 2018
Dhaka, Bangladesh



Economic Research Group
D-6, House 06, Road 33, Gulshan, Dhaka
Email: info@ergonline.org; url: www.ergonline.org

INNOVATIVE MSE- FINANCING PRODUCTS AND DELIVERY CHANNELS IN BANGLADESH: Opportunities & Challenges

Sajjad Zohir¹

Shafiun Shimul²

Asad Karim Khan Priyo³

Tariq Ali⁴

K M Masnun Hossain⁵

December 2018

Dhaka, Bangladesh

Economic Research Group

D-6, House 06, Road 33, Gulshan, Dhaka

Email: info@ergonline.org; url: www.ergonline.org

-
1. Executive Director, Economic Research Group (ERG)
 2. Assistant Professor, Institute of Health Economics, University of Dhaka
 3. Assistant Professor, Department of Economics, North South University
 4. Independent Consultant
 5. Research Associate, Economic Research Group, (ERG)

ACKNOWLEDGMENT

The study owes much to the numerous stakeholders who helped us conduct the policy study on innovative mSE financing products and delivery channels in Bangladesh, and to shape the content of this report. The stakeholders came from diverse origins – regulators of banks, insurance, securities & exchange and other segments of the financial sector in Bangladesh, as well as from the telecommunication sector. There were numerous practitioners, particularly from the banking and fintech sectors.

The research team from the Economic Research Group (ERG) acknowledges comments and suggestions made by several anonymous reviewers, and to numerous stakeholders who spared their valuable time in articulating the issues. The report has been prepared in fulfilment of ERG's commitment to the Nathan Associate (London) Ltd., which facilitated the functioning of the Business Finance for the Poor in Bangladesh (BFP-B). We also acknowledge the fund provided by the UK Aid from the UK Government to BFP-B, a five-year programme implemented in Bangladesh to promote innovative finance and financial services for micro and small enterprises (mSEs).

The research team acknowledges the supports provided by the BFP-B team at the Nathan Associates. Mr. Feisal Hussain, Team Leader, BFP-B, provided useful insights on BFP-B's expectation with regard to the study. Mr Rashed Al Hasan, Policy Manager, BFP-B, and Ms. Tanzila Tajreen, Policy Coordinator, BFP-B, provided supports in liaising between the researchers and the policymakers, as well as with different groups of practitioners.

For a successful completion of a study that critically examines regulations, it is imperative that supports from government administration and regulators in the financial sectors were critical. We take this opportunity to specially thank Mr. Md. Ashadul Islam, Senior Secretary, Financial Institutions Division, Ministry of Finance and Chairman BFP-B Policy Advisory Committee and Mr. Arijit Chowdhury, Additional Secretary, Financial Institutions Division, Ministry of Finance and Chairman BFP-B Policy Working Committee for their keen encouragement and support. We are also thankful to the members of both BFP-B Policy Advisory Committee and Policy Working Committee for reviewing and finalising the findings of this policy study.

Finally, we acknowledge the contributions of all the participants at various consultation meeting. Without their time and input, this study would have been incomplete.

Given a setting of changing rules and regulations, no attempt was made to update the findings of the report. Readers may kindly note that the final report had been completed in May 2018 and the final presentation was made in December 2018. An edited version of that report may be found at the website of BFP-B/Nathan Associates.

Dr. Sajjad Zohir

(On behalf of the ERG research team)

Table of Contents

Acronyms.....	5
GLOSSARY OF TERMS.....	6
EXECUTIVE SUMMARY.....	10
CHAPTER 1	13
Introduction	13
1.1 Background	13
1.2 Context and rationale.....	14
1.3 Conceptual issues	15
1.3.1 Defining innovative financing	15
1.3.2 Key Concepts	16
1.4 Study Objectives	17
CHAPTER 2.....	18
Methodology	18
2.1 Conceptual Framework – understanding the FinTech Canvas.....	18
2.1.1 Interfaces between stakeholder-technology, and product-delivery channel.....	18
2.2 Study design	22
2.2.1 Sketch of the Consultation Process.....	22
2.2.2 Study Methodology: selection of themes and stakeholders for consultations	23
CHAPTER 3.....	26
Regulatory Issues – findings from review and consultations.....	26
3.1 Regulatory Issues in Insurance	26
3.1.1 Background	26
3.1.2 Functional separation between Life and Non-life insurance companies.....	26
3.1.3 Regulation regarding the investment options of the insurance companies.....	28
3.1.4 Alleged strict actuary certification requirement	29
3.1.5 Absence of guideline for innovative insurance product	30
3.1.6 Other policy issues	31
3.2 Regulatory Issues in Lending (Agent Banking)	32
3.2.1 Background	32
3.2.2 Complex Account opening process	32
3.2.3 Stringent requirement for the eligibility of being agent and complex agent licensing process.....	33
3.2.4 Low transaction (number) limit	34
3.2.5 Requirement of specific dedicated premises.....	34
3.2.6 Other issues	35

3.2.6.1	Location of the agent's premise	35
3.2.6.2	Agent compensation	35
3.2.6.3	Agent exclusivity	36
3.3	Alternative investment	36
3.3.1	Background	36
3.4	Payment Digitisation/Digitisation of financial transfers	38
3.4.1	Background	38
3.4.2	Requirements on KYC and Storage of Information.....	39
3.4.3	Big data, storage, reporting and privacy issues	41
3.4.3.1	Data Storage and Privacy Issues	41
3.4.3.2	Additional Note on Data Retentions	42
3.4.4	Point of Sale (POS) machines can only be sold by respective banks	44
3.4.5	Regulatory issues around Value Added Services (VAS).....	44
3.4.6	Interoperability of MFS	44
3.4.7	FinTech Companies /MFS providers cannot extend loans	45
3.5	Issues on Secured Lending.....	46
3.6	Summary of International Experience	47
CHAPTER 4	58
Recommendations	58
4.1	General Recommendations.....	58
4.2	Specific Recommendation	59
4.2.1	Insurance:	59
4.2.2	Agent banking:.....	59
4.2.3	Alternative investment:.....	59
4.2.4	Digitisation of financial transfers:	59
4.3	Suggested Action and Responsibility to Implement Recommendations	61
REFERENCES	64
ANNEXES	69
Annex 1:	69
Brief on Digital Financial Services in Bangladesh	69
A1.1	Industry Configuration	69
A1.2	Intra-Industry Configuration	69
A1.3	Parties to the Transactions.....	70
A1.4	Delivery Channel.....	70
A1.5	Technology Interface.....	71
A1.6	The Current Market.....	71
A1.7	Emerging Market Segments	71
A1.8	Cost side of the equation	71

A1.9 Future Outlook	72
Table A1.1 Mobile Financial Service	72
Table A1.2 Number of ATM & POS	72
Table A1.3 Agent Banking	73
Figure A1.1 Percentage of People covered by Digital Inclusion.....	73
Figure A1.2 Bank's share in total Number of Agents	73
Figure A1.3 Bank's share in Number of Outlets under Agent Banking	73
Figure A1.4 Bank's share in Number of Accounts (Agent Banking).....	74
Table A1.4 Number of Agents and Outlets (Agent Banking)	74
Table A1.5 Trends in ATMs and Online Banking.....	75
Table A1.6 Use of Internet Banking	75
Annex 2:.....	76
Circulars and Guidelines Reviewed (partial).....	76
A2.1: Act, Guidelines and Circulars Reviewed.....	76
Table A2.1.1: List of Act, Guidelines and Regulations Reviewed.....	76
Table A2.1.2: List of Circulars Reviewed	78
Annex 3:.....	81
List of Stakeholders Consulted	81
Table A3.1: List of Stakeholders of Initial Consultation	81
Table A3.2: Focus Group Discussion	82
Table A3.3: List of Regulators Consulted	82
Table A3.4: List of Experts Consulted	82
Annex 4:.....	83
Sampling Frame	83
Annex 5:.....	84
Matrix of Actions	84
Annex 6:.....	87
Additional regulatory issues concerning agent banking discussed in connection to international experience	87
Issue: Agent compensation.....	87
Issue: Agent exclusivity	87

Acronyms

AIG	American International Group
AML	Anti-Money Laundering
API	Advance Passenger Information System
ASIC	Australia's Securities and Investment Commission
ATM	Automated Teller Machine
BB	Bangladesh Bank
BBS	Bangladesh Bureau of Statistics
BDS	Business Development Service
BFIU	Bangladesh Financial Intelligence Unit, BB
BRPD	Banking Regulation and Policy Department, BB
BSEC	Bangladesh Securities and Exchange Commission
BTRC	Bangladesh Telecommunication Regulatory Commission
CARD	Center for Agriculture and Rural Development
CBS	Core Banking System
CF	Challenger Fund
CFT	Combating the Financing of Terrorism
CIBA	Composite Insurance Brokers & Advisors
CSP	Content Service Provider
DFS	Digital Financial System
FCA	Financial Conduct Authority
FGD	Focus Group Discussion
FI	Financial Institution
FinTech	Financial Technology
GoB	Government of Bangladesh
ICMIF	International Cooperative and Mutual Insurance Federation
IDRA	Insurance Development & Regulatory Authority (Bangladesh)
IRDA	Insurance Regulatory and Development Authority (India)
IP	Internet Protocol
KYC	Know Your Customer
MAS	Monetary Authority of Singapore
MFI	Micro Finance Institution
MFS	Mobile Financial Service
MNO	Mobile Network Operator
MoFin	Ministry of Finance
MRA	Microcredit Regulatory Authority
MSE	Micro and Small Enterprise
mSME	Micro, Small and Medium Enterprise
NBFI	Non-Bank Financial Institution
NPSB	National Payment Switch Bangladesh
OECD	The Organisation for Economic Co-operation and Development
PAC	Policy Advisory Committee
PCI	Payment Card Industry
PCN	Payment Card Network
POS	Point of Sale
PSD	Payment System Department, BB
PSO	Payment System Operator
PSP	Payment Service Provider
SIM	Subscriber Identity Module
USSD	Unstructured Supplementary Service Data
VASP	Value Added Service Providers

GLOSSARY OF TERMS

Agent Banking¹

Agent Banking means the business of providing banking and financial services through agent's networks. A qualified third party can act as an agent on behalf of a bank to act as the customer interface on behalf of the bank. Agents may also act as a Master Agent; a Master Agent supervises and provides support to an agent.

Credit Rating²

Credit rating is an analysis of the credit risks associated with a financial instrument or a business or economic unit entity. It is a formal assessment and evaluation of a company's or stakeholder's creditworthiness, credentials and of its ability to meet payments on time. A credit rating information is obtained while taking decision on lending or offering credit to new customers. It may be obtained from specialised credit rating agencies or suppliers.

Crowd Funding³

The practice of obtaining funding typically for a new business by soliciting contributions from a large number of people especially using online communication. Crowd funding is now considered a major and distinct funding modality in advanced countries for start-up entities especially those that have a social mission or aspect to their business concept as well. A few companies in Bangladesh have tried to and / in the process of setting up the infrastructure for starting crowd funding for small business entities.

Debenture⁴

It is a type of debt instrument that is not secured by physical assets or collateral. Debentures are backed only by the general creditworthiness and reputation of the issuer. Both corporations and governments frequently issue this type of bond to secure capital. Like other types of bonds, debentures are documented in an indenture.

Delivery Channel⁵

A distribution or delivery channel is a chain of operating points or intermediaries through which a good or service reaches the end consumer. For banking services, agents, ATMs are some of the end points in the delivery channel. Technological advancement has in the recent years resulted in large scale use of internet banking, and banks are also using mobile financial service (MFS) as a delivery channel.

Digital Financial System (DFS)⁶

Digital financial system is a system that provides access to financial services using automated and digitised technology and processes. The challenge for providers of the service is to provide the service in an affordable way and maintain integrity and security to the process.

¹ Bangladesh Bank (2017)

² India Times, <https://economictimes.indiatimes.com/definition/Credit-Rating>

³ For definition, see, Hossain and Oparaocha (2017).

⁴ Investopedia

⁵ ibid

⁶ CGAP

E-commerce⁷

Electronic commerce (ecommerce) is a type of business model, or segment of a larger business model, that enables a firm or individual to conduct business over an electronic network, typically the internet. Electronic commerce operates in all four of the major market segments: business to business, business to consumer, consumer to consumer and consumer to business.

Electronic Banking⁸

Banking service conducted through computerized systems intended to speed operations, reduce costs, and allows bank's customers to request information and carry out most retail banking and limited other banking services through computer, mobile phone, or other electronic means.

Electronic Fund Transfer or Electronic Payment⁹

Any transfer of funds or payments initiated through an electronic terminal, internet, mobile phone, telephone, computer, online payment gateway or magnetic tape for the purpose of ordering, instructing, or authorising` a financial institution to debit or credit a consumer's bank or e-money account.

Equity Financing¹⁰

Equity finance is a method of raising capital by selling shares of the company to private entities, the public, institutional investors, or financial institutions. The people who buy shares are referred to as shareholders of the company because they have received ownership interest in the company.

Factoring¹¹

The business of collecting someone else's debt on their behalf. A company sells its receivable to a factor at a discount. The factor then sets out to collect the money owed. Its profit comes when it collects more than the discounted price that it pays for the debts. A company that sells its debt to a factor gets cash, does not have to work on collecting the debts.

Financial Inclusion¹²

Financial inclusion means that individuals and businesses have access to useful and affordable financial products and services that meet their needs such as effecting transactions, savings, getting credit and insurance. Greater Financial Inclusion implies a greater number of people and business who are not necessarily high value entities in traditional sense and are often in rural areas have access to the services in a cost effective and socially responsive way.

FinTech - Financial Technology¹³

Financial technology (FinTech) is the emerging technology that is delivering financial solutions in new and innovative ways utilising myriad technologies and platforms especially Information Technology platforms and applications. Many FinTech applications are now provided over mobile phone platforms.

⁷ Gibson N., (2014)

⁸ Alliance for Financial Inclusion (2012)

⁹ ibid

¹⁰ ibid

¹¹ ibid

¹² The World Bank

¹³ ibid

Impact Investment¹⁴

Impact investing refers to investments made into firms, enterprises, companies, organisations, with the intention to generate a measurable, beneficial social or environmental impact alongside (or in lieu of) a financial return.

Innovative Finance¹⁵

Innovative finance is a way of creating new funding options, mitigating development challenges (i.e., financial inclusion to marginal and unbanked populations) which are not addressed by traditional financial system, and includes ways that enhances the efficiency of traditional financial services by reducing delivery time and cost applying new methods and technologies.

Internet Banking¹⁶

The practice of banking service (i.e., transfer of funds, payments) over the internet. Many banks set up banking over internet and online platform to provide real time banking service.

Invoice Financing¹⁷

Invoice financing is a general term used whenever a third party agrees to buy unpaid invoices. It is a type of factoring service. Richardson, J. (2016)

Leasing¹⁸

It is a form of financing through the application of leases. A lease is a contract outlining the terms under which one party agrees to rent property owned by another party. It guarantees the lessee, the tenant, use of an asset and guarantees the lessor, the property owner or landlord, regular payments from the lessee for a specified number of months or years.

Mobile Banking¹⁹

Mobile banking is the act of doing financial transactions on a mobile device (cell phone, tablet, etc.). This activity can be as simple as a bank sending fraud or usage activity to a client's cell phone or as complex as a client paying bills or sending money abroad. Advantages to mobile banking include the ability to bank anywhere and at any time. Disadvantages include security concerns and a limited range of capabilities when compared to banking in person or on a computer.

Mobile Financial Service (MFS)²⁰

A mobile phone based financial services using internet and mobile networks. The use of a mobile phone to access financial services and execute financial transactions. This covers both transactional and non-transactional services, such as viewing financial information on a bank customer's mobile phone. A mobile-based transactional service that can be transferred electronically using mobile networks.

Payment System Operator²¹

It refers to an entity licensed by the Bangladesh Bank for operating a settlement system for payment activities between/among participants of which the principal participant must be a scheduled bank or financial institution maintaining accounts with the Bangladesh Bank for meeting Cash Reserve Requirements.

¹⁴ UNDP

¹⁵ The World Bank; and ACCA.

¹⁶ Gibson N., (2014)

¹⁷ Richardson, J (2016).

¹⁸ Gibson N., (2014)

¹⁹ Alliance for Financial Inclusion (2012)

²⁰ ibid

²¹ BB (2014)

Regulatory Sandbox²²

A Regulatory Sandbox is a way for regulators to give limited duration and scale approval to companies they regulate in order for them to test their innovative products (especially financial products) within a safe and controlled environment without unduly breaking the financial regulations and / stifling innovation.

Secured Lending²³

Secured lending is a process of lending where a borrower has to pledge some asset to lender as collateral as a form of protection against defaulting on the loan. A secured business loan is backed up by security, valuable asset or items that a business entity owns.

Special Purpose Vehicle (SPV)²⁴

A special purpose vehicle is a subsidiary company with an asset/liability structure and legal status that makes its obligations secure even if the parent company goes bankrupt. An SPV/SPE is also a subsidiary corporation designed to serve as counterparty for swaps and other credit-sensitive derivative instruments.

Unbanked²⁵

People who do not have an account at a financial institution and are not getting reasonable banking services and credits that they may need, for reasons of poverty, cost, travel and documentation requirements, etc.

Venture Capital²⁶

Venture Capital is a way of financing start-up firms that have long term growth potential. It may come with managerial and business expertise and limited form of monitoring and control. Venture Capital requires a higher-than-average return for a higher risk profile of the investment.

²² Jenik. I., Lauer K. (2017)

²³ Investopedia

²⁴ ibid

²⁵ The World Bank.

²⁶ Investopedia

EXECUTIVE SUMMARY

Micro and Small Enterprises (mSEs) play a pivotal role in a country's quest for achieving inclusive economic growth. Like many business organisations, mSEs need affordable access to financial services for smooth functioning. Financial innovations facilitated by wider application of information & communication technology have opened up new avenues for delivering various types of financial service to the mSEs. If rightly regulated, such innovations can foster economic growth by ensuring more efficient allocation of financial resources and reduce inequity in access to finance as well. An enabling regulatory environment where financial innovations can flourish and contribute to growth and equity, and at the same time preserves investors' rights, safety and interests, is therefore desirable.

Business Finance for the Poor in Bangladesh (BFP-B) programme, funded by UK Aid and implemented by the Bangladesh Bank, and Microcredit Regulatory Authority (MRA), carried out several activities to foster increased access to finance for Bangladesh's micro- and small enterprises (mSEs). As a fallout of BFP-B's support to policy research, Economic Research Group (ERG) was awarded the contract to undertake the study on 'Innovative MSE Financing Products and Delivery Channels in Bangladesh: Opportunities and Challenges'. The purpose was to understand the regulatory barriers in launching, operationalising, pilot-testing and up-scaling innovative financing products and delivery channels. The Study also aimed at understanding the regulators' views on the justifications of keeping regulations so that policies may be recommended to create an enabling regulatory environment that will ease the financing constraints faced by MSEs. The ERG research team undertook extensive reviews of documents and research materials during October-November 2017 and consulted different groups of stakeholders during December 2017 till early March 2018. Innovative financing products were grouped into four categories: insurance, agent banking, alternative investment and digitisation of financial transfers. While detail discussion pertaining to each of the product groups as well

as at a general level is included in the study, some selected issues are highlighted here.

According to current (as of May 2018) regulations in Bangladesh, life insurance companies cannot offer non-life products and vice versa. Insurance companies in some countries are allowed to offer composite insurance products, and in some, they are not. While separating life and non-life products may imply higher efficiency in service delivery, some exceptions – similar to Sanasa Insurance Company Limited in Sri Lanka – may be granted in order to provide more flexibility in product design if the said product leads to greater financial inclusion. There is also a serious shortage in availability of professional actuary services in Bangladesh (allegedly rooted in skewed market powers), which acts as barrier to developing innovative insurance products. The study recommends that regulators engage in supporting institutions to increase skilled manpower in the market and relax requirements on hiring foreign actuary in the short term in order to ease supply of required manpower.

Based on consultation with the stakeholders, it appears that there has been low penetration under agent banking due to stiff competition with MFS firms and wider application of ICT making agent banking less attractive. The study does not consider the current regulations to be too constraining for the expansion of agent banking. Rather, the regulators are found to be responsive to market needs, particularly, in adjusting the limits on transfers to balance concerns with money laundering and widening financial inclusion. The existing Alternative Investment Act, 2015, covers only venture capital, equity financing, and impact investment. Given the debacles in the capital market, there is a good case for finding alternative routes to mobilise small savings targeted to finance specific MSEs, and 'crowdfunding' is worth considering as one such alternative. Although crowdfunding is a relatively a new concept that has received regulators' attention even in the developed world only recently, it turns out that detailed guidelines for crowdfunding are available in a

number of countries. While digital equity crowdfunding platform is illegal in India for the fear of misappropriation, there are a number of successful crowdfunding platforms elsewhere. Examples include, Kiva, the Spark Project, Gava and Upbuilds. Given some success stories around the world, and since there are large number of small savers/investors in Bangladesh, regulators may develop effective guideline for alternative investments that includes crowdfunding.

MFS companies in Bangladesh, similar to India, are not allowed to extend loans. While FinTech/MFS companies are allowed to extend loans in some countries such as Kenya and the Philippines, the volume of mobile lending in the world remains very small. Additionally, allowing FinTech/MFS firms to extend loans would imply a complete paradigm shift in terms of loan regulations and would need involvement of multiple regulatory bodies. Considering these issues, the study recommends no change in current regulation.

Rather than allowing FinTech/MFS companies to extend loans directly, policymakers need to encourage lending institutions to avail MFS for cost reduction and time-efficiency. The review notes success stories of mobile application-based Nano/micro loans in East Africa and Pakistan. The study also notes that some MFIs in Bangladesh already provide similar types of micro loans with short maturity periods in semi-urban market areas, and current MRA regulation does not prohibit MFIs from incorporating mobile application-based technology. Thus, existing micro lending models can be made more efficient in terms of both time and cost, which however call for appropriate policy incentives and enforcement of contracts with MFS providers.

FinTech and MFS firms in Bangladesh can store financial data only in Bangladesh Bank (BB) sanctioned digital storage facilities but fintech/MFS firms opined that it would be cheaper and easier if they were allowed to store data in privately owned clouds. The Bangko-Sentral Philippines (BSP), the Central bank of the Philippines, allows banks to store customer data in private clouds provided all safety measures are followed. It is a cost-effective method, especially for smaller banks in Philippines to store

and manage their data without heavy investment in infrastructure. However, this is not the case in most countries including India. In Bangladesh, a bank or MFS requires NOC (no objection certificate) to avail such facility. Regulators in Bangladesh want to ensure that contracts with Cloud-keepers or similar agencies be sufficiently explicit to allow regulators to access data as and when required, and local stakeholders do not turn captives of global powers.

The MFS firms allege that Know Your Customer (KYC) requirements are demanding and may hamper the growth of the digitisation process of financial transfer in the country. In India, regulators also issued similar guidelines in 2017 on stricter and mandatory KYC norms for users of mobile wallets in the country. Concerns were also expressed by Indian FinTech/MFS industry players. However, as the experience with Aadhar e-KYC services introduced by the Unique Identification Authority of India (UIDAI) reveals, having database at back-end with real time connection with frontends can quicken the process of opening a new trading account or bank account or availing a new mobile connection. The study finds that there are confusions around information required for opening an account and KYC. The primary responsible body, BFIU, is gradually developing unified KYC, and appears to be open to ideas. It is recommended that the process of developing robust backend data at the Bangladesh Bank, identifiable by unique characterization (such as, via NID) of customers, be supported. Along with it, a minimum requirement be placed (under eKYC) for those already included in the database.

Information on customers as well as all financial transactions they engage in, are meant to enrich the Big Data, which are in soft (digitised) form. There is however confusion with regards to retention of accounts and KYC-related information in hard copies. On the assumption that such retention is mandatory, some MFS firms voiced concerns. The same applies for banks. In-depth review of Acts and regulations, as well as extensive exchanges with regulators, revealed that hard copies are not must other than for legal purposes. The study identifies certain aspects of evidence Act which may be revised to allow digitised documents to be used as

evidence. Till such changes are brought in, clarity in interpreting regulations may be made public that the requirements are not imposed by regulatory authorities -- rather, those are the discretion of banks whose management may feel the necessity to safeguard against fraudulence. In this regard, the study also recommends that a limit be imposed on banks collecting private information from their clients in order to protect the clients from undue harassment.

Bangladesh Bank may facilitate to ensure that interoperability of MFS is established within a specific deadline. A committee may be formed to understand the current technological limitations, which is delaying the process. Furthermore, following Tanzania's successful example, industry inputs need to be considered in order to make interoperability effective. It is expected that the new ICT Policy will address the issue.

In addition to the product specific issues, the study addresses several important issues regarding innovative financing in general. For example, substantial variation exists in KYC requirements, which creates confusion regarding which KYC requirements are to be followed in the case of collaboration between different types of entity, e.g., that between a MFS firm (relatively simple KYC requirements) and a commercial bank (relatively complex KYC requirements). Setting up a tiered KYC standard could be a solution, and focused study on it needs to be undertaken.

Innovation may involve packaging a product with multiple interfaces and bringing in the best ones from different segments of service provision options. Consequently, innovation or innovative products may involve multiple regulators. There

is no guideline regarding the sequence of regulatory compliance that needs to be followed if some product involves multiple regulators. Lack of coordination among the various organs of the government is a major problem. It is, therefore, highly recommended to form a cell which encompasses several regulatory agencies. For example, there may be a cell comprising different divisions of BB, BTRC, ICT, IDRA etc. Unfortunately, an imbalance appears to exist in the relative strengths of the two broad groups of actors (PSD in BB and BTRC in ICT), which may get further aggravated with depleting strength of banks vis-a-vis the MNOs.

Finally, to come up with an effective set of rules to promote innovative products while ensuring consumer protection, regulators may want to consider introducing a regulatory sandbox approach following the examples of UK, Singapore, Australia, Hong Kong and Canada. A regulatory sandbox will provide a platform where firms will be allowed to experiment with innovative products where certain regulations are relaxed within the platform. This will be done under a controlled environment, and under the close supervision of the regulators. If the experiment is successful, it can be scaled up and some regulatory changes can be advised.

CHAPTER 1

Introduction

1.1 Background

Role of finance in promoting economic growth is widely recognised. However, financial inclusion, particularly of those left out of the mainstream delivery of financial services, is perceived critical for promoting inclusive growth. Such inclusion may address households, enterprises, geographic locations, demographic groups, etc. Recognising the importance of the enterprise sector, Business Finance for the Poor in Bangladesh (BFP-B) programme, funded by UK-Aid and implemented by the Bangladesh Bank, aims to foster increased access to finance for Bangladesh's MSEs, especially those that are currently un-served/ underserved by the formal financial sector. There are (as of 2013) 8.08 million micro, small and medium enterprises (mSMEs) in Bangladesh²⁷, 90% of which are micro and small enterprises (MSEs)²⁸. While there are concerns with infrastructure and regular supply of energy, access to finance is one of the key constraints identified by 68.6% of microenterprises (Vila, 2013). Thus, financial inclusion remains a major concern in programmes of the Government of Bangladesh (GOB) as well as those of external development partners (EDPs).

Recognising the changing FinTech canvas in the country, the Policy component of the BFP-B programme actively engaged in identifying

various financial products and delivery mechanisms, which may promote financial inclusion of the MSEs. Since BFP-B aims at improving the policy and regulatory environment for financial institutions to make long-term investments in growing their small business portfolio, the Policy component of the Programme commissioned the present study, titled, Innovative mSE Financing Products and Delivery Channels in Bangladesh: Opportunities and Challenges. The purpose was to understand the regulatory barriers in piloting, launching, implementing, and upscaling of innovative financing products and delivery channels, as well as to understand the regulators' views on the justifications of keeping regulations so that enabling regulatory environment is created to ease the financing constraints faced by MSEs and recommend areas of further improvement²⁹. Economic Research Group (ERG), a not-for-profit research organisation operating out of Bangladesh, was awarded the contract in mid-October of 2017.

This report, a revised version of an earlier draft, presents the researchers' triangulated perspectives drawn from review of existing regulations, consultation with practitioners, review of international experiences, and from consultation with regulators.

²⁷ Such estimates are based on Economic Census administered by BBS in 2013. The "Speech of the Governor of Bangladesh Bank in Launching of 'SME Banking Strategy' Seminar", April 28, 2013, mentions the figure to be 8.08 million.

²⁸ The mSME segment provides employment to more than 28 million people and generates about 25% of the country's GDP.

²⁹ The Terms of Reference is attached in Annex 1.

1.2 Context and rationale

A recent study undertaken for BFP-B suggests that use of bank accounts for business transaction is still not universal among mSMEs - only 62% of the surveyed mSMEs were found to have company bank accounts. The study however noted that 68% of the latter group reported their preference to transact through cash and found significant presence of mobile banking accounts which are price-sensitives. More robust findings on financial inclusion of households are found from nation-wide surveys, such as the HIES 2016. Using those data, an ERG study³⁰ finds hand-to-hand transfers to dominate transfers under social safety net programs even when actual disbursements may have been made through a formal route, such as the bank or post office. The study also mentions that less than 4 percent of the survey households reported of borrowing from banks or GOB microloan programmes, and another 23 percent of the households borrowed from MFIs (with or without informal lending). While the non-borrowing households accounted for less than a percent, 72.3% are found to have borrowed from business and informal sources, without availing financial services of banks or MFIs. The evidence suggests of inadequate inclusion of people in the formal financial sector³¹.

Yet, the same BFP-B study finds 46 percent of surveyed MSEs using MFS for business purposes³². The persistent technological changes and their wider applications to allow introduction of new delivery mechanism as well as new products have opened up avenues for furthering financial inclusion. The present study is commissioned at a period when many consider Bangladesh to be

at an inflexion point in the growth of MFS.

Importance of micro and small enterprises (MSEs) in promoting widely shared economic growth has long been recognised in Bangladesh, and along with it, the importance of ensuring their access to credit received increased attention over the years. Financial innovations facilitated by wider application of information & communication technology, have opened up new avenues for delivering financial services of various shades to the MSEs. If rightly regulated, such innovations can foster economic growth by ensuring more efficient allocation of financial resources and reduce inequality in access to finance as well. However, improper management of financial products, asymmetric dissemination of information to end-users and underestimation of risks that involved with financial innovations may lead to increased volatility of investment climate and may result in delinquencies and bankruptcies. Recognising these, BFP-B has been supporting new initiatives in the field by administering a Challenge Fund (CF), which ran into the initiation of the third round when the present study was commissioned. On the understanding that these and other experiences would allow one to identify regulatory barriers that the practitioners are facing at the entry, launching, pilot testing and up-scaling stages, the study was commissioned. It is commonly agreed that a regulatory approach that creates an environment where financial innovations can flourish and contribute to growth and equity, and at the same time, investors' rights³³, safety and interests are preserved, is desirable.

³⁰ Draft report on

³¹ One may raise issues with the functioning of the formal financial sector and the extra tax-related obligation an association with the sector may bring. Such concerns of clients are generally ignored when push or financial inclusion in the formal financial sector is pursued.

³² Bangladesh is the ninth largest mobile market, with a current (2017) penetration rate of 51% (85 million) in terms of unique mobile subscription (GSMA 2018).

³³ The term 'investors' in the context of financial (particularly, capital) market refers to savers/depositors in banks and buyers of stocks, which should not be mixed up with 'entrepreneurs' (both actual and deceivers) who access the investors' fund through debt and/or equity instruments.

1.3 Conceptual issues

1.3.1 Defining innovative financing

The term 'innovative financing' is coined mostly in the context of inclusive financing and the latter often refers to extending the financial net to include the micro and small enterprises (MSEs)³⁴. There is, however, little consensus about the definition of innovative financing. The idea of innovative financing and interest in the subject was stimulated to foster sustainable and effective development aid, following the global economic and financial crisis (Sandor, Scott & Benn 2009). The most concise definition is provided by World Bank (2010), breaking up the idea into several parts:

"Innovative finance refers to any financing that helps to generate additional funds by tapping new funding sources or mutual engagement of new partner agencies, enhance the efficiency of financial flows by reducing delivery time or costs, making financial flows more result oriented by explicit linkage of flow to measurable performance. Often this mechanism involves the combination of using new resources or existing resources in a new context by two-fold mechanism: to create new resources and using them effectively."

In a similar fashion, ACCA (2014) defines innovative finance as a solution that mitigates development challenges, not adequately addressed by traditional financial flows. Creating and nurturing micro, small and medium social enterprises, are identified by ACCA as the primary targets of innovative financing, and lending is considered the most obvious form of financing.

The list of ACCA solutions also includes

packaging financing products with use of technology, either to reduce transaction costs, or removing the barrier in the way of reaching to previously un-served or under-served group. While being less exposed, having high interest rates and risks for MSEs– conventional banking system has advocated a pathway to create more diverse financial ecosystem through above-mentioned innovative mechanisms (SME Financing Forum 2012). Innovative financing benefits go beyond financial returns – it helps developing capacity, maximising efficiency and social development. According to Pilot Group, innovative financing should be additional or complementary to official development assistance (ODA) not as a substitute to it. Suggestions are made to make it predictable and stable through multi-year commitments (Sandor, Scott & Benn 2009). For this purpose, they consider innovative financing to comprise of raising funds and stimulating actions to support international development that go beyond traditional approach of spending.

European Commission considers innovative financing as a way of arraying budgetary resources and complement grants and subsidies within a dedicated regulatory policy. According to EU, innovative finance instruments involve a range of activities that include participation of equity funds; guaranteed lending to a large number of final beneficiaries (SMEs), risk sharing with financial institution to boost investment in larger infrastructure. The aim is to boost the real economy through increasing the access to finance for enterprises and industry that are producing goods and services.³⁵

³⁴ According to National Industrial Policy 2016, Small Enterprise in the manufacturing sector is defined to include those having total fixed asset (TFA) between BDT 7.5 m to 150 m and engage 31 to 120 employees. In the Service sector, SEs are those with TFA between BDT 1m to 20 m and the number of employees is between 16 and 50. In cases of micro enterprises (mE) in manufacturing, TFA is between BDT 1 m and 7.5 m, and the band for number of employees is 16 to 30. For mEs in the service sector, TFA ought to be less than BDT 1 m and the number of employees is less than 15.

³⁵ https://ec.europa.eu/info/business-economy-euro/growth-and-investment/financing-investment/innovative-financial-instruments_en

1.3.2 Key Concepts

For the ease in communication between researchers, practitioners, regulators and policymakers, we need to reach common understanding on several key concepts. Some of those have been included in the glossary. Taking cue from the previous discussion, a selected number of key concepts is discussed in this sub-section.

Innovative Financing: Innovative is considered a strategy that has not been practiced before, or a financing strategy that has been practiced in other country but not in Bangladesh. At an operational level, the study uses the following attributes to identify an innovative financing:

- (a) Financing tool that increases access of target group to financing, particularly those who were previously under-served and/or un-served,
- (b) It involves innovative source of funding and applies innovative financing mechanism or delivery channel using information and communication technology (ICT).

While lending is the most often sought instrument in innovative financing, there are other instruments as well. Those include, insurance tied to finance, digitisation of transactions, alternative finance such as impact investment, venture capital, crowd-funding, factoring, hybrid financial instrument, Special Purpose Vehicle (SPV), etc.

Stages of innovative financing: We consider four stages in the processes whereby a decision to deliver a financial service gets realised through identification of a delivery-contingent product

and its marketing on a wider scale. These are distinguished with a view to contextualise specific regulations and/or regulatory barriers, and are noted below³⁶:

- (i) Pre-entry decision - to enter or introduce a new financial service,
- (ii) Designing a product along with the delivery mechanism - which may involve negotiations with multiple actors (market and non-market agents). at an operational level, often involving multi-party negotiations,
- (iii) Pilot testing of a product under one or more delivery mechanisms³⁷, and
- (iv) Up-scaling, once the results of pilot-testing are found encouraging.

Regulations and Policies: We recognise differences between (policies) guidelines that are often indicative, and regulations (and directives) that define compliances and policies with financial and/or non-financial incentives to promote (or discourage) a financial product or activity. Beyond regulators, there may also be organisation-level (actors in the financial market) policies to guide the actions of agents (employees) within those organisations. We exclude the last kind of policy for the present assignment. The study focuses on regulatory issues and recognises the differences between regulations pertaining to promoting innovation process and those aimed at facilitating innovative products. Though the primary focus of this study is on regulations, addressing policies to incentivise or discourage one or the other activity may be unavoidable.

³⁶ The Terms of Reference mentions of four stages of innovative financing -- piloting, launching, implementing, and up-scaling. We take cue from those ideas and reformulate to reflect the processes as were observed.

³⁷ In the latter case, there would be more than one delivery-contingent financial product.

1.4 Study Objectives

Following the extensive exchanges on scope of the study at the kick-off meeting, the overall objectives of this study are considered the followings³⁸:

- Drawing upon experiences of the applicants and awardees of BFP-B's Challenges Fund (CF), identify the regulatory barriers observed by the financial service providers during different stages of innovations such as entry, pilot testing and up-scaling stages.
- Review existing regulations across relevant financial domains to identify the ones that may hinder progresses in innovations.
- Review global regulatory practices that were adopted in situations that CF applicants are facing in promoting specific innovative financial products and delivery channels.
- Consult the regulators to understand their views on presence, absence or non-implementation of specific regulations identified earlier and assess the factors that discourage the regulators from addressing the above-identified problems and promote innovations. Along with it, assess how the regulators

could promote innovations through creating enabling regulatory environment.

- Recommend changes in umbrella policies including regulatory Sandbox, as we determine, to promote innovation on some specific financial products.

Following this introduction, Chapter 2 discusses the study methodology. Since the subject involves multiple dimensions with several actors and regulators, which are distinct and yet have overlaps, the chapter attempts to draw the canvas adequately prior to proposing the methodology. Chapter 3 presents the summary findings drawn from reviews, and from discussion with practitioners and regulators. While the concluding chapter proposes policy recommendations, details on various aspects are relegated to seven annexes.

³⁸ The objectives were reformulated in the Technical Proposal submitted, and further focus is brought in following the meeting at BFP-B on 30 October 2017.

CHAPTER 2

Methodology

2.1 Conceptual Framework – understanding the FinTech Canvas

ERG commenced the study in early December 2017 with a team of four researchers³⁹ and a number of research associates. The Study team undertook extensive reviews of documents and research materials, organised several individual-level consultations with the practitioners of several Challenge Fund winners to identify regulatory issues faced by them, and organized

several group consultations after circulating revised briefs. The research team also met relevant regulators to understand the regulators' views on the issues identified. Moreover, the study team gathered substantial information on the global experience in innovative finance and perspectives in a selected number of countries.

2.1.1 Interfaces between stakeholder-technology, and product-delivery channel

Within a traditional regulatory setup, financing can be envisaged in either the money market, or by resorting to the capital market. The former, involving various lending instruments & products has been under the domain of the central Bank (Bangladesh Bank). And, the latter involves sourcing equity finance by enlisting in stock markets regulated by the Bangladesh Securities and Exchange Commission (BSEC). The insurance market stood independent, regulated by the Insurance Development and Regulatory Authority (IDRA), with marginal or no direct overlaps with the financial market.⁴⁰ With the introduction of ICT and with fast developments in its application, technology shaped the financial canvas in significant ways, particularly, the money and capital markets. Yet, important applications of the technology use platforms, such as, mobile network services and internet services, operating in a market of bandwidth and high frequency radio and/or satellite connectivity, which are regulated by a different authority called BTRC. In some important ways, the ICT Ministry that BTRC belongs to, influence the outcomes in the technology-driven financial

market. The dynamics of changes in markets of financial products and the regulatory domains those trespass into, are yet to settle down in Bangladesh.

The on-going changes noted above call for an adequate understanding of the Fin-Tech canvas to appreciate the complexities faced by regulators, often in conflicting policy environment.⁴¹ Financial Technology or FinTech refers to the emerging technology that is delivering financial solutions in a new innovative way utilising technological platform especially information and communication technology platform and applications. The term 'FinTech' can be applied to any innovation in transaction from fund transfer readiness to data storage for bringing greater financial inclusion. Ever since the internet and mobile phone revolution, FinTech has brought versatile technological interventions into personal and commercial finance⁴². The use of technology has opened up new avenues in the financial sector of Bangladesh.

³⁹ One of the researchers is a Consultant having experience working in FinTech industry.

⁴⁰ Actors in the financial market created mutual funds and derivatives to address risk associated with individual financial asset, while insurance products addressed real sectors (such as, international trade, industries, etc) and human life and hazards.

⁴¹ Details on the industry are provided in Annex 2.

⁴² Investopedia, <https://www.investopedia.com/terms/f/fintech.asp>

However, the proper use of financial technology remains insignificant (see Annex 2). The technology is used in Bangladesh primarily for the digitalisation of fund transfers. Financial institutions are offering different financial services to reach the final recipient using the delivery channel such as mobile financial service, point of sale, agent banking where different types of technological and regulatory stakeholders are involved. The following diagram (Figure 1) captures the process(s) of providing financial services to customers using financial technology.

Figure 2 exhibits a general framework for identifying the two groups of stakeholders, regulators and service providers, in connection with innovations and marketing of innovative financial products for MSEs. While the traditional financial products were exclusively delivered by the financial institutions (banks, NBFIs and MFIs) who are regulated by financial authorities (BB, Ministry of Finance and MRA), delivery of innovative products require packaging of financial services with other products and activities. The latter brings in other service providers (insurance and non-financial) who are regulated by different set of agencies within the government. In addition, the requirements of an authority, unrelated to banking or other financial institutions, may affect regular financial transactions leading to adverse implication for inclusive financing. Current KYC requirement under the Money Laundering Act is a case in hand, which is further discussed in later sections.

Figures 1 and 2 are self-explanatory. The former shows different service products, identifies the various delivery channels used to deliver those to end users, along with the providers and processes involved. The latter abstracts from the details and links the markets to two different set of regulators

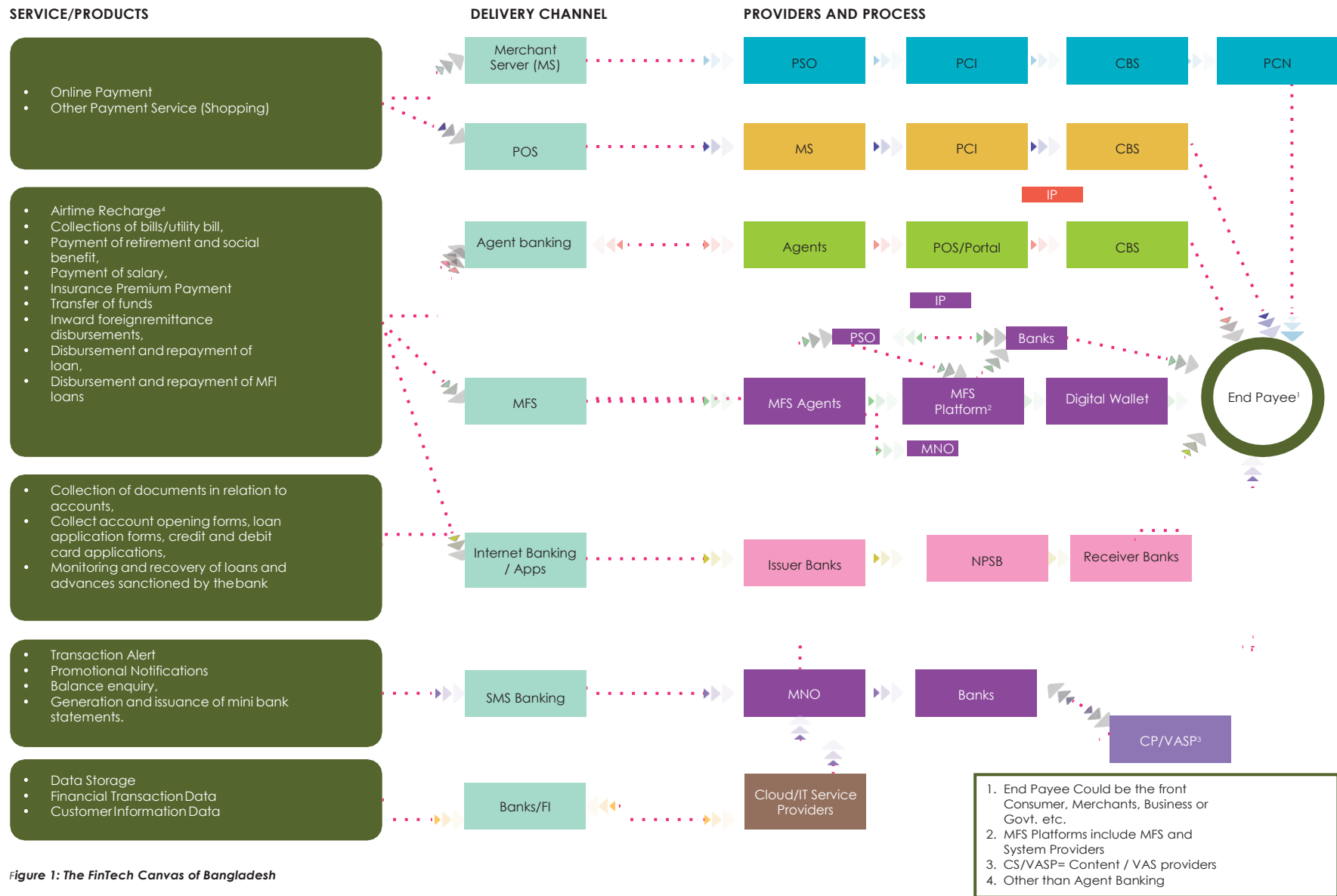
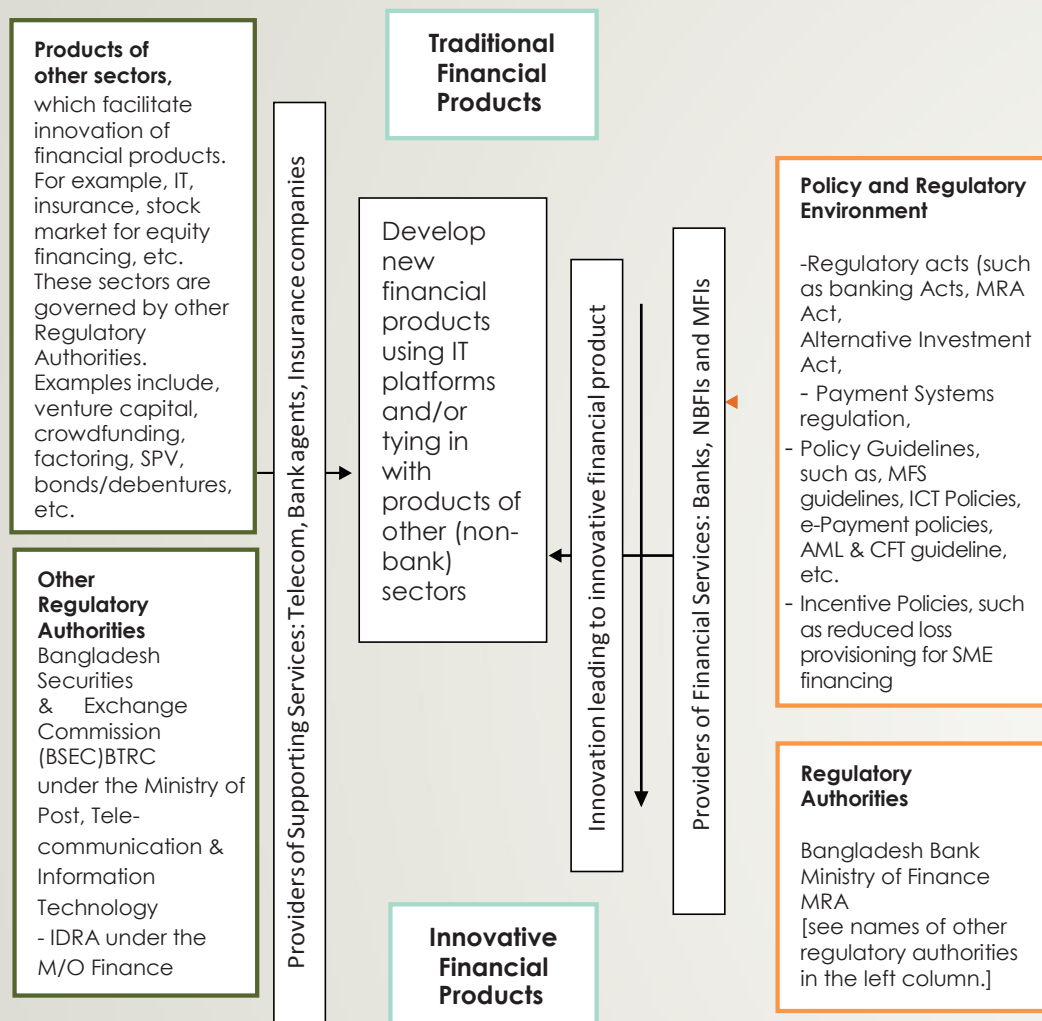


Figure 2: Sketch of the Canvas where Innovative Financial Products are delivered

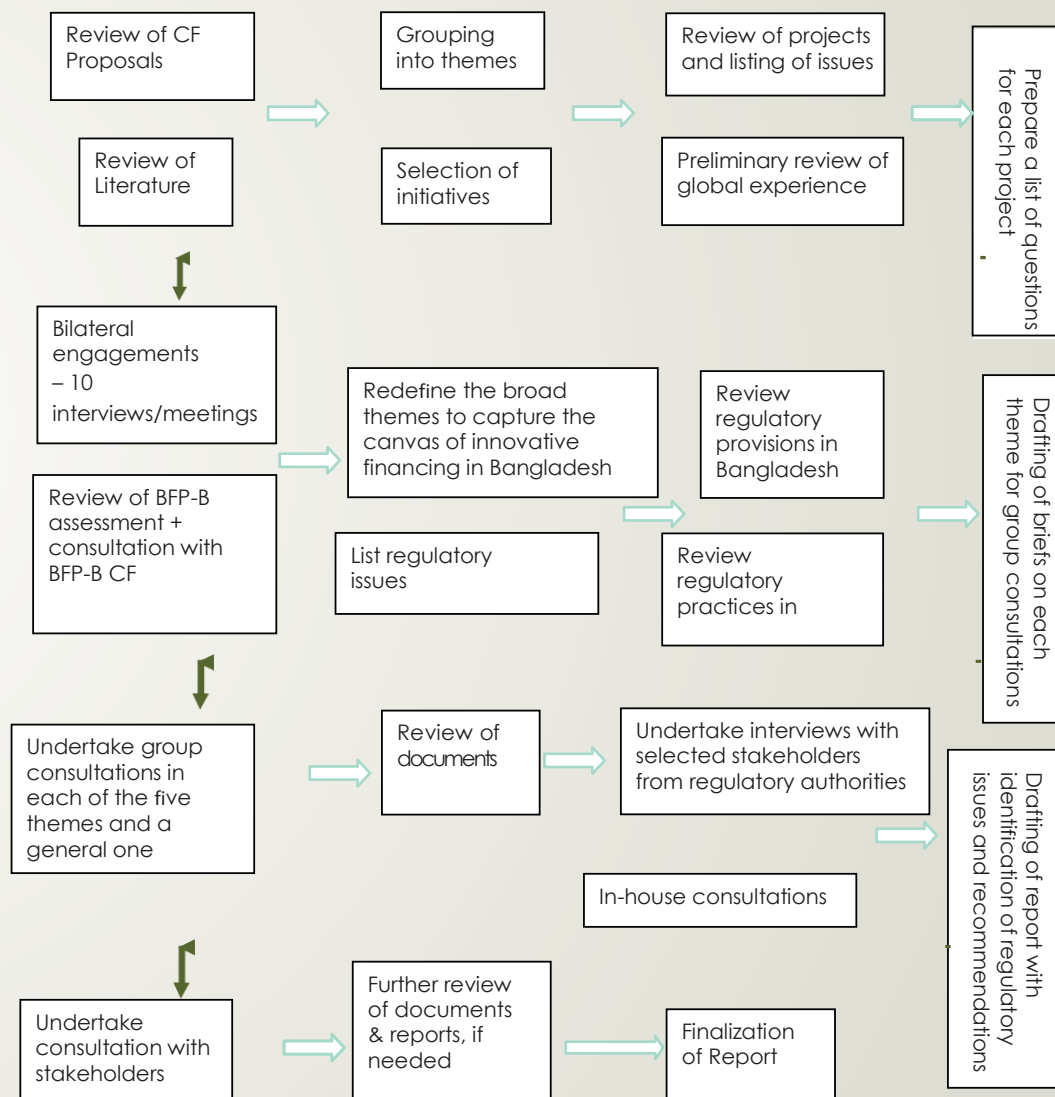


2.2 Study design

2.2.1 Sketch of the Consultation Process

The core research methodology is stakeholder consultation and document reviews. The following schema provides a process followed to conduct this research

Figure 3: Schema of Research Process



Generally stating, the tasks were:

1. Review of CF proposals and literature and grouping the CF application into themes, and selection of initiatives from the green and amber applicants.
2. Understanding the innovation journey through consultation with a sample of CF awardees and actively engaged non-awardees⁴³, with a view to identifying the key regulatory barriers they faced or are facing.
3. Following initial consultation, undertook focused review of existing regulations in the relevant areas of banking, insurance and securities & exchange from each category as shown in Figure 3.
4. Undertook subject-specific consultation/FGDs with practitioners (those who innovate the financial products and/or facilitate delivery of the products to MSE-s) and experts to better link problems encountered in promoting innovative financing and specific regulations or lack of appropriate regulations.
5. Review experiences of innovative financing in other comparable countries, which faced problems similar to those in Bangladesh, with a view to identify regulatory measures that had worked and those which did not.
6. Undertook consultation with regulators to understand the regulatory risks perceived by them, which may be discouraging them to promote innovative financial products and alternative delivery channels. The meetings will also seek opinions on how to create a regulatory environment conducive for responsible financial innovation.

This report is prepared upon receiving views from service providers and regulators. We will provide a synopsis that will delineate the suggested changes in regulatory regimes/systems. Once accepted, the research team hopes to present the paper at a workshop to be organised by BFP-B⁴⁴.

2.2.2 Study Methodology: selection of themes and stakeholders for consultations

Following the extensive exchanges on scope of the study at the kick-off meeting, there was an important reformulation of one of the key objectives of this study.⁴⁵ The first objective was restated as follows:

“Drawing upon experiences of the applicants and awardees of BFP-B’s Challenger Fund (CF), identify the regulatory barriers observed by the financial service providers during different stages of innovations such as entry, pilot testing

and up-scaling stages.”

Accordingly, we took cue from the CF proposals and by method of induction, arrived at a number of broad categories. Once BFP-B provided summary of proposals submitted in each of the three rounds, those were sorted to come up with mutually exclusive strata so that we could draw samples from each. Several strata identified in the process are presented in Table 1 below.

⁴³ It is understood that some of the CF applicants are engaged in innovative financing even though their proposals were not awarded.

⁴⁴ While all consultation meetings are included in the project budget of ERG, it is presumed that the workshop with participation from all stakeholders will be organised by BFP-B.

⁴⁵ The objectives were reformulated in the Technical Proposal submitted, and further focus was brought in following the meeting at BFP-B on 30 October 2017. The inception report of 19 November 2017 mentions those issues.

Table 1: Broad category of products from the concept notes⁴⁶

Main/broad category of product	Sub-category/description
Lending	Lending with agent/mobile banking; digitization of process; alternative delivery channel, etc.
Insurance	Providing insurance product to the MSEs
Alternative finance	Venture capital, crowdfunding, factoring, community banking etc. (i.e., non-traditional financing)
Payment digitisation/ Ecommerce/Web and App development	digitisation of the records of payment/ transactions, developing e-commerce portal for target group etc.
Capacity development/BDS/ Investment readiness	Increasing the capacity of MSEs or providing BDS for investment readiness
Rating/evaluation activities	Through cloud; digitization of evaluation

Subsequently, all proposals (concept notes) were classified using the above category. The purpose was to construct a sampling frame with mutually exclusive groups. Firms submitting proposals during Rounds 1 and 2, considered under Green but not awarded, were contacted to know about the status of their projects.⁴⁷ It was learnt that almost 100% of the non-awardees' projects of Round 1 are not in operation, and only about 30% of 'Green' in Round 2 are reportedly being implemented. It was also learnt that several aspirants for CF in rounds 2 and 3, who did not get funds (or were not awarded

yet), were not implementing projects that exactly matched the proposals they had submitted.

Following initial query, organisations were selected for preliminary consultations to understand their journey with innovative financing (Table 2). The selection was based on total number of applicants in each stratum (in all rounds) as well as to ensure diversity of the organisation, with greater emphasis put on diversity than on proportional representation.

⁴⁶ Matching project proposals uniquely with activity groups was not possible since several projects had multiple focuses. We therefore categorised them based on the primary focus reported in the proposals. Few of the concept notes dealt with issues outside the categories listed, but were found unimportant in the context and were left out.

⁴⁷ Green, Amber/Yellow and Red are three categories that BFP-B uses for the purpose of initial grouping of proposals. Ones considered eligible for receiving awards are included in Green, those at the margin and having the potential of succeeding are included in Amber/Yellow, and those failing to claim a minimum merit are included in Red.

Table 2: Organisation selected for initial consultations⁴⁸

	Awarded Projects/Organisation		Non-Awarded Projects/Organisation		Total
	Number	Name of Organisation	Number	Name of Organisation	Total
Lending	3	Save & Grow, Diganta, Bank Asia, Finance Against Merchandise	1	EBL (automation of loan process)	1
Insurance Product	2	Pragati Insurance, Pragati Life Insurance & INAFI, and Green Delta Insurance (Weather Index Based Insurance)	0	-	0
Alternative Finance	2	BD Venture Ltd (crowd funding), Agribusiness Booster Bangladesh,	0	Factoring or Venture capital	0
Digitisation of Financial Transfer	2	Hisab, Aamra Payment Network	0	-	0
Rating/evaluation digit	1	iSME	0	-	0

Note: More than a quarter of the proposals were on capacity development/BDS, which have been left out.

For initial consultation we selected wide range of participants from the CF winner projects. Since lending, and IT related issues seems to more pertinent towards innovative financing more organisations are included for the initial consultation from this group. After the issues are recognised under several themes, we identified the relevant stakeholders for Focus Group Discussion upon consultation with expert in the field as well as in consultation with BFPB project persons.

⁴⁸ The initial consultation was to identify the key factors/regulatory issues under several themes. These themes were discussed in the focus groups. The group includes more participants or organisations and if those individuals or organisations counted, then total number from each category is more than three.

CHAPTER 3

Regulatory Issues – findings from review and consultations

Each of the broad themes identified earlier is discussed in separate sections in this chapter. There may be several issues under a single theme, and the presentation is structured in a way to bring together findings from consultations and reviews of documents as well as international experiences under each of those issues.

3.1 Regulatory Issues in Insurance

3.1.1 Background

Insurance is regarded as one of the essential pillars of financial inclusion. Insurance can provide financial protection and safeguard the Micro and Small Enterprises (MSEs) from catastrophic expenditure or loss incurred due to unforeseen events. People who are vulnerable, needs insurance protection more than others. However, costs associated with marketing of the insurance products within the traditional delivery network allegedly outweighs the premium the poor and vulnerable can afford. Advancements in ICT are believed to have made ways for innovative insurance products which is very vital for the financial inclusion. Several insurance companies have already started many innovative products to include these segments of the society which are usually considered are not insurable.

One interesting innovation is offering a

composite insurance product for members of Micro Finance Institutions (MFIs). MFIs have large client base and many MFIs collect premium from loans to provide limited 'insurance'. A partnership between an insurance company (Pragati Insurance) and one or more MFIs, mediated through a network of MFIs (INAFI in this case), is expected to successfully market an insurance product that address both life and assets.

Another innovation is seen offering insurance product for the agricultural sectors. It is challenging to provide a traditional crop insurance product since it may have substantial moral hazard. A weather index-based insurance is expected to reduce moral hazard as well as cost of monitoring, thus, allowing insurance companies (e.g., Green Delta Insurance) to bring farmers within the insurance net.

3.1.2 Functional separation between Life and Non-life insurance companies

Problem: As per current regulation, a life insurance company cannot offer general or

non-life insurance product, and similarly, a nonlife insurance provider cannot offer life

insurance product. A composite insurance (combination of life and non-life) product can attract more clients and may provide strong incentives for the MSEs to participate. Moreover, it may reduce some administrative costs, and insurance company can enjoy economies of scope - lowered average cost by packaging two or more products in one. However, it is alleged that current regulation does not permit offering the composite insurance products.

International Experience: Life and non-life products are offered separately in many other countries in the world also. Countries that offer these insurance products separately include Australia, India⁵⁰, Chile, Denmark, Estonia, Germany, Iceland, Ireland, Japan, Korea, Netherlands, Norway, Poland, Sweden, Switzerland, Turkey and the USA⁵¹ (OECD, 2014).

This is not the case for many other countries in the world, which allow composite insurance products. This is true for Austria, Belgium, Canada, Costa Rica, Czech Republic, France, Greece, Hungary, Israel, Italy, Mexico, Portugal, Slovak Republic, Slovenia, Spain, the UK, Argentina, El Salvador, Guatemala, Malaysia, Nicaragua, Panama, Paraguay, Peru, Singapore, South Africa, the Philippines, Uruguay, Kenya and Nigeria. (OECD, 2014; Torres 2015; Gikera et al., 2016; NAICOM, 2017)

An interesting case in this regard is that of the Sanasa Insurance Company Limited (SICL), an insurance company that offers offered both life and general insurance products for low-income groups in rural areas of Sri Lanka (Kiriwandeniya, 2016). According to the Insurance Board of Sri Lanka (IBSL) regulation, insurers were required to separate their life and general insurance businesses before 1 January 2015 (Asia Insurance Review, 2017). SICL, however, is still

Regulators' view: The two types of insurance are different in terms of risk attributes, requiring different approaches to identification of payoffs and calculation of premium. Thus, keeping them separate makes sense, which is claimed to be the universal practice. They recognise the need for packaging⁴⁹, and claims that most company/groups in the market own both types of insurance companies. Thus, partnership in undertaking both activities is internally realised.

offering composite insurance products to the rural population.⁵² In addition to life and motor insurances, they offer agricultural insurance products such as indemnity-based crop insurance, weather index insurance and livestock insurance. The agricultural insurance products have proved to be very useful for the rural farmers and have performed very well (Kiriwandeniya, 2016).

Observations: It is our observation that restricting insurance companies to engage in one or the other product restricts innovative product design. And the interest groups associated with each line of specialization do not feel the urgency to converge, since clear division of revenue and burden is often cumbersome. The latter also explains why regulators (cum-enforcers) find it operationally convenient to deal with the two products separately. The systemic inertia is furthered due to widening of insurance-related contracts beyond borders. Yet the increased varieties in demands of business and general people to guard against risks, and with life increasingly perceived in terms of quality of living and not only by the length of human life, there is rationale for experimenting with alternative regulatory regimes. However, the latter calls for capacity building within the regulatory authority, that is, enhancing research capacity inside IDRA.

⁴⁹ Microinsurance and mutual insurance provide alternative ways to address clients' demand for multiple services. Experiences with those are discussed in sub-section 3.5.1.

⁵⁰ According to Tuli and Jenkins (2017), India has stand-alone health insurers and reinsurers in addition to Life and General insurance companies.

⁵¹ In USA, insurance companies are separated between Life/Health and Property/Casualty (Insurance Information Institute, 2016)

⁵² <http://www.sicl.lk/>

3.1.3 Regulation regarding the investment options of the insurance companies

Problem: Financial inclusion through reaching out to the uninsured people with acceptable and affordable insurance products call for partnering with other agencies, such as the MFIs, which already have established savings-credit network of members. The space for mutually gainful contracts in such partnership may be enhanced if there are scopes for the MFIs to access to the (specific premium) fund of insurance companies at favourable interest rates. That is, premium collected by MFIs will be deposited to insurance companies, and insurance companies usually invest those collected premium in several sectors as prescribed by the Insurance Development and Regulatory Authority (IDRA) guideline. If insurance company could invest (or give loan) to the MFIs at a favourable rate, it would offer incentive for the MFIs to engage in partnering with insurance companies.⁵³

Essentially, the argument calls for internalizing internalising transactions of two agencies that are regulated by separate authorities so that the cost of involving a third party (banks, in this case) may be avoided and scope of negotiations between the two (insurance company and MFI) may be widened. However, current regulations of IDRA do not permit investing in MFIs, even though MRA regulations reportedly do not bar MFIs to borrow. Insurance companies can only invest in some certain sources, and though there is an 'other category', the list spelled out for the latter does not include lending to MFIs. The latter, subsumed under loan issue, is within the jurisdiction of BB.

Regulators' response: Detailed asset management guideline is not developed yet. Regulators, however, are currently working on developing a rigorous asset management guideline. However, insurance companies are said to have the option to propose alternative

investment plans for IDRA approval. It appears from consultations that the regulators would want to give foremost priority to protection of clients' (insured MFI members, in this case) interests. Admittedly, adequate knowledge is lacking to assess the alternatives, particularly, in the language commonly understood by regulators of insurance markets.

International experience: In an analysis of investment portfolio of selected general (non-life) insurance companies (13) in Bangladesh, Samina (2012) reports that between 1999 and 2010, the general insurance industry in Bangladesh increased its investments substantially with the ratio of investments to total assets increasing from only 28.53% in 1999 to 51.26% in 2010. She also reports that the majority of the firms had two basic streams of investment: government securities and shares, with most companies investing primarily in shares.

We did not find any concrete evidence to suggest that investment portfolios of insurance industries in other countries vary significantly or that regulations elsewhere are more relaxed in terms of what kind of investments these companies can make. In OECD countries in 2013, e.g., investment portfolios of insurance companies consisted of bonds, shares, real estate and other investments. Although the investment portfolios of insurance companies (for all three sectors: life, non-life and composite) in most of the OECD countries were dominated by government bonds, the non-life insurance sector in several countries exhibited a substantial shift away from bond investments towards shares. Share of investment in real estate was very small for most countries. While a number of countries reported substantial investments in "other assets", not much information was available to understand the nature of investments in this category (OECD, 2014).

⁵³ There are MFIs which are uncomfortable with intrusion of insurance companies to share the premium they deduct from their clients on account of one or the other form of micro-insurance. There are others, who are keen on specializing, but would like to see the insurance companies reciprocate with 'lending' at interest rates lower than the banks offer to those MFIs.

Insurance Regulatory and Development Authority of India (IRDA) seems to provide even stricter guidelines compared to IDRA in Bangladesh as to what type of investments the insurance companies can make. As per IRDA regulations as of 2015, at least 50% of the investment portfolio of an insurance company in India must be made up of central government securities, state government securities, and other approved securities (all debt instruments) with at least 25% of the investments in central government securities (Kotakmoneywatch 2015). To promote expansion of the housing and infrastructure sector, at least 15% of the investments have to be made in these sectors. Investments across various industrial sectors are limited to a maximum of 20% with a maximum of 15% investment in the equity of an individual company. Overall, the approved investment instruments are very safe and generate low returns. The adherence to the stated guidelines is closely monitored by IRDA and any non-compliance results in a show-cause notice followed by appropriate punishment or penalty, if proven guilty. In contrast, Bangladeshi insurance companies appear to be allowed to invest in much riskier assets and therefore can potentially earn a much higher return on their investments. For example, according to Samina (2012), in 2010, proportion of investments in the

share market for some insurance firms in Bangladesh was as high as 98.24% (Eastern insurance), 97.83% (United insurance), 95.86% (Pioneer), 95.18% (Reliance) and 95.10% (Eastland).

Observations: Historically, regulations of institutional spaces in the financial sector have evolved in a way to define independent spaces for banks (and NBFIs), insurance and capital market. Accordingly, separate Acts have been promulgated. For obvious reasons interest groups associated with each have also emerged that resist changes towards coordination and unified actions. To break away from the tradition in a smaller economy and (globally) a less powerful state is a difficult task. The same setting however provides opportunities for experimentation, which ought to be agreed upon conceptually within a larger community of academia, practitioners and policymakers. Within a “regulatory sandbox” approach, several countries are already relaxing certain regulations for innovative tech-based insurance projects, which may be worth pursuing. However, developing IDRA’s human and technological capacity is a pre-requisite for such engagements,

3.1.4 Alleged strict actuary certification requirement

It was alleged that as per current regulation, in Bangladesh, any new life insurance product must be certified by an actuary. According to one of our interviewees only one actuary is currently living and working in Bangladesh. One solution could be getting certification from an external actuary. Since 2011, IDRA regulation requires an actuary to have a physical office in Bangladesh and be physically present during the time of the certification process making it almost impossible for an insurance company to get certified by an actuary who is a foreign

resident. This restriction delays getting permission for new products, and it has made innovation in the insurance sector very hard.

Regulators’ views: Though regulators prefer local actuary, it is claimed that there is no apparent restrictions on hiring foreign actuary. Regulators keep some stringent requirement to ensure that a product is launched with proper estimation of risks, and the latter can be ensured through qualified actuary certifications.

⁵⁴ There are others who contest the figure. After consulting several groups, we understand that there are quite a few actuaries in Bangladesh, most of whom are employees of large firms, and are not available to others for professional services.

International experience: According to A.K.M. Elias Hussain, the president of the Actuarial Society of Bangladesh, in 2014, there were only one fellow and two associate actuaries in Bangladesh (Hussain, 2014).⁵⁴ These figures, if true, are obviously negligible compared to other countries in the regions. According to Institute of Actuaries of India (2017) report, there were a total of 429 fellow and associate actuaries in India during 2014 (which increased to 504 in 2017). This number was 23 in Sri Lanka in 2013 (Krishnaratna, 2013).

Observations: Consultations with different groups of stakeholders lead us to believe that the problem of scarce actuaries lie elsewhere. There are many working in the country, but they are in the payroll of companies and their services are not available for others. For various

reasons, one being the alleged oligarchic structure of the market, independent practice by professional could not get established in the country. Unfortunately, no prior research exists to draw firm conclusion and recommendation. Clearly, IDRA needs to take initiatives for creating professionals to strengthen the insurance sector⁵⁵. Till a significant capacity is in place, the alleged IDRA requirement of an office in the country and physical presence of the professional during the time of the certification process may restrict innovative financing that are linked to insurance products. The dilemma for IDRA appears to be genuine - the restriction may defeat the purpose by creating undue rent for the limited number of in-country professionals, and yet, the high rent may attract professionals to engage actively in the local market.

3.1.5 Absence of guideline for innovative insurance product

Background: There is no clear guideline regarding the steps to be followed if some innovative insurance product is to be offered. This was found to be the case for weather index-based crop insurance. Traditionally, insurance companies apply for 'NOC' or inform the regulatory authority. However, having a clear guideline would help expedite the process. There is however no clear guideline regarding the steps to be followed when it comes to innovative insurance product. There is also an alleged restriction on whether any insurance company can offer price guaranty (on agricultural product). In reality, prices of agricultural products vary significantly, causing instability in farming income. Price guaranty or insurance on price instability could be attractive to the farmers. However, there is some concern from the insurance companies whether they can offer such kind of product in Bangladesh.

Regulators' view: It is true that there is no guideline. While a guideline will be developed, it is asserted that absence of it should not be

viewed as a hindrance to introduction of new insurance products. Insurance companies can always request for NOCs as and when a new product is developed.

International experience: When it comes to innovation in insurance products, clear-cut regulations are not always in place and often existing regulations can become prohibitive in fostering innovation. For example, according to a recent OECD study (OECD, 2017), very few InsurTech⁵⁶ start-ups have managed to gain insurance underwriting licenses because of the existence of potentially prohibitive capital and/or fit and proper requirements that must be met to obtain permission to operate. While it's sensible to have such requirements to ensure consumer protection, these could potentially prevent entities with innovative ideas from entering the industry. In order to address such issues, regulators in some countries have established new platforms where

⁵⁵ Such undertakings may include Qualification Training/Surveyors Insurance Diploma for Actuary/ACII holders/Agent.

⁵⁶ The term being used to describe the new technologies with the potential to bring innovation to the insurance sector and impact the regulatory practices of insurance markets.

certain regulations are relaxed for innovative tech-based insurance projects within the platform (a “regulatory sandbox” approach). The UK Financial Conduct Authority (FCA), Monetary Authority of Singapore (MAS), Australia’s Securities and Investment Commission (ASIC), The Hong Kong Monetary Authority and Canada’s Ontario Securities Commission have all established such platforms with a view to understanding the effectiveness of the innovative projects as well as helping the innovative firms understand the regulatory requirements.

The importance of having proper guidelines can also be understood by analysing the case of India’s mutual and cooperative insurance sector. According to a study (published in July 2017) by the International Cooperative and Mutual Insurance Federation (ICMIF) in association with the Insurance Institute of India (III), a total of 15 mutuals and cooperatives operating out of 13 states in India were providing insurance-like services to approximately one million low-income people using risk retention or risk sharing models. In spite of not having the desired scale, these mutual, cooperative and other community-based organisations (MCCOs) were able to demonstrate noticeable impact in protecting the lives and livelihoods of the poor by bringing insurance services to them. Surprisingly, the Indian Insurance Laws Amendment Act of 2015, instead of creating enabling regulations to foster the growth of this sector, excluded them from its scope altogether. ICMIF viewed this lack of regulation and recognition by the Government as one of the biggest threats to the spread of necessary insurance services for the un-served/underserved segment of the population. The ICMIF-III study strongly recommended specific

enabling legislation leading to recognition (if not regulation) of MCCOs as a viable alternative risk management (ARM) mechanism for achieving inclusive growth. They also suggested collaboration between MCCOs and commercial insurers (e.g., commercial insurers offering reinsurance to mutual micro insurers) in providing efficient risk management to the low-income population.

An example of a successful innovative product targeted towards the low-income segment of the population which is well supported by an enabling regulatory environment is the Centre for Agriculture and Rural Development Mutual Benefit Association (CARD MBA) – a part of the system of CARD Mutually Reinforcing Institutions (MRI) that also includes CARD Bank, CARD Inc. (a NGO), and the CARD Training Centre. The MBA, based in the Philippines, offers life and disability insurance, a mandatory provident fund to CARD Bank and CARD Inc. members and a loan redemption scheme for CARD borrowers. According to a case study by McCord and Buczkowski (2004), the mutually reinforcing nature of the relationships makes the operations of the MBA extremely efficient. The study also suggests that the regulators in the Philippines offer an enabling regulatory environment for MCCOs which has allowed CARD and others to offer insurance to their members successfully. As of February 2018, CARD MBA provided insurance coverage to nearly 15.8 million low-income Filipinos.⁵⁷

Observations: Given the complexities and potential risks involved in the insurance industry, the IDRA can certainly think of introducing a regulatory sandbox approach to address this issue.

3.1.6 Other policy issues

Insurance premium also has VAT on it. VAT increases the effective premium, which may reduce the adoption. While agriculture and

agricultural products are often kept out of the VAT, it is not understandable why insurance offers for farming have VAT compliance.

⁵⁷ <https://www.cardmba.com/>

Regulators' response: It is an issue of NBR and Ministry of Finance Policy which requires substantial changes in VAT acts.

Observations: If financial inclusion is justified on grounds of social benefits, fiscal incentives can

be justified. Background work in support is however needed. Though there is no VAT on life insurance premium, if anything else is added with life then there would be a VAT on it which makes composite insurance pricier.

3.2 Regulatory Issues in Lending (Agent Banking)

3.2.1 Background

Mere provision of ATM services, internet banking etc., may not in the themselves increase the likelihood of the unbanked mSEs getting banking service and especially financing from the banks or the financial institutions. The most relevant service delivery for increasing the access to finance for the MSEs are admittedly agent banking and for agent banking to take off we will need to see high penetration and consequent usage of the accounts in the catchment area served by an agent. In particular, the account holders will have to utilize their accounts to effect payments, not just

to save money and withdraw cash for hand-to-hand transactions. Unless transactions are at least to some degree generally and customarily through bank, the banks will not have a good and dependable idea on the transaction volume handled by its different clients. They will therefore be unable to provide financing and other customized product to increase lending to SMEs. Based on the consultation with CF winner related to agent banking, the Study identified few regulatory issues, which are discussed below.

3.2.2 Complex Account opening process

Background: The hindrances to opening accounts include at present, the unwieldy Biometric Account Opening Forms that run into several pages, and Information pertinent to a Bank's understanding and those required for predicting a client's likely potential, may be lacking.

Regulators' response: The issue was discussed at length with the responsible regulatory authority, the Bangladesh Financial Intelligence Unit (BFIU) of BB. The regulators however opine that individual banks are free to collect information they need for their assessment of clients. The requirements for the purposes of better AML/CTF compliance, is emphasized for improved branding of Bangladesh's financial sector. However, BFIU recognises the need to reduce load of excessive information requirement at the front-end and plans to pilot e-KYC and real time account opening with biometric verification by

end 2018.

Observations: The KYC issue surfaces in several fields of query in this assignment, all of which have a common root in BFIU. Many feel that the national authority should revisit the concerns and make the basic requirements simpler and stick to those which find uses in the authority's regular monitoring exercises. It is our understanding that there is no dearth of intent. However, there is a need to bring transparency and clarity regarding the minimum 'requirements' so that confidentiality is not compromised in the name of a non-transparent requirement!⁵⁸ Verification of identity with National ID is already in practice by banks. It is apprehended that the banks are extremely risk averse and are keen on passing all liabilities to clients and therefore demand excessive information in the guise of KYC and during opening of a bank account.

⁵⁸ In a recent circular (BRPD Circular No. 04), dated 21 May 2018, centrality of BFIU Circular No. 10, dated 28 December 2014, with regards to Customer Due Diligence and KYC, is noted. The BRPD circular also mentions of introducing biometrics, Iris recognition and facial recognition for those not literate!

3.2.3 Stringent requirement for the eligibility of being agent and complex agent licensing process

Background: There are now more and increasingly stringent requirements for the agents and master agents' credentials before banks can engage them as agents. These requirements are in the nature of character certificates, police verification, etc. Until recently Bangladesh Bank used to provide approvals for agents and agent banking premises on application by the banks. Now Bangladesh Bank is providing approvals on specific requests against agents, master agents and premise address. As the approval can and often does take some time, often several months, the banks have to keep the premises idle during the period between application and approval. This is a regulatory constraint; while it may not be by itself very onerous, it obviously adds to the costs of compliance for the banks.

Regulators' response: Initially, BB allowed bulk licensing for piloting the scheme. There were however lapses in compliance and the requirements for selecting agents were not adequately fulfilled. Hence, BB introduced the requirement of banks needing to request for separate licenses.

International experience: Regulators in some countries allow only a certain type of individuals and/or organisations to become an agent. For example, Indian regulators initially did not allow any for-profit organisation to become agents assuming such entities may end up exploiting the poor. Although they have lifted this restriction recently, they still do not allow the large microfinance institutions (MFIs) registered as nonbank finance companies (NBFCs) to become agents (Tarazi and Breloff, 2011). The Central Bank of Kenya on the other hand allows only for-profit entities to become agents and explicitly prohibits non-profit organisations such as faith-based organisations, NGO-s and educational institutions from becoming an agent (Central Bank of Kenya, 2015). The Kenyan regulators very likely believe that agent banking would operate more efficiently under a profit maximizing framework and engaging in such activities would steer the non-profit organisations away from pursuing their original social aspirations. Regulators in Brazil allow any legal entity to work as an agent but do not allow

any individual to do so, probably with a view to minimising fraudulence and ensuring consumer protection (Tarazi and Breloff, 2011). Additionally, in spite of there being no regulation against it, financial institutions in Brazil in practice do not offer agent-ship to businesses such as gas stations, night clubs, funeral homes and bars since these are likely to be more susceptible to robberies. In Mexico, in addition to being a qualifying business, agents must have a permanent address, the necessary infrastructure to complete banking operations, staff certified to operate the required equipment, an acceptable business and credit record and have no record of felony or fraud (Alliance for Financial Inclusion, 2012).

Observations: Comparatively, regulators in Bangladesh initially took a much more flexible approach in terms of agent eligibility. According to an earlier version of Bangladesh Bank (BB) guidelines (Bangladesh Bank, 2013), a vast array of entities including for-profit organisations, non-profit organisations including NGO-s and MFI-s and individuals (educated Individuals capable to handle IT based financial services, agents of insurance companies, owners of pharmacies, chain shops and petrol pumps/gas stations) were given permission to become agents in Bangladesh. In the most recent version of regulatory guidelines (prudential) for agent banking (Bangladesh Bank, 2017), however, BB has imposed several additional conditions with respect to the entity owner's/manager's experience (at least 1 year of experience in related field), entity's expertise (possess managerial, financial and technical expertise for managing agent banking outlet of a bank in addition to its regular operations) and minimum number of people required in the entity (must have at least 2 (two) persons (a manager and a teller) for this purpose). BB has also imposed restrictions on individuals who can become agents – agents of mobile network operators and insurance companies that fulfil the eligibility criteria – in this new set of guidelines. These new guidelines certainly have put limitations on a bank's ability to appoint agents. Given the widespread need of providing banking services to a large number of underserved people in the country, reduction in cost and delivery time are

important. It may therefore be worthwhile to revisit the issues to find the right balance

between regulators' concerns and efficiency in banks' performance.

3.2.4 Low transaction (number) limit

Background: At present only two over the counter transactions can be made in a day by an agent banking client from the agent premise. This restriction does not go with the admittedly shared goal of ensuring quality banking service to SMEs and therefore merits a revisiting by the regulators. Though section 27.6. of the Guidelines provides the means for banks to increase the transaction limit on a case-to-case basis, the procedure laid down for that do appear to be onerous for both banks and the customers and are likely to result in a de facto rigid limit which in turn will constrain the SMEs from utilizing banking service at depth.

Regulators' response: The limits apply to P2P services, and there is no limit for B2B transfer. Moreover, agents can apply to increase the limit. Hence, it is not a problem.

Observations: Because of additional requirements for opening accounts as business entities, (MSEs), which are also under single proprietorship or self-employed, have their accounts as private individuals. It is alleged that businesses of this group of people are adversely affected by the limits, even when those are on P2P. Thus, the regulatory authority may like to find ways to encourage these people to open accounts as business entities, which may require relaxed fiscal measures; or, alternatively, to relax the limits with increased real time monitoring of purpose-specific transfers and retention of records on persons to whom transfers are made. It is understood that the technology permits, and programmes may be designed to set alarms whenever transactions through an account gets suspicious.

3.2.5 Requirement of specific dedicated premises

Background: There appears to be stringent requirements for the banks to vet the agents' business premise, the security of the premise and the equipment that needs to be there. However, it is doubtful if banks can set up stand alone or dedicated agent booths where the agents do not carry any other business in truly remote and / less vibrant economic areas. So, it is debatable whether it would be beneficial if it is made explicit if agents, at least in some locations, can operate the agent banking business with their existing business-like retailing etc.

Regulators' response: Since it is a financial transaction, it is important to maintain some level of security measure, and hence these

regulations are in place.

Observations: Fits in well with a generic problem in the regulatory regime in countries such as Bangladesh. A requirement, if mandatory, ought to be complied with, and violation (non-compliance) ought to be severely dealt with. Unfortunately, pre-inspections, approvals and certifications are too often considered substitutes of compliance, and the processes demand more time and incur costs without necessarily ensuring compliance. Often policies to put the burden (costs) of thefts to the providers may force compliance, without calling for processes currently in place.

3.2.6 Other issues

The following additional issues came up while reviewing local and foreign regulations on agent banking.

3.2.6.1 Location of the agent's premise

Location of an agent's area of operation has been restricted by some countries in the past. Such restrictions, however, have often been lifted when regulators recognised the adverse effects of such regulations on financial inclusion. For example, initially, regulators in India required agents to be within 15 kilometres of a base branch of the appointing bank in rural areas and within 5 kilometres in urban areas. Later on, this distance has been increased to 30 kilometres and banks can also apply for exemption in order to serve people living in remote areas where establishing a branch is not viable. In Brazil, on the contrary, regulators initially allowed banks to appoint agents only in municipalities that did not have bank branches with a view to protect bank branches from competition. Afterwards, they repealed this regulation in 2000 (Tarazi and Breloff, 2011).

An earlier version of BB regulatory guidelines for agent banking indirectly imposed limitation on an agent's service area by implying that the agent's activities remain within the designated area of a particular branch of the bank

(Bangladesh Bank, 2013; see guideline 6.2). This seems to be counterintuitive as the core objective of agent banking is to provide banking and financial services to the underserved population, many of whom live outside the designated area of any particular branch of a commercial bank. In the newer prudential regulatory guidelines for agent banking, however, Bangladesh Bank has outlined a specific set of guidelines addressing the location issue. Where it has prudently emphasized that while giving permission, it shall give preference to banks that establish new agent banking outlets in an area that does not have any bank branch or agent point within 1-kilometre radius (Bangladesh Bank, 2017). Bangladesh Bank has also urged banks to give priority to remote rural areas, chars, islands and other geographical areas with limited accessibility and suggested to maintain a minimum ratio of 3:1 for rural and urban agent banking outlets. From an equitability point of view and for promoting financial inclusion, this new set of direct "location" guidelines should be viewed in a positive light.

3.2.6.2 Agent compensation

In most countries, agent compensation depends on negotiations between the bank and the agent. However, almost in all the countries, regulation prohibits the agent from charging the customers directly for providing agent services (Tarazi and Breloff, 2011). Bangladesh is no different in this respect. Like most countries, in Bangladesh also, the bank has to establish a fees, charges and commission structure for the agent and ensure that agent collects fees, charges and commission payable to the bank as specified in the schedule of charges only (Bangladesh Bank, 2017). Although our interviews with Dutch-Bangla Bank Ltd and Bank Asia revealed that agents at present generally take 1% from the loans sanctioned by the banks, we did not find any regulation that imposes such restriction.

While charging fee for agent services is prevalent today, it was not always the case. For example, regulators in India initially did not allow banks or agents to charge any fee to the customers (Tarazi and Breloff, 2011). Later on, they realised that such prohibition would make agent banking nonviable and therefore, lifted the restriction in 2009 (Reserve Bank of India, 2009).

There are rare instances where agents are allowed to practice some discretion regarding the fees, they charge their customers. For example, in the Philippines, one electronic money service provider allowed agents to charge between 1 and 3 percent of the transaction amount. While this practice rewarded the agents, the lack of uniform fees in all likelihood resulted in customer confusion and

may have contributed toward a very limited success in spreading agent banking in the

Philippines. (Tarazi and Breloff, 2011)

3.2.6.3 Agent exclusivity

As Tarazi and Breloff (2011) point out, countries vary in their regulations regarding agent exclusivity. Some countries prohibit agent exclusivity, e.g., Fiji, Pakistan and the Maldives. Regulators in these countries hold that such prohibition will allow agent banking to penetrate greater number of remote areas, foster competition and prevent large banks from monopolising the best agents and locations. Regulators in some other countries allow exclusivity because it provides greater incentives to the banks to enter into agent banking and prevents potential underinvestment by minimising spill-over effects (later entrants getting the benefits of first mover's investments on identifying, screening, training and recruiting agents). For example, although

regulatory frameworks in Brazil, Columbia and Peru do not explicitly address the question of exclusivity, exclusive contracts between banks and agents are prevalent in these countries. India's case on the other hand is a bit different. Although regulation permits an agent to serve multiple banks, at one retail point or outlet, only one bank can be represented. Regulators in Bangladesh initially imitated the Indian regulation (Bangladesh Bank, 2013: see guideline 6.1) but have come away from that practice more recently. According to the recent BB prudential regulation guidelines for agent banking, an agent is explicitly prohibited from entering into a contract with more than one bank (Bangladesh Bank, 2017: see guideline 15.1).

3.3 Alternative investment

3.3.1 Background

Traditional financing systems often fail to deliver a product and financing need to the poor and under-served, and so the alternative investment has been often considered as the route to financial inclusion. Until recently, there was no guideline so as to cover the alternative investment in Bangladesh. The alternative investment rules of 2015 include only three types of investments: equity financing, venture capital and impact investment⁵⁹. However, there are more varieties out there. An example, cited by several CF awardees, is the equity crowdfunding. The regulatory issues relevant for the field are listed below.

- a) There is currently no regulation (or, guideline) for crowdfunding in Bangladesh. Since ECF is a pilot project,

the CF recipient (BD Venture) applied for an NOC from BSEC. However, they have been waiting for about one year to get the NOC, which is allegedly hindering commencement of their operations.

- b) The firm is trying to run it under existing Alternative Investment Rules, 2015. Under this rule, three types of investment are allowed: impact investment, venture capital and equity funding. The organisation has the license for venture, which allows running alternative investment.

However, the existing rules put some restrictions which may conflict with the idea of crowdfunding. These are,

⁵⁹ In a gazette notification of 24 May 2018, the government announced formation of a high-powered committee to formulate a policy guideline regarding venture capital and investment eco-system in the country. The committee will also scrutinise the possibilities of forming an 'Impact Investment Fund' under BIDA for the small entrepreneurs, especially for the women entrepreneurs (Financial Express, 29 May 2018).

- I. The minimum investment is 5 million TK, and maximum 200 persons can invest altogether. But the particular organisation would like to mobilize funds from a larger number of small investors, and total investment on an mSE project may be a lot less than the minimum set-in current regulations.
 - II. Fund manager collects the fund and it goes to the best investment, but in crowdfunding, fund is collected for a specific project. Moreover, the role of the intermediary is often as a commission agent, not bearing any risk on either side of the transfers.
- c) The regulatory authority is alleged to be hesitant to allow crowdfunding due to the negative experience observed in the neighbouring countries.

Regulators' response: The system allows for financing operations through money market (debt financing) or through the capital market (equity financing). There are also provisions for raising funds through the bond market. Thus, allowing 'commission agents' to engage in crowdfunding activities will expose a large number of small savers to fraudulence.

International experience: Our investigation revealed that crowdfunding is a relatively new concept that has received regulatory attention even in the developed world only recently. According to Cusmano (2015), e.g., it took till 2013 for a well-defined regulatory framework for crowdfunding to be established in USA. Italy was the first country in Europe to implement an ad hoc regulation on equity crowdfunding, which

came into effect in July 2013. UK and France are the two other European countries to have established regulatory frameworks for crowdfunding by 2014. We were able to find out detailed guidelines for crowdfunding for a number of developed countries including USA, Canada, UK, Australia, New Zealand, Italy and France.⁶⁰

An example of a successful crowdfunding platform is Kiva⁶¹, an international non-profit organisation, established in 2005 and based in San Francisco, with a mission to connect people through lending to alleviate poverty. Thus far, Kiva has raised \$1.14 billion worth of loans from 1.7 million lenders, which has funded various kinds of projects involving a total of 2.8 million borrowers in 85 countries with an impressive repayment rate of 96.9%.

Although the regulatory framework for crowdfunding is a recent phenomenon even in the developed world, we have identified detailed crowdfunding guidelines in our neighbouring country India. In India, digital equity crowdfunding platform is illegal and any form of equity crowdfunding that involves a large amount of money or is equity-based, is strictly monitored (Prabhu, 2016). As Murlidharan (2014) points out, the primary cause of this is the use of crowdfunding for money laundering, a glaring example of which is the Sahara case whereby the Supreme Court of India ordered Sahara Housing Investment Corporation Ltd and Sahara Real Estate Corporation Ltd to return about INR 25,000 crore to an astounding 2.96 crore investors reports. According to the Securities and Exchange Board of India (SEBI), the susceptibility of the digital market to security threats while funding businesses online is another reason for imposing the ban on digital equity crowdfunding.

⁶⁰ See, Cusmano (2015); Financial Conduct Authority (2015); Cormick (2016); U.S. Securities and Exchange Commission (2016); Australian Securities and Exchange Commission (2018); Financial Market Authority: New Zealand (2018).

⁶¹ <https://www.kiva.org>

The Securities and Exchange Commission (SEC) in the Philippines also provides comprehensive regulatory guidelines about crowdfunding. In a memorandum issued in November 2011, the SEC of the Philippines has provided detailed rules and regulations governing crowdfunding. In the memorandum, they have outlined guidelines on general provisions, issuer requirements, intermediary requirements, funding portal regulation, reports, and recordkeeping & other post registration/operational requirements.⁶²

Given the supportive regulatory environment, a number of crowdfunding platforms such as the Spark Project⁶³, Gava⁶⁴ and Upbuilds⁶⁵ are operating successfully in the Philippines. For example, the Spark Project, an online crowdfunding platform, started its operations in 2013 where Filipinos can campaign to fund their creative, innovative, and passion-driven projects. The platform since its inception has raised about 5.8 million Philippine pesos (equivalent to about USD 112,000) for 63 projects.

Observations: The minimum required investment of BDT 5 million and a maximum of 200 people,

stipulated in the alternative Investment Act, 2015 were cited as hindrances. According to our interviewee, the minimum required investment is too high while the maximum number of investors allowed is too low for crowdfunding. In India, as per the SEBI guidelines, the maximum allowable number of investors is the same, i.e., 200 but the minimum required investor contribution is only INR 20,000 (there is also a maximum allowable investment of INR 60,000), which would make it easier for a crowdfunding platform to operate funds (Murlidharan, 2014).

Review and consultations were also undertaken to assess if the practices of crowdfunding could be done under the umbrella of any other existing Act or regulation. It is apprehended that both investors (small savers) and entrepreneurs (borrowers) may be made members of a Cooperative to allow transfers. While this does not yet resolve the problem in giving the commission agent (so called crowdfund manager) some kind of legal identity, there are ample cases in the real estate sector, wherefrom lessons may be drawn. Clearly, there is a case for regulatory sandbox here as well.

3.4 Payment Digitisation/Digitisation of financial transfers

3.4.1 Background

Financial transfer involves movement of funds and/or assets from one account to another, which typically comes from but not limited to purchase, sales, or receipts. Unilateral transfers, such as, allowances from government to private individuals/ households, is one example. Yet, people in the financial industry chooses to use “payments” to describe all kinds of financial transfers. Payments may involve transfers between persons, businesses and government

— both intra and inter. These include, among other things, disbursement of remittances, salaries, loans, merchant payments, deposit into and withdrawal from financial institutions, insurance premium payment, pension payments, government allowances, tax, fee payments, etc. Within a larger canvas, payments also include intra-bank and inter-bank financial transfers, fund transfers within or outside brokerage accounts — both within a country and worldwide.

⁶² https://www.sec.gov.ph/wp-content/uploads/2017/11/2017_Notice_DraftRulesandRegulationsGvernmentCrowdv2.pdf

⁶³ <https://www.thesparkproject.com>

⁶⁴ <https://www.gavagives.com/>

⁶⁵ <https://upbuilds.com/>

Digitisation is the process of converting analogue information in any form or process to digital form so that those can be processed, transmitted and stored through electronic mediums and networks. Payment can be made by using traditional ways of using physical cash transactions, lengthy paper works and/or simply by utilising digital means such as electronic fund transfer, crypto-currencies or interconnectivity between the mediums. Thus, payment digitisation is a process of altering traditional way of financial transfer by the integration of digital process such as interoperability, interconnectivity, use of internet and mobile phone, electronic fund transfer or making payments using e-currencies, electronic cheque and digital record keeping, etc. to reduce transaction cost, time, and the use of paper works involved in an effective manner. Use of digital payment via mobile financial service or internet banking enables greater financial inclusion to unbanked and marginal segments in the population, both private and business.

We presume that digital payments require platforms provided by land or mobile phones, internet connections provided by ISPs, or an extended LAN established with exclusive internal control of a financial institution (which may or may not combine internet and mobile-based connectivity). With the advances in mobile technology and fibre-optics communication, the standard platforms availed are mobile financial service (MFS), and the non-mobile financial services provided by payment card industry (PCI)⁶⁶. The important distinction is whereas hard cash is anonymous, digital payments are not. A record of who is paying whom, is generated every time a payment is made, and the record remains with a third party for validation who is the PCI or MFS. Internet banking also can be seen to be digital payment. In the latter case, the record is maintained by the remitting and receiving banks, which may be one when both the payee and the payer are transacting in the same bank.⁶⁷ The regulatory issues that seem to be a barrier to the development of this sector are given below.

3.4.2 Requirements on KYC and Storage of Information

Background: To our knowledge, various regulatory agencies place demands on KYCs from the agencies who engage in provisioning of services at retail level. The core objective of KYC requirements is to establish customer relationships and monitor transactions for decisions on future financial transactions. The importance and stringency around KYC increased when the urge to prevent money laundering and combating terrorist financing came to centre stage at policymaking. Thus, various stakeholders are advised to maintain the entire KYC requirement issued by Bangladesh Financial Intelligence Unit. Currently there are four sets of KYC forms issued by BFIU, separately for scheduled Banks, Financial Institutions, Mobile Financial Service and for Insurance. The basic structure of KYC is more or less the same among the institutions with the information

about customer profile, nominee profile. The minimum KYC requirement is for MFS among the issued uniform KYC forms. If the MFS account of any customer is linked with a Bank account, then it is not required to maintain separate KYC. For banks additional information is required such as tentative transaction limit, risk grading, source of income, reason of opening bank account etc. for both person and non-person account. However, the institutions can include additional information requirements if they think it is necessary. BTRC requires a different set of KYC information with biometric verification for people purchasing mobile SIM cards. For internet service, the minimum KYC requirement is customer's name, address, contact and IP address.

⁶⁶ The latter may use dial-up based service or a wireless connection implying a dedicated mobile phone connection, or a wi-fi based router linking to internet.

⁶⁷ Reduced cost due to cash-less transactions is well-recognised. The significant additional fallout is the information generated on each transaction that allow transparency and informed decisions by regulatory authorities. For MSEs, such information generates credit profiles, which subsequently facilitate their financial inclusion.

Additionally, the MFS firms are currently required to maintain hard copies of the KYC documents. One MFS representative suggested that their firm is currently maintaining hard copies of 30 million KYC documents for which they need a physical area of 12,000 square feet. This imposes a substantial amount of cost burden on the firm (both in terms of rent and employee time), which in turn gets translated into higher transaction cost. The MFS representative also added that when asked to share KYC information of any client with a bank or a regulator, they have always had to only submit the digital record and never had to submit a hard copy.

Regulators' view: Regulators understand that there is some avenue for rethinking regarding the revision of KYC. However, BFIU is the authority posting those requirements on KYC, and are guided by concerns that are trans-boundary in nature.⁶⁸

International experience: The Fintech and MFS representatives also expressed concerns over the rigid and comprehensive KYC (Know Your Customer) requirements stating that these may hamper the growth of the digitisation process of financial transfer in the country. Last year, Indian regulators also issued guidelines on stricter and mandatory Know Your Customer (KYC) norms for users of mobile wallets in the country, which according to Indian Fintech/MFS industry players would be a deterrent to the growing industry and might also destroy smaller transactions (Pani, 2017). However, in all likelihood, the regulators in both the countries are enforcing these stricter KYC requirements as measures to counter money laundering and terrorist funding.

However, there are ways to reduce the amount of time required to complete the KYC process.

Consider the Aadhar e-KYC services introduced by the Unique Identification Authority of India (UIDAI). UIDAI issues an Aadhar card to Indian residents, subject to a verification process, which any resident of India can voluntarily enrol to obtain.⁶⁹ The UIDAI has combined an electronic-KYC (e-KYC) service with the card, which enables an individual with an

Aadhar number to allow UIDAI to disclose her/his personal information to service providers to instantly activate services such as mobile connections, bank accounts, etc. This e-KYC service can be used by customers to go through electronic verification of their identity. Although the entire KYC process still takes a relatively long period of time to complete due to documentation, this Aadhar e-KYC service reportedly quickened the process of opening a new trading account or bank account, or, availing a new mobile connection in India. A recent study on KYC benchmarking and harmonisation conducted by MicroSave suggests that e-KYC can potentially result in an estimated direct saving of over US\$ 1.5 billion within the next five years. In addition to significant cost savings for banks and financial institutions, e-KYC is shown to be more efficient compared to the alternative paper-based KYC. According to the study, traditional customer enrolment processes pursued in commercial banks can take from two to four weeks before an account is activated, and all KYC details have been verified and stored for future retrieval whereas e-KYC enabled bank accounts can be activated and prepared for transactions within a minute (Chopra et al., 2016). Something similar can be done in Bangladesh given that the Government of Bangladesh has introduced Smart National Identification (NID) cards for the citizens of Bangladesh.

⁶⁸ See discussion on the subject presented earlier in this report.

⁶⁹ <https://www.uidai.gov.in/your-aadhaar/about-aadhaar.html>

Observations: There have been persistent changes in the formulation of information required by BFIU showing responsiveness to changes in market conditions. While opening an account with MFS hardly requires a page of information, those MFS operating on behalf of a bank requires to fill in more information. It is opined by many that an effective collaboration of MFS with banking sector to work, the KYC requirement needs to be revised and reduced.

The general aspects and the need for reflections at BFIU have already been discussed. Since BB would like to promote bank-led digitisation, agent banking is expected to play an important role in financial inclusion. BFIU is planning to pilot e-KYC and real time account opening for MFS also for agent banking in 2019 for the account holders whose balance is less than 5 lacs (for agent banking customer).

3.4.3 Big data, storage, reporting and privacy issues

The following issues were identified:

- Ambiguity in interpretation on hard and soft in reporting and information/data storage.
- Paragraph 17 of the Bangladesh Payment and Settlement Systems Regulations-2014 mentions that information supplied to another country should only be in summary or aggregate form.
- Since MFS is expected to play a supportive role to banking institutions, under current regulations, banks are presumed to be accountable for information storage for a period of 6 years.
- There appears to be confusion with regards to requirements on form in which data ought to be retained, among both MFS and regular banks/FIs.

3.4.3.1 Data Storage and Privacy Issues

Currently there is no clear regulatory restriction on monetising the big data that results from payment transactions that they process and record. As a matter of fact, such monetisation generates additional revenue, which may partly get transmitted in the form of reduced prices charged on the end clients of the MFS. The latter is expected to have positive impact on financial inclusion. However, it runs contrary to protection of clients' privacy. There can be more clarity on the use of data in big data paradigm, and also the need for obtaining approval of the end clients in this respect may be made more explicit in the regulations.

During our interviews, Fintech and MFS representatives said that they can store financial data only in Bangladesh Bank (BB) sanctioned digital storage facilities and suggested that it would be cheaper and easier for them if they were allowed to store data in privately owned clouds such as Amazon and the like. BB does not allow these firms to do so due to concerns over security and accessibility. This is understandable given the regulators' strong position in

countering money laundering and financing of terrorism.

Regulators' response: Recognise that allowing companies to store data with global service providers may provide a cheaper option and may secure data from regular hacking. Such an option also reduces the demand for in-house capacity build-up, thus, reducing costs of operation. However, such arrangements raise problems with regards to contract enforcements, and increases risks associated with contract failures. Therefore, Bangladesh government or BB may face difficulty in accessing the data in case of AML and CTF. The regulators, however, are open to allow storing data in other countries if appropriate contracts between entities can be established.

International experience: Bangladesh, is not the only country to be facing issues regarding client privacy. In neighbouring Although the Indian government has specific set of guidelines to protect

Sensitive Personal Data or Information (SPDI) of the clients (The Centre for Internet & Society, 2013), enforcement is inadequate, and the regulatory framework needs major upgrading (Jatania, 2016). Better than Cash Alliance, a partnership of governments, companies, and organisations in 60 member countries of the UN (including Bangladesh) – and international organisations works towards the transition from cash to digital payments. It provides a set of “Responsible Digital Payments Guidelines”, in order to reduce poverty and drive inclusive growth.⁷⁰ These guidelines are designed to protect clients from risks such as loss of privacy, exposure to fraud, and unauthorised fees. Among the eight guidelines reported in the document, guideline number 2 (keep client funds safe) and 7 (protect client data) deal directly with privacy. The document provides detailed suggestions and examples regarding how to achieve each of the guideline objectives and is meant to help the regulators in developing their rules.⁷¹ Since Bangladesh is a member country of this alliance, regulators should not have too many difficulties in formulating their own set of regulations where the privacy guidelines will also be addressed.

Neighbouring India, where similar concerns regarding digital storage outside of regulator's

jurisdiction are prevalent, Fintech/MFS companies are not allowed to store digital data outside of RBI (Reserve Bank of India) regulated space.⁷² The Bangko Sentral ng Pilipinas (BSP), the Central bank of the Philippines, on the other hand, allows banks to use cloud technology, i.e., the BSP allows Filipino banks to avail third party services provided over the Internet. These services include the storage of data and the processing of transactions, among others. This permission provides a cost-effective way for smaller banks in the Philippines to store and manage their data without the need to invest in infrastructure. To reduce the security risks associated with third parties handling bank data, the BSP's IT regulations framework requires that customer information be stored in private clouds, which are designed to be safer as the infrastructure remains under the control of the bank at all times. Unlike most countries, the BSP allows banks to store their customer data in private clouds that are outside the country as long as all safety measures are followed. Banks in the Philippines are allowed to store other data such as marketing materials and other non-essential information in public clouds, which are relatively less secure as these are made up of servers shared by several clients. (Montecillo, 2013)

3.4.3.2 Additional Note on Data Retentions

The legal obligation to keep the customer record is outlined in MLP Act 2012, which states that, the reporting organisations shall have to keep the transaction records of any close account at least for 5 (five) years from the date of such closure and provide the information maintained under the clause of Bangladesh Bank. Subsequently, MLP Rules 2013 delineated that the transactions record shall be kept in a manner such that it should be sufficient to permit

reconstruction of individual transactions so as to provide if necessary, evidence for the prosecution of the criminal activity. In addition to that, the rule also states that, the bank shall keep all the records obtained through CDD measures and transactions records for at least five years and shall ensure that the records are swiftly available to BFIU or investigation authority upon court order⁷³.

⁷⁰ <https://www.betterthancash.org/about>

⁷¹ <https://www.betterthancash.org/tools-research/case-studies/responsible-digital-payments-guidelines>

⁷² As stated by, Mr. Devdutta Guha Roy, Assistant Vice President, Traditional Funds Services, HSBC – Global Banking and Markets, Kolkata, India.

⁷³ Obligation to keep KYC record is stated under BFIU Circular – 10; dated 28/10/2014: “All information and documents collected during CDD procedure along with KYC, account related documents, business correspondence and any report prepared on a customer has to be preserved for at least 5(five) years after closing the account.”

Following the Act and Rules Bangladesh Bank published guideline titled Money Laundering & Terrorist Financing Risk Management Guideline 2015 where it instructs banks and other financial institutions on record keeping, formats and retrieval of records. In the guideline, it is mentioned that the precise nature of the records required is not specified in the legal and regulatory regime; however, the idea is to ensure that the bank meets the obligations in any subsequent investigation in such way that it can provide the authorities with sufficient information. According to the guideline the records ideally should cover the information of customer, transactions, suspicion reports, report from agencies (e.g.: CCU/CAMLCO), monitoring etc. By the guideline, BB instructs the bank that, to satisfy the legal requirement and purpose of record keeping it is important that records are capable of retrieval without undue delay. It is not necessary to keep all the records related to customer identity and transaction in their original hard copy form, provided banks have reliable procedures for keeping in electronic form that can be reproduced without undue delay. From the aforementioned review of the act, rules and guideline, it is clear that the requirement of keeping data regardless of formats (original hard copy and electronic form) is only to present the information or documents as evidence for the prosecution of criminal activity or for the use of investigation if necessary or by the court order. The ICT Act 2006 establishes the legal recognition of electronic records⁷⁴,

“Where any law provides that information or any other matter shall be in writing or in the typewritten or printed form, then,

notwithstanding anything contained in such law, such information or matter is rendered or made available in an electronic form: Provided that such information or matter is accessible so as to be usable for a subsequent reference.”

According to Evidence Act 1872 however, “Document means any matter expressed or described upon any substance by means of letters, figures or marks, or by more than one of those means, intended to be used, or which may be used, for the purpose of recording that matter.” According to this law, writing is a document; words printed, lithographed or photographed are documents; an inscription on a metal plate or stone is a document; a map or plan is a document; a caricature is a document. Furthermore, The Banker's Book Evidence Act 1891, illustrates that, the legal authority may inspect or take copies of any entries in a banker's book⁷⁵ for any of the purposes of such proceeding or order bank to prepare or produce within a specific time. However, both the acts leave a little room for the electronic form as a record to be placed as evidence. Henceforth, the inconsistency among the ICT Act, 2006, Evidence Act, 1872 and The Banker's Book Evidence Act 1891 creates a provision for legal loopholes to not to recognise electronic form as a proper evidence to be submitted in front of prosecution. Apparently, these discrepancies preclude the option of keeping all the records only in electronic form. Hence, the banks are bounded by the legal requirement to keep the records both in original hard copy and in electronic format, which consequently impairs the effectiveness of using new technology and also causes proliferations of operational cost.

⁷⁴ According to ICT Act 2006, “Electronic form” with reference to information means any information generated, sent, received or stored in media, magnetic, optical, computer memory, microfilm, computer generated microfiche or similar device or technology. “Electronic record” means data, record or data generated, image or sound stored, received or sent in an electronic form or microfilm or computer-generated microfiche.

⁷⁵ “Bankers' books” include ledgers, daybooks, cashbooks, account-books and all other books used in the ordinary business of a bank.

3.4.4 Point of Sale (POS) machines can only be sold by respective banks

Background: Establishing accountability is said to be difficult if information is routed through third party software, using POS machines (as in the case of PCs). One would therefore think that the current Bangladesh Bank regulation of allowing only banks to sell the POS to the merchants is appropriate. However, concerns were expressed that banks were hesitant to establish POS-connectivity in new areas on the apprehension that there would not be enough customers to recoup the cost.

On the contrary, suppliers of POS machines in Bangladesh expressed the view that there is potential market that individual banks are unable to tap, removal of bank-monopoly over installation of POS machines drastically promotes financial inclusion.

Regulators' response: Banks are not willing to allow other organisations to sell the POS machines. Since the cooperation from the banks is required for an effective execution of the activities related to transactions; without their cooperation it is not possible to increase the

penetration only by allowing other entities to sell the POS. Hence, it appears that no changes are coming anytime soon in this regard.

International experience: We have found evidence that suggests POS machines can indeed be purchased from non-bank firms in some other countries. For example, regulations in India allow business entities to purchase POS machines directly from non-bank entities. A merchant in India can avail a POS device from a list of dedicated companies or directly from banks. As of December 2016, a total of 14 non-bank Fintech companies were given permission to sell POS machines directly to business entities (Iamwire, 2016). Non-bank private companies are allowed to sell POS machines in Sri Lanka also although only one such private company had been issued a license to do so by the Central Bank of Sri Lanka as of 2017 (Central Bank of Sri Lanka, 2017).

Observations: The trade-off between accountability and gains through inducing competition needs to be weighed.

3.4.5 Regulatory issues around Value Added Services (VAS)

Background: By providing additional revenue at marginal or no additional cost, VAS allows reaching out to a wider net of MSEs, most of which are local, and more importantly, provide grooming to a young generation of IT operators and experts. It is alleged that the current revenue sharing norm ensures more than 70% of the revenue for the MNOs. Increased marginalisation of small or start-up enterprises due to the latter's limited bargaining power, discourages innovation. Thus, many feels that having a clear guideline on CP and SP will reverse the trend.

Regulators' view: BTRC already sent a proposal

to the ministry with detailed guideline. They are waiting for the approval from the respective ministries.

Observations: Enforcing rules on revenue sharing may not be feasible in a market where power is skewed. While there are on-going initiatives to address prices and revenue sharing rules, we recommend probing into establishing patents for contents so that the CPs are empowered. There may also be measures, pursued in collaboration with NBR, to protect a local CP market since growths in MSEs in IT sectors has high social benefits.

3.4.6 Interoperability of MFS

Interoperability among the MFS providers would be needed to make payment digitisation a reality. How can we ensure that the National ICT Policy, 2015's objective 3.7.3 on Data security

and interoperability be realised through actions such as setting of encryption standards and international agreements on interoperability? While MFS companies would welcome

interoperability, they would like to participate in discussion with the regulators to determine how it can be implemented to ensure that the process runs smoothly. One MFS representative shared the following story in order to highlight how regulations, not driven by industry needs, can create serious problems. In the initial stages, customers were allowed to deposit money to their MFS accounts only at the branches of a particular bank. Although this particular bank had many branches all over the country, given the remote locations many of the MFS customers lived in and the poor transportation facilities that were available to them, they would often need to walk many a mile to deposit their money. This put their security in jeopardy and many instances of robbery took place. After several such incidences the MFS providing company shared their experience with the regulators. Subsequently, the regulators took the safety issue seriously, and amended the regulation so that the customers could deposit money to their MFS accounts at any bank branch. Following this amendment in regulation, the number of robberies with respect to MFS money deposits declined drastically. In order to avoid such unwanted situations, the MFS representatives emphasise on taking industry inputs before deciding how interoperability would be implemented.

Regulators' response: Regulators claim of pressuring the MFS firms to make their technology interoperable ready. Since not all MFS providers use similar technology, some technological changes are required to introduce interoperability. Though the previous deadline was June 2018, it appears that it may take longer than that since not all companies are, technology wise, ready yet. However, Bangladesh Bank representative was confident that interoperability can be established by the end of the year 2018, if the following three issues are dealt with in time:

1. Make the different technologies used by the different MFS providers compatible with each other.
2. Reach agreement to smooth functioning between MFS firms and the banks, and
3. Agree on ways to ensure smooth functioning among the various MFS firms.

International experience: Though the discussion regarding interoperability among MFS firms in Kenya – one of the most successful MFS markets in the world – started in 2015 (Mazer and Rowan, 2016), the process has just started being piloted (Muli, 2018). According to an IFC (2015) report, successful interoperability across firms within an industry has been rare outside of bank-to-wallet integrations which is largely because interoperability has either been made mandatory by the central bank or has only concerned with technical integration (e.g., in Indonesia).

According to the same report, Tanzania is a rare success story when it comes to effective interoperability among MFS providers. In 2014, it developed and implemented guidelines for interoperable MFS transactions that proved to be effective. Registered users at participating MFS providers in Tanzania can carry out transactions directly to one another's wallets under a set of guidelines that was developed at the industry level rather than by country regulators. The success story is most likely due to the fact that instead of being imposed upon through regulation at an early stage, interoperability among MFS providers in Tanzania was allowed to evolve naturally in a mature and competitive market reported (IFC, 2015), which can be a useful lesson for Bangladesh.

3.4.7 FinTech Companies /MFS providers cannot extend loans

Background/Problem: Bangladesh Bank does not allow Fintech or MFS companies to extend loans, which, according to these companies, is a regulatory barrier that hinders financial inclusion.

Regulators' response: Very few countries allow MFS providers to lend, and the success story of MFS is also very limited. Only Kenya was successful in improving the financial inclusion situation by allowing MFS providers or FinTech companies to lend but Kenya's banking sector is

not well developed and that could be the reason for success. Another apprehension is that if FinTech companies (e.g., MNOs) are allowed to lend, there could be some long run market power issues. Since only MNOs are operating, allowing them run financing service may eventually go against financial inclusion because of having substantial market power.

International experience: During our interview, Mr. Devdutta Guha Roy –our Indian interviewee from HSBC, Kolkata, India – said that in India also, Fintech/MFS firms cannot yet extend loans. Sorrentino et al. (2017) terms mobile lending as the new frontier in mobile financial services involving a complex environment with no clear champion yet. In developed countries, Fintech companies such as Zopa in UK⁷⁶ and Lending Club in USA⁷⁷ have launched peer-to-peer (P2P) lending completely cutting out commercial banks whereas in developing countries, mobile operators such as Safaricom in Kenya⁷⁸ and Globe in the Philippines⁷⁹ offer mobile lending as part of their mobile money solutions. While we

do see Fintech/MFS companies being allowed to extend loans in various countries, the volume of mobile lending in the world still remains relatively small. According to Sorrentino et al. (2017), as of 2016, only 52 out of 277, i.e., only 19% of the mobile money providers in the world offered mobile enabled loans or pure mobile loans. Even in Kenya, which is considered to be the most active market for MFS lending, total value of mobile lending amounted to less than 1% of the total transaction value of mobile money in 2016 (basic P2P transfers contributed nearly 70% of total transaction value).

Observations: As mentioned before, lending is a special privilege of the banking system (including NBFIs) and MFIs (under MRA), and any other agency may provide platforms to facilitate lending by one or more of these regular stakeholders. Any change ought to be addressed at general policy level, which may however be preceded by piloting of operational research to learn the pros and cons, as well as to familiarise regulators with the implications.

3.5 Issues on Secured Lending

The issue was raised from the banking community, who sees much prospect in expanding the net of finance by designing enforceable contracts. It is recognised that prosperity of mSEs lies in supporting sustainable sub-contracting arrangements. It is alleged that the risk lies in inadequacies in current laws (and practices) to ensure repayments, aggravated by lack of awareness among bank staffs, lack of readily available information and vulnerability of bank staffs to wrongdoings. Thus, regulatory measures that do not add extra stops in making payments, but reduce risk of lending under tripartite agreements, may go a long way to

ensure access of mSEs to bank finance.

The issue was further probed, and a consensus among all stakeholders was reached that the problem does not lie in presence or absence of regulations, rather in enforcements. Since mSEs are likely to gain most with increased sub-contracting arrangements along the value chains, and reduction in risks associated with various instruments of collaterals are expected to encourage financial inclusion, there is a need to study on the enforcement issues. This, however, is beyond the scope of the present study.

⁷⁶ www.zopa.com

⁷⁷ www.lendingclub.com

⁷⁸ www.safaricom.co.ke

⁷⁹ www.globe.com.ph

3.6 Summary of International Experience

Theme: Insurance

Issues	Country/ Region	Experience
Functional separation between Life and Non-life insurance companies	Multiple countries	Countries that offer life and non-life insurance products separately include Australia, India ⁸⁰ , Chile, Denmark, Estonia, Germany, Iceland, Ireland, Japan, Korea, Netherlands, Norway, Poland, Sweden, Switzerland, Turkey and the USA ⁸¹ . Separation of life and non-life products implies higher efficiency in service delivery since different companies can focus on a single area of operation.
	Multiple countries	Countries that allow composite insurance products include Austria, Belgium, Canada, Costa Rica, Czech Republic, France, Greece, Hungary, Israel, Italy, Mexico, Portugal, Slovak Republic, Slovenia, Spain, the UK, Argentina, El Salvador, Guatemala, Malaysia, Nicaragua, Panama, Paraguay, Peru, Singapore, South Africa, the Philippines, Uruguay, Kenya and Nigeria. Allowing composite insurance provides more flexibility in product design.
	Sri Lanka	Sanasa Insurance Company Limited (SICL) is an insurance company that offers both life and general insurance products for low-income groups in rural areas of Sri Lanka. According to the Insurance Board of Sri Lanka (IBSL) regulation, insurers were required to separate their life and general insurance businesses before 1 January 2015. SICL, however, is still offering composite insurance products to the rural population. In addition to life and motor insurances, they offer agricultural insurance products such as indemnity-based crop insurance, weather index insurance and livestock insurance. The agricultural insurance products have proved to be very useful for the rural farmers and have performed very well.

⁸⁰ India has stand-alone health insurers and reinsurers in addition to life and general insurance companies.

⁸¹ In USA, insurance companies are separated between Life/Health and Property/Casualty.

Issues	Country/ Region	Experience
Regulation regarding the investment options of the insurance companies	OECD countries	In OECD countries in 2013 investment portfolios of insurance companies consisted of bonds, shares, real estate and other investments. Although the investment portfolios of insurance companies (for all three sectors: life, non-life and composite) in most of the OECD countries were dominated by government bonds, the non-life insurance sector in several countries exhibited a substantial shift away from bond investments towards shares. Share of investment in real estate was very small for most countries. While a number of countries reported substantial investments in “other assets”, not much information was available to understand the nature of investments in this category.
	India	As per Insurance Regulatory and Development Authority (IRDA) of India regulations (as of 2015), at least 50% of the investment portfolio of an insurance company in India must be made up of central government securities, state government securities, and other approved securities (all debt instruments) with at least 25% of the investments in central government securities. To promote expansion of the housing and infrastructure sector, at least 15% of the investments have to be made in this sector. Investments across various industrial sectors are limited to a maximum of 20% with a maximum of 15% investment in the equity of an individual company. Overall, the approved investment instruments are very safe and generate low returns. The adherence to the stated guidelines is closely monitored by IRDA and any non-compliance results in a show cause notice followed by appropriate punishment or penalty, if proven guilty.
	Pakistan	In Pakistan, the investment portfolio of insurance companies typically consists of listed shares, corporate debt bonds and money market instruments as these companies are prohibited from investing in National Savings Schemes. About 80 percent of investments of Pakistani life insurance companies are in risk-free government securities, while around 19 percent are in the equity market

Issues	Country/ Region	Experience
Alleged strict actuary certification requirement	India, Pakistan, Sri Lanka	According to A.K.M. Elias Hussain, the president of the Actuarial Society of Bangladesh, in 2014, there were only one fellow and two associate actuaries in Bangladesh. These figures, if true, are obviously negligible compared to other countries in the regions. According to the Institute of Actuaries of India (2017) report, there were a total of 429 fellow and associate actuaries in India during 2014 (which increased to 504 in 2017). This number was 40 in 2008 in Pakistan (Jamal, n.d.) and 23 in 2013 in Sri Lanka.
	Bhutan, Hong Kong, Indonesia, Japan, Korea, Malaysia, Philippines, Singapore, Thailand, Vietnam	On the basis of a survey conducted in 2007 to assess the development of the Actuarial Profession in Asia and the Pacific, the number of qualified (fully and partly) actuaries in Bangladesh was among the lowest in the region.
Absence of guideline for innovative insurance product	UK, Singapore, Australia, Hong Kong, Canada	When it comes to innovation in insurance products, clear-cut regulations are not always in place and often existing regulations can become prohibitive in fostering innovation. Very few InsurTech start-ups have managed to gain insurance underwriting licenses because of the existence of potentially prohibitive regulatory requirements. While it's sensible to have such requirements to ensure consumer protection, these could potentially prevent entities with innovative ideas from entering the industry. In order to address such issues, regulators in some countries have established a regulatory sandbox approach (platforms where certain regulations are relaxed for innovative tech-based insurance projects within the platform). The UK Financial Conduct Authority (FCA), Monetary Authority of Singapore (MAS), Australia's Securities and Investment Commission (ASIC), the Hong Kong Monetary Authority and Canada's Ontario Securities Commission have all established such platforms with a view to understanding the effectiveness of the innovative projects as well as helping the innovative firms understand the regulatory requirements.

Issues	Country/ Region	Experience
Absence of guideline for innovative insurance product	India	According to a study (published in 2017) by the International Cooperative and Mutual Insurance Federation (ICMIF) in association with the Insurance Institute of India (III), a total of 15 mutuals and cooperatives operating out of 13 states in India were providing insurance-like services to approximately one million low-income people using risk retention or risk sharing models. In spite of not having the desired scale, these mutual, cooperative and other community-based organizations (MCCOs) were able to demonstrate noticeable impact in protecting the lives and livelihoods of the poor by bringing insurance services to them. Surprisingly, the Indian Insurance Laws Amendment Act of 2015, instead of creating enabling regulations to foster the growth of this sector, excluded them from its scope altogether. ICMIF viewed this lack of regulation and recognition by the Government as one of the biggest threats to the spread of necessary insurance services for the unserved/underserved segment of the population. The ICMIF-III study strongly recommended specific enabling legislation leading to recognition (if not regulation) of MCCOs as a viable alternative risk management (ARM) mechanism for achieving inclusive growth. They also suggested collaboration between MCCOs and commercial insurers (e.g., commercial insurers offering reinsurance to mutual micro insurers) in providing efficient risk management to the low-income population.
	Philippines	An example of a successful innovative product targeted towards the low-income segment of the population which is well supported by an enabling regulatory environment is the Center for Agriculture and Rural Development Mutual Benefit Association (CARD MBA), which is part of the system of CARD Mutually Reinforcing Institutions (MRI) that also includes CARD Bank, CARD Inc. (an NGO), and the CARD Training Center. The MBA, based in the Philippines, offers life and disability insurance, a mandatory provident fund to CARD Bank and CARD Inc. members and a loan redemption scheme for CARD borrowers. The mutually reinforcing nature of the relationships makes the operations of the MBA extremely efficient. The regulators in the Philippines offer an enabling regulatory environment for MCCOs which has allowed CARD and others to offer insurance to their members successfully. As of February 2018, CARD MBA provided insurance coverage to nearly 15.8 million low-income Filipinos.

Theme: Agent banking

Issues	Country/ Region	Experience
Stringent requirement for the eligibility of being agent and complex agent licensing process	India	Indian regulators initially did not allow any for-profit organization to become agents assuming such entities may end up exploiting the poor. Although they have lifted this restriction recently, they still do not allow the largest microfinance institutions (MFIs) registered as nonbank finance companies (NBFCs) to become agents.
	Kenya	The Central Bank of Kenya only allows for-profit entities to become agents and explicitly prohibits non-profit organizations such as faith-based organizations, NGO-s and educational institutions from becoming an agent. The Kenyan regulators very likely believe that agent banking would operate more efficiently under a profit maximizing framework and engaging in such activities would steer the non-profit organizations away from pursuing their original social aspirations.
	Brazil	Regulators in Brazil allow any legal entity to work as an agent but do not allow any individual to do so, probably with a view to minimizing fraudulence and ensuring consumer protection. Additionally, in spite of there being no regulation against it, financial institutions in Brazil in practice do not offer agent-ship to businesses such as gas stations, night clubs, funeral homes and bars since these are likelier to be susceptible to robberies.
	Mexico	In Mexico, in addition to being a qualifying business, agents must have a permanent address, the necessary infrastructure to complete banking operations, staff certified to operate the required equipment, an acceptable business and credit record and have no record of felony or fraud.
Location of the agent's premise	India	Initially, regulators in India required agents to be within 15 kilometres of a base branch of the appointing bank in rural areas and within 5 kilometres in urban areas. Later on, this distance has been increased to 30 kilometres and banks can also apply for exemption in order to serve people living in remote areas where establishing a branch is not viable.
	Brazil	In Brazil, regulators initially allowed banks to appoint agents only in municipalities that did not have bank branches with a view to protect bank branches from competition. Afterwards, they repealed this regulation in 2000.

Issues	Country/ Region	Experience
Agent compensation	General practice globally	In most countries, agent compensation depends on negotiations between the bank and the agent. However, almost in all the countries, regulation prohibits the agent from charging the customers directly for providing agent services.
	India	While charging fee for agent services is prevalent today, it was not always the case. For example, regulators in India initially did not allow banks to charge any fee to the customers for agent services. Later on, they realized that such prohibition would make agent banking nonviable and therefore, lifted the restriction in 2009.
	Philippines	There are rare instances where agents are allowed to practice some discretion regarding the fees, they charge their customers. For example, in the Philippines, one electronic money service provider allowed agents to charge between 1 and 3 percent of the transaction amount. While this practice rewarded the agents, the lack of uniform fees in all likelihood resulted in customer confusion and may have contributed toward a very limited success in spreading agent banking in the Philippines.
Agent exclusivity	Fiji, Pakistan and the Maldives	Agent exclusivity is prohibited in these countries. Their regulators hold that such prohibition will allow agent banking to penetrate a greater number of remote areas, foster competition and prevent large banks from monopolizing the best agents and locations.
	Brazil, Colombia and Peru	Regulators in some countries allow exclusivity because it provides greater incentives to the banks to enter into agent banking and prevents potential underinvestment by minimizing spill over effects (later entrants getting the benefits of first mover's investments on identifying, screening, training and recruiting agents). For example, although regulatory frameworks in Brazil, Colombia and Peru do not explicitly address the question of exclusivity, exclusive contracts between banks and agents are prevalent in these countries.
	India	India's case is a bit different. Although regulation permits an agent to serve multiple banks, at one retail point or outlet, only one bank can be represented.

Theme: Alternative investment (crowd funding)

Issues	Country/ Region	Experience
Except venture capital, equity financing, and impact investment, the SEC AI Rules (2015) does not cover any other form of alternative investment such as crowd funding.	USA-based crowdfunding platform with lending activities in 85 countries	An example of a successful crowdfunding platform is Kiva, an international non-profit organization, established in 2005 and based in San Francisco, with a mission to connect people through lending to alleviate poverty. Thus far, Kiva has raised \$1.14 billion worth of loans from 1.7 million lenders, which has funded various kinds of projects involving a total of 2.8 million borrowers in 85 countries with an impressive repayment rate of 96.9%.
	India	Although the regulatory framework for crowdfunding is a recent phenomenon even in the developed world, we have identified detailed crowdfunding guidelines in our neighbouring country India. In India, digital equity crowdfunding platform is illegal and any form of equity crowdfunding that involves a large amount of money or is equity-based, is strictly monitored. The primary cause of this is the use of crowdfunding for money laundering, a glaring example of which is the Sahara case whereby the Supreme Court of India ordered Sahara Housing Investment Corporation Ltd and Sahara Real Estate Corporation Ltd to return about INR 25,000 crore (about US 3.7 billion) to an astounding 2.96 crore investors. According to the Securities and Exchange Board of India (SEBI), the susceptibility of the digital market to security threats while funding businesses online is another reason for imposing the ban on digital equity crowdfunding.
	Philippines	The Securities and Exchange Commission (SEC) in the Philippines also provides comprehensive regulatory guidelines about crowdfunding. In a memorandum issued in November 2011, the SEC of the Philippines has provided detailed rules and regulations governing crowdfunding. In the memorandum, they have outlined guidelines on general provisions, issuer requirements, intermediary requirements, funding portal regulation, reports, and recordkeeping & other post registration/operational requirements. Given the supportive regulatory environment, a number of crowdfunding platforms such as the Spark Project, Gava and Upbuilds are operating successfully in the Philippines. For example, the Spark Project, an online crowdfunding platform, started its operations in 2013 where Filipinos can campaign to fund their creative, innovative, and passion-driven projects. The platform since its inception has raised about 5.8 million Philippine pesos (equivalent to about USD 112,000) for 63 projects.

Theme: Digitisation of financial transfer

Issues	Country/ Region	Experience
Requirements on KYC	India	<p>Last year, Indian regulators, with a view to countering money laundering and terrorist funding, issued guidelines on stricter and mandatory KYC norms for users of mobile wallets in the country, which according to Indian Fintech/MFS industry players would be a deterrent to the growing industry and might destroy smaller transactions. However, there are ways to reduce the amount of time required to complete the KYC process. Consider the Aadhar e-KYC services introduced by the Unique Identification Authority of India (UIDAI). UIDAI issues an Aadhar card to Indian residents, subject to a verification process, which any resident of India can voluntarily enrol to obtain. The UIDAI has combined an electronic-KYC (e-KYC) service with the card, which enables an individual with an Aadhar number to allow UIDAI to disclose her/his personal information to service providers to instantly activate services such as mobile connections, bank accounts, etc. Although the entire KYC process still takes a relatively long period of time to complete due to documentation, this Aadhar e-KYC service does quicken the process of opening a new trading account or bank account or availing a new mobile connection to a large extent. A recent study suggests that Aadhaar-enabled e-KYC can potentially result in an estimated direct saving of over US\$ 1.5 billion within the next five years. The study also suggests that traditional customer enrolment processes pursued in commercial banks can take from two to four weeks before an account is activated, and all KYC details have been verified and stored for future retrieval whereas Aadhaar e-KYC enabled bank accounts can be activated and prepared for transactions within a minute.</p>
Big Data, Data Storage, Reporting and Privacy Issues	Better than Cash Alliance: the alliance has 60-member countries including Bangladesh	<p>While investigating this issue, we found out that a UN based organization, better than Cash Alliance (the alliance has 60 member countries including Bangladesh) – a partnership of governments, companies, and international organizations that accelerates the transition from cash to digital payments in order to reduce poverty and drive inclusive growth – provides a set of guidelines titled “Responsible Digital Payments Guidelines”. These guidelines are designed to protect clients from risks such as loss of privacy, exposure to fraud, and unauthorized fees. Among the eight guidelines reported in the document, guideline number 2 (keep client funds safe) and 7 (protect client data) deal directly with privacy. The document provides detailed suggestions and examples regarding how to achieve each of the guideline objectives and is meant to help the regulators in developing their rules.</p>

Issues	Country/ Region	Experience
Big Data, Data Storage, Reporting and Privacy Issues	India	In neighbouring India, although the government has specific set of guidelines when it comes to protecting Sensitive Personal Data or Information (SPDI) of the clients, according to practitioners, electronic financial data protection in India is founded upon rudimentary regulations with inadequate enforcement and the regulatory framework is in need of major upgrades. As far as digital storage outside of regulator's jurisdiction is concerned, Indian Fintech/MFS companies are not allowed to store digital data outside of RBI (Reserve Bank of India) regulated space.
	Philippines	The Bangko Sentral ng Pilipinas (BSP), the Central bank of the Philippines, allows banks to use cloud technology, i.e., the BSP allows Filipino banks to avail third party services provided over the Internet. These services include the storage of data and the processing of transactions, among others. This permission provides a cost-effective way for smaller banks in the Philippines to store and manage their data without the need to invest in infrastructure where instead of buying their own servers, they can just pay a third-party service provider to manage their customer information. To reduce the security risks associated with third parties handling bank data, the BSP's IT regulations framework requires that customer information be stored in private clouds, which are designed to be safer as the infrastructure remains under the control of the bank at all times. Unlike most countries, the BSP allows banks to store their customer data in private clouds that are outside the country as long as all safety measures are followed. Banks in the Philippines are allowed to store other data such as marketing materials and other non-essential information in public clouds, which are relatively less secure as these are made up of servers shared by several clients.
Point of Sale (POS) machines can only be sold by respective banks	India	Regulations in India allow business entities to purchase POS machines directly from non-bank entities. A merchant in India can avail a POS device from a list of dedicated companies or directly from banks. As of December 2016, a total of 14 non-bank Fintech companies were given permission to sell POS machines directly to business entities.
	Sri Lanka	Non-bank private companies are allowed to sell POS machines in Sri Lanka although only one such private company had been issued a license to do so by the Central Bank of Sri Lanka as of 2017.

Issues	Country/ Region	Experience
Interoperability among MFS providers	Kenya, Indonesia	Though the discussion regarding interoperability among MFS firms in Kenya – one of the most successful MFS markets in the world – started in 2015, the process has just started being piloted. Successful interoperability across firms within an industry has been rare outside of bank-to-wallet integrations which is largely because interoperability has either been made mandatory by the central bank or has only concerned with technical integration, e.g., in Indonesia.
	Tanzania	Tanzania is a rare success story when it comes to effective interoperability among MFS companies. In 2014, it developed and implemented guidelines for interoperable MFS transactions that proved to be effective. Registered users at participating MFS providers in Tanzania can carry out transactions directly to one another's wallets under a set of guidelines that was developed at the industry level rather than by country regulators. The success story is most likely due to the fact that instead of being imposed upon through regulation at an early stage, interoperability among MFS companies in Tanzania was allowed to evolve naturally in a mature and competitive market reported.
FinTech companies /MFS providers cannot extend loans	India	In India, FinTech companies /MFS providers cannot yet extend loans directly.
	UK, USA, Kenya, Philippines	In developed countries, Fintech companies such as Zopa in UK and Lending Club in USA have launched peer-to-peer (P2P) lending completely cutting out commercial banks whereas in developing countries, mobile operators such as Safaricom in Kenya and Globe in the Philippines offer mobile lending as part of their mobile money solutions. While we do see Fintech/MFS companies being allowed to extend loans in various countries, the volume of mobile lending in the world still remains relatively small. As of 2016, only 52 out of 277, i.e., only 19% of the mobile money providers in the world offered mobile enabled loans or pure mobile loans. Even in Kenya, which is considered to be the most active market for MFS lending, total value of mobile lending amounted to less than 1% of the total transaction value of mobile money in 2016 (basic P2P transfers contributed nearly 70% of total transaction value).

Issues	Country/ Region	Experience
FinTech companies /MFS providers cannot extend loans	Kenya, Tanzania, Malawi, Ghana, Philippines, Mexico, India	Rather than allowing Fintech/MFS companies to extend loans directly, which poses significant regulatory barriers, policymakers can think of using these firms as a channel that lending institutions can use to offer loans to the un-served/underserved segment of the population at a lower cost. One example would be MFS facilitated micro/Nano loans – the very small instant consumer loans – that have experienced quite a bit of growth in recent years, with a particular concentration in East Africa. In just a few years, through models such as M-Shwari (Kenya), M-Pawa (Tanzania), Tala (Kenya) and Airtel Money (Malawi, Ghana), tens of millions of people have got access to micro/Nano loans over their mobile phones, which have addressed the critical need of lower income people for very short-term money management tools that enable them to deal with income and expenditure volatility. M-Shwari working in conjunction with the Commercial Bank of Africa and Safaricom has issued more than 60 million loans in Kenya while M-Pawa working with the Commercial Bank of Africa through Vodacom made loans to nearly 5 million borrowers in Tanzania within its first two years of operations. Tala, Kenya's first smartphone-based lending app – launched in 2014 – has experienced substantial growth in recent years and has expanded to Tanzania, the Philippines and Mexico. The company has recently entered the Indian market with new offices in Mumbai and Bengaluru where it is currently developing its local team and testing its product with a small segment of customers with a view to adapting its app to the Indian market. The company does not work with any particular bank; rather it obtains funds from a number of (around 30 at present) venture capital firms. Till date, Tala has delivered more than 6 million loans worth \$300 million to nearly 1.3 million customers.
	Pakistan	EasyPaisa, a project of Telenor Pakistan and Tameer Microfinance Bank, offers digital loan services (also called EasyPaisa Sahara loan services) to its customers with a view to reaching millions of unbanked residents of the country. Users of the service can get short-term loan for 7 to 14 days of amounts varying from Rs. 850 (about US \$7) to Rs. 10,000 (about US \$86) at a service charge of 10%-25% of the loan amount for 7 days and 12%-35% of the loan amount for 14 days with 2.5% penalty of the outstanding amount in the case of late payments. The amount of the loan is directly deposited to the EasyPaisa mobile account of the user and takes only about 5 minutes to process. The loan, however, needs to be approved by the bank before it is disbursed. Customers benefit from quick processing times with a simplified payment plan and fixed pricing. Those who make timely repayments are given the opportunity to obtain loans of higher denominations. Easypaisa Sahara loans create additional value for the customers by providing them with a credit history that can potentially be used to apply for bigger loans in the future, even from the traditional banking sector.

⁸² The reported data are based on the work of Ansar (2017); according to the latest Telenor Pakistan Website, the lower limit of the allowable loan amount has been increased to Rs. 1050 (about US \$9) while the maximum maturity has been extended to one month.

CHAPTER 4

Recommendations

This section recasts those and groups all into general and specifics. The last part of the section

suggests several actions and identifies agencies who may take lead in those actions to realise the recommendations made in this study.

4.1 General Recommendations

- I. Innovation may involve packaging a product with multiple interfaces and bringing the bests from the different segments of service provision options. Consequently, the innovation or innovative products may involve multiple regulators. There is no guideline regarding what sequence of the regulatory compliance needs to be accomplished if some product involves multiple regulators. Lack of coordination among various organs of the government is a problem. Hence, the study recommends forming a cell which would comprise several regulatory agencies. For example, there could be a cell comprising different divisions of BB, BTRC, ICT, IDRA etc.
- II. Regulators can consider any alternative tool which will allow innovative financing mechanism to work without exposing the overall sector to higher risk. It will however require those experiments to be done under close supervision of the regulators. Regulatory SANDBOXES have that potential. It means FinTech innovators are allowed to experiment some innovative products under a controlled environment, and regulatory supervision. If the experiment is successful, it can be scaled up and some regulatory changes can be advised. Moreover, having regulators involved with the process, ensures identification of many risks, and with appropriate technical inputs, may be included in designs that go into scaling up.
- III. Substantial variation in the KYC requirements often creates confusions regarding the specific one to be followed under a particular circumstance. For example, even though KYC requirements for MFS are small, if MFS collaborates with banks for loan disbursement or approval, then KYC requirements will be very small if MFS is regarded as standard but would be very long if banks KYC requirements are considered as the standard. Setting up a tiered KYC requirements standard could be a solution.
The Study recommends a serious undertaking to develop a consistent KYC for different sectors/services, which will require minimum resources to meet most relevant demands.
- IV. In a dynamic setting, regulators in financial and FinTech sectors need to have the capacity to collect and process information for monitoring as well as for evaluation and for making informed decisions. Having a competent in-house research wing is recommended as an essential first step towards that direction.

4.2 Specific Recommendation

4.2.1 Insurance:

Although separation of nonlife and life insurance may be justified from an efficiency point of view, some exceptions could be allowed if it is targeted towards financial inclusion. If any composite product indeed has the potential of enhancing financial inclusion, IDRA may consider piloting it within a regulatory sandbox approach, and the new guideline under process may include such provision.

Additionally, given the increased varieties in individuals as well as business demand for safeguarding against various kinds of risk, different types of composite insurance products may be needed in the coming days. This implies that there is a rationale for experimenting with alternative regulatory regimes that would allow for such composite insurance products. In order to allow for such experimentation, capacity building within the regulatory authority is a pre-

requisite, an essential component of which is enhancing research capacity inside the IDRA.

While shortages in availability of professional actuary services in Bangladesh, allegedly rooted in skewed market powers, need to be addressed in the medium to long term, the regulators may consider relaxing stringent requirements in hiring foreign actuary during transitional phase.

Detailed investment guideline for the collected premium (i.e., asset management of the insurance company) needs to be developed. Such guidelines can accommodate new areas of investment, not currently listed in the IDRA documents. In addition, there may be provisions to experiment with new forms of contracts that internalize risks through sharing of gains between contracting parties.

4.2.2 Agent banking:

Based on our interviews and FGDs with the stakeholders, we understand that there has been low penetration under agent banking due to stiff competition with MFS firms and wider application of ICT, making agent

banking less attractive. The Study team does not think that the current regulations are too constraining for the expansion of agent banking.

4.2.3 Alternative investment:

Given the debacles in the capital market, there is a good case for finding alternative routes to mobilise small savings targeted to finance specific MSEs, and 'crowdfunding' is worth considering as an alternative. Current

rules & regulations do not permit non-discriminatory engagement in such activities. A regulatory sandbox approach may be undertaken to test the viability of crowdfunding.

4.2.4 Digitisation of financial transfers:

- a) There is a lack of clear privacy guidelines in terms of how data can

be used or stored. It is strongly recommended that the ICT ministry

develops a detailed privacy and ICT guideline.

- b) The Study takes note of limited evidence on MFS lending being successful. Moreover, allowing Fintech/MFS firms to extend loans will imply a complete paradigm shift in terms of loan regulations which will need the involvement of multiple regulatory bodies. Thus, the Study recommends no change in current regulation. However, the issues to be addressed in a tripartite contract between banks, MFS providers and the telecom/internet service providers need greater transparency and better enforcement.
- c) Detailed Value-Added Service (VAS) guideline with special emphasis on revenue sharing issues between MSEs and MNOs need to be developed. The guideline may accommodate provisioning of price bands within which market players ought to remain. Additionally, we recommend probing into establishing patents for Contents so that the Content Providers (CP) are empowered. There may also be measures, pursued in collaboration with NBR, to protect a local CP market with appropriate fiscal measures, since growths in MSEs in IT sectors has high social benefits.
- d) BB should make sure that interoperability of MFS is established within a specific deadline. A committee can be formed to understand the current technological and institutional limitations which are delaying the process. Also, following Tanzania's successful example, industry inputs need to be seriously considered in order to make interoperability effective.
- e) The Study team does not think that the current regulation which only permits

banks to sell the POS, need any changes. With more transfers through online payments, MFSs payment, or with advent to technology, say QR based transactions, the usage of POS may face a shorter life than expected.

- f) Often the justification for restricting data storage in other countries is made on ground of countering money laundering and terrorism financing. The problem however lies in absence of appropriate contracts and with regards to contract enforcements, leading to increased risks. The regulatory authority in Bangladesh, such as the BB, would like to ensure that they face no difficulty in accessing the data as and when required, particularly in cases of AML and CTF. The regulators claim to be open to allow storing data in other countries if appropriate contracts between entities can be established.
- g) Given that digital records have always been enough to answer any KYC related question to a bank or regulator, MFS firms need not maintain hard copy KYC records. Clear statements from the regulatory bodies with regards to non-requirement of hard copies will reduce costs on account of storage and employees' time. The latter may transmit to reduction in fees charged to MFS clients and increased financial inclusion.

4.3 Suggested Action and Responsibility to Implement Recommendations

Issues	Recommendations			
Life insurance company cannot offer non-life product and vice-versa	If any composite product has the potential of enhancing financial inclusion, IDRA may consider piloting it within a regulatory sandbox approach, and the new guideline under process may include such provision. Additionally, to allow for experimentation with alternative regulatory regimes, capacity building within the regulatory authority (IDRA) is essential.	1st Phase of Designing a product	Effort to ensure its inclusion in current formulation of Insurance Act in progress. Supports to IDRA for capacity building within IDRA and for the market.	IDRA; GoB and EDPs
Alleged strict actuary requirements especially when it comes to hiring a foreign actuary	Regulators may allow for relaxing requirements in cases of engaging a foreign actuary at least until there are an adequate number of certified actuaries in practice to provide the service.	2nd Phase of Designing a product (Negotiation Stage)	Develop/design programmes to connect IDRA with relevant local and global training & educational institutions.	IDRA and EDPs
Lack of detailed investment guideline (partnership with MFI)	Detailed investment guideline for insurance premiums (i.e., guideline for asset management of the insurance company) needs to be developed	Up scaling	Support consultation process to ensure its inclusion in the new insurance Act in progress.	IDRA &MRA
Agent cannot open accounts; complex licensing procedure for agents; the requirement of dedicated premises	Based on our interviews and FGDs with the stakeholders, we understand that the initial practice of bulk licensing was not an ideal policy, and the regulators are responsive to changes, Current regulations are not too constraining for the expansion of agent banking, and changes at the margin can be negotiated.	Up scaling	No change in regulation to be initiated. However, constant dialogue to share experiences of agent banking with the regulators should continue.	BB (BRPD)
Comprehensive and rigid KYC requirements	Regulators should revisit the concerns and make the basic requirements simpler and stick to those which are useful in the authority's regular monitoring exercises	Up scaling	Undertake needs assessment at BFIU.	BB (BFIU)
Comprehensive and rigid KYC requirements	Regulators should revisit the concerns and make the basic requirements simpler and stick to those which are useful in the authority's regular monitoring exercises	Up scaling	Undertake needs assessment at BFIU.	BB (BFIU)
Low transaction limit on P2P transactions	The regulatory authority may like to find ways to encourage these people to open accounts as business entities, which may require relaxed fiscal measures; or alternatively, to relax the limits with increased real time monitoring	Up scaling	A public declaration from the NBR that no information on transactions	BB (PSD) & BB (BRPD), NBR
Except venture capital, equity financing, and impact investment, the SEC AI Rules (2015) does not cover any other form of alternative investment	Given the debacles in the capital market, there is a good case for finding alternative routes to mobilise small savings targeted to finance specific MSEs, and 'crowdfunding' is worth considering as an alternative. Current rules & regulations do not permit non-discriminatory engagement in such activities. A regulatory sandbox approach may be undertaken to test the viability of crowdfunding.	1st Phase of Designing a product / 2nd Phase	-	BSEC

Issues	Recommendations	Stages	Actions	Agency
MFS firms cannot lend	Given the very limited number of success stories regarding MFS lending and the fact that allowing Fintech/MFS firms to extend loans would imply a complete paradigm shift in terms of loan regulations which would need the involvement of multiple regulatory bodies, ERG recommends no change in current regulation. However, the issues to be addressed in a tripartite contract between banks, MFS providers and the telecom/internet service providers need greater transparency and better enforcement.	2nd Phase of Designing a product	-	BB (PSD)
No VAS guideline	Detailed Value-Added Service (VAS) guideline with special emphasis on revenue sharing issues between MSEs and MNOs need to be developed. The guideline should ensure that MNOs are not able to exploit MSEs. Additionally, we recommend probing into establishing patents for Contents so that the CPs are empowered. There may also be measures, pursued in collaboration with NBR, to protect a local CP market since growths in MSEs in IT sectors has high social benefits.	Piloting	-	BTRC
Lack of clear privacy guideline	It is strongly recommended that the ICT ministry develops a detailed privacy and ICT guideline	Too generic.	-	BTRC, ICT Division, BB (BRPD)
Only banks can sell POS machines	ERG does not think that this regulation needs to be changed since the usage of POS will very likely be limited in the long run with potential increase in online payments, MFS payments and with the advent of more modern technology-based payment systems such as QR based mobile payments.	Up scaling	-	BB (PSD)
Data can be stored only in Bangladesh Bank (BB)-sanctioned digital storage facilities	In all likelihood, BB has this digital storage regulation in place to counter money laundering and terrorist funding. Such regulation seems justified and important in order to protect national security.	Up scaling but in some cases may face this during piloting	-	BB (PSD), ICT Division, BB (BRPD), BB (BFIU)
Retention of hard copies of KYC documents	While proper and complete KYC requirements are desirable to ensure national security, MFS firms should not need to maintain hard copy KYC records. Abolishing this requirement will reduce a significant amount of rental cost and free up a lot of employee time, which in turn will help reduce transaction cost charged to the MFS clients.	Does not relate to any stages	-	BB (BFIU)
Lack of interoperability among MFS firms	BB should make sure that interoperability of MFS is established within a specific deadline. Following Tanzania's successful example, industry inputs need to be considered in order to make interoperability effective.	Up scaling	-	BB (PSD)

Issues	Recommendations	Stages	Actions	Agency
Lack of consistency in KYC requirements	A consistent set of KYC requirements should be developed. It could be tiered, i.e., some basic KYC requirements for all services, and seeking additional information related to the services offered	Up scaling	-	BB (BFIU)
Lack of coordination among various ministries and various regulatory bodies	It is very important to have a coordination cell which will ensure a strong collaboration between/among several regulators. For the specific purpose of promoting innovative finance, a project to tie in initiatives of BB (PSD in particular) and BTRC (with ICT ministry) may be worth undertaking.	This is too generic and bureaucratic level. May be categorized Piloting	-	General
Lack of understanding some innovative financing tools	Some organs of regulators may consider establishing research cells which can spend more time in research activities rather than being in operations.	2nd Phase of Designing Product (Negotiation Stage)	-	General
Lack of effective set of rules to promote innovative products	To come up with an effective set of rules to promote innovative products while ensuring consumer protection, regulators can consider introducing a regulatory sandbox approach following the examples of UK, Singapore, Australia, Hong Kong and Canada. A regulatory sandbox will provide a platform where firms will be allowed to experiment with innovative products where certain regulations are relaxed within the platform.	1st Phase of Designing a Product	-	General

Note: Actions are worth articulating only after the problems are commonly diagnosed and recommendations are agreed upon. Only few are included as examples to be finalised after the consultation meeting.

REFERENCES

ACCA. (2014). Innovations in access to finance for SMEs. London: The Association of Chartered Certified Accountants. Retrieved: February 7, 2018, from <http://www.accaglobal.com/content/dam/acca/global/PDF-technical/small-business/pol-afb-iiatf.pdf>, February.

Australian Securities and Exchange Commission (2018). Crowd-sourced funding. Retrieved March 10, 2018 from <http://asic.gov.au/regulatory-resources/financial-services/crowd-sourced-funding/>, February 2.

Banerjee, S. S. (2015). From Cash to Digital Transfers in India: The Story So Far. CGAP Brief. Retrieved March 3, 2018, from https://www.cgap.org/sites/default/files/Brief-From-Cash-to-Digital-Transfers-in-India-Feb-2015_0.pdf, February.

Banerjee, S. S., Rotman, S., Rasmussen, R. S., & Rai, S. (2013). Direct Benefit Transfers and Financial Inclusion: Learning from Andhra Pradesh India. Washington D.C.: CGAP.

Bangladesh Bank. (2013). "Speech of the Governor of Bangladesh Bank in Launching of 'SME Banking Strategy' Seminar", Retrieved February 7, 2018, from <http://www.bangladeshbank.org/governor/speech/apr282013gse393.pdf>, April 28.

Bangladesh Bank. (2017). Monetary Policy Statement July-December 2017. Retrieved February 7, 2018, from [http://www.unnayan.org/reports/meu/July_2017_MPS/UO_Full%20Report_MEU_MPS_July17%20\(2\).pdf](http://www.unnayan.org/reports/meu/July_2017_MPS/UO_Full%20Report_MEU_MPS_July17%20(2).pdf)

Bangladesh Bank. (2017). Prudential Guideline on Agent Banking Operation in Bangladesh. Retrieved February 7, 2018, from <https://www.bb.org.bd/aboutus/regulationguideline/brpd/sep182017agentbank.pdf>

BBS. (2011), Report on Labour Force Survey 2010, August.

BBS. (2013), Preliminary Report on Economic Census 2013, August.

Central Bank of Kenya. (2010), Guideline on Agent Banking. Retrieved February 7, 2018, from <http://www.bu.edu/bucflp-fig/files/2012/01/Guideline-on-Agent-Banking-CBKP15.pdf>

Central Bank of Sri Lanka. (2017). Payments Bulletin First Quarter 2017. Retrieved March 9, 2018, from http://www.cbsl.gov.lk/pics_n_docs/10_pub/_docs/periodicals/payment_bulletin/2017/Payments_Bulletin_1Q2017.pdf

Cormick, A. (2016). Equity Crowdfunding Regulations. Retrieved February 13, 2018, from <http://ncfacanada.org/equity-crowdfunding-regulations>, February.

Cusmano, L. (2015). New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Instruments. Retrieved February 7, 2018, from <https://www.oecd.org/cfe/smes/New-Approaches-SME-full-report.pdf>

European Commission. (2017). Innovative Financial Instruments. Retrieved February 14, 2018, from https://ec.europa.eu/info/business-economy-euro/growth-and-investment/financing-investment/innovative-financial-instruments_en, December 14.

Financial Conduct Authority. (2015). A Review of the Regulatory Regime for Crowdfunding and the Promotion of Non - Readily Realisable Securities by Other Media. Retrieved February 7, 2018, from <https://www.fca.org.uk/publication/thematic-reviews/crowdfunding-review.pdf>, February.

Financial Market Authority: New Zealand. (2018). Crowdfunding Platforms. Retrieved March 10, 2018, from <https://fma.govt.nz/compliance/role/crowdfunding-platforms/>

Gikera, N., Vadgama, P., and Njeru, N. M. (2016). Insurance and reinsurance in Kenya: overview [Editorial]. Thomson Reuters Practical Law. Retrieved February 13, 2018, from [https://uk.practicallaw.thomsonreuters.com/9-619-6505?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&bhcp=1](https://uk.practicallaw.thomsonreuters.com/9-619-6505?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1) , April 1.

Government of Bangladesh. (2015). Seventh Five Year Plan: FY 2016 to 2020, General Economic Division, Planning Commission.

Hossain, M. and G.O. Oparaocha (2017). "Crowdfunding: Motives, Definitions, Typology and Ethical Challenges", Entrepreneurship Research Journal.

Hussain, A. (2014). The Actuarial Profession in Bangladesh. International News (63). Society of Actuaries, September.

Iamwire. (2016, December 16). List of mPOS Machine & Solution Providers in India – How to Buy One? Retrieved March 9, 2018, from <http://www.iamwire.com/2016/12/mpos-india-machine-solution-providers/146049>

IFC. (2015). Achieving Interoperability in Mobile Financial Services: Tanzania Case Study. Retrieved March 9, 2018, from https://www.ifc.org/wps/wcm/connect/8d518d004799ebf1bb8fff299ede9589/IFC+Tanzania+Case+study+10_03_2015.pdf?MOD=AJPERES

Institute of Actuaries of India. (2017). Retrieved February 7, 2018, from http://www.actuariesindia.org/subMenu.aspx?id=28&val=Membership_Statistics&AspxAutoDetectCookieSupport=1, March 9.

Insurance Information Institute. (2016). Facts + Statistics: Industry Overview. Retrieved March 9, 2018, from <https://www.iii.org/fact-statistic/facts-statistics-industry-overview>

Jamal, A. (n.d.). International: Pakistan uncovered. Retrieved February 07, 2018, from <http://www.theactuary.com/archive/old-articles/part-4/international-3A-pakistan-uncovered/>

Jatania, B. (2016). Electronic Financial Data and Privacy in India. DVARA Research. Retrieved March 3, 2018, from <https://www.dvara.com/blog/2016/12/23/electronic-financial-dat>, December 23.

Kotakmoneywatch. (2015). Analysis of Indian Insurance Industry Investment Portfolio Practices for Traditional Products (2015). Retrieved January 10, 2018, from <https://www.kotakmoneywatch.com/index.php/article/633-analysis-of-indian-insurance-industry-investment-portfolio-practices-for-traditional-products>

Krishnaratna, T. (2013). Actuarial Profession in Sri Lanka. Lecture presented in Sri Lanka. Retrieved February 13, 2018, from http://www.actuaries.org/FUND/singapore/SpeakersfromAssociations_Krishnaratna.pdf, November 15.

Mazer, R., & Rowan, P. (2016). Competition in Mobile Financial Services: Lessons from Kenya and Tanzania. CGAP. Retrieved March 9, 2018, from <http://www.cgap.org/sites/default/files/Working-Paper-Competition-in-MFS-Kenya-Tanzania-Jan-2016.pdf>, January.

Murlidharan, S. (2014). How Sahara's Subrata Roy was smoked out by RBI-Sebi. Retrieved February 7, 2018, from <http://www.firstpost.com/india/how-saharas-subrata-roy-was-smoked-out-by-rbi-sebi-1413273.html>, February 28.

Muli, B. (2018). Kenya is On the Cusp of Building World-Beating Firms; We Can't Stop Now. Standard Digital. Retrieved March 9, 2018, from <https://www.standardmedia.co.ke/business/article/2001270129/kenya-is-on-the-cusp-of-building-world-beating-firms-we-can-t-stop-now>, February 18.

Monetary Authority of Singapore (2017, November). Response to Feedback Received – FinTech Regulatory Sandbox.

NAICOM. (2017). List of Registered Composite Insurance Companies (Life & Non Life Business). Retrieved March 10, 2018, from <https://www.naicom.gov.ng/index.php/insurance-industry/insurance-companies/composite>, October 16.

OECD (2014). Global Insurance Market Trends 2014. Retrieved February 7, 2018, from <https://www.oecd.org/daf/fin/insurance/Global-Insurance-Market-Trends-2014.pdf>

OECD (2017). Technology and innovation in the insurance sector. Retrieved February 7, 2018, from <https://www.oecd.org/finance/Technology-and-innovation-in-the-insurance-sector.pdf>

Pani, P. (2017). RBI guidelines on full-KYC 'can kill wallets'. The Hindu BusinessLine. Retrieved from <https://www.thehindubusinessline.com/money-and-banking/rbi-guidelines-on-full-kyc-can-kill-wallets/article9901830.ece>, October 12.

Prabhu, D. (2016). Is Crowdfunding Legal in India? SEBI Regulations & Its Implications. Retrieved March 3, 2018, from <https://www.linkedin.com/pulse/crowdfunding-legal-india-sebi-regulations-its-dee-pak-prabhu>, October 28.

Reserve Bank of India. (2009). Financial Inclusion by Extension of Banking Services – Use of Business Correspondents (BCs). Retrieved February 13, 2018, from <https://rbi.org.in/scripts/NotificationUser.aspx?Id=5390&Mode=0>.

Samina, Q. S. (2012). Investment Portfolio of Insurance Companies in Bangladesh: A Study on Selected Insurance Companies of Bangladesh. *World Journal of Social Sciences*, 2(7), 37-47. Retrieved February 7, 2018, from <http://www.wjsspapers.com/static/documents/November/2012/4.%20Quazi.pdf>

Sandor, E., Scott, S., and Benn, J. (2009). Innovative Financing to Fund Development: Progress and Prospects. DCD Issues Brief, 1-2.

SME Finance Forum, and APEC Business Advisory Council. (2014). APEC Framework for Innovative SMME Financing Mechanisms. Retrieved February 14, 2018, from <http://www.smefinanceforum.org/post/apec-framework-for-innovative-smme-financing-mechanisms>, October 14.

Sorrentino, S., Grilli M. V., & Zhou, G. (2017, September). Mobile Lending - The New Frontier in Mobile Financial Services: A Complex Environment with No Champion Yet. Perspective. Value Partners Management Consulting. Retrieved March 3, 2018, from <http://www.valuepartners.com/wp-content/uploads/2017/10/MOBILE-LENDING-09-2017-DIGIVERSION.pdf>

Tarazi, M., and Breloff, P. (2011). Regulating Banking Agents (Rep. No. 68). Retrieved February 7, 2018, from <https://www.cgap.org/sites/default/files/CGAP-Focus-Note-Regulating-Banking-Agents-Mar-2011.pdf>, March.

The Center for Internet & Society. (2013). The Personal Data (Protection) Bill, 2013. Retrieved March 10, 2018, from <https://cis-india.org/internet-governance/blog/the-personal-data-protection-bill-2013>

The World Bank. (2013). Bangladesh Enterprise Survey 2013. Retrieved February 7, 2018, from <http://www.enterprisesurveys.org/Data/ExploreEconomies/2013/bangladesh#finance--size>

The World Bank. (n.d.). Innovative Financing for Development Solutions. Retrieved February 7, 2018, from <http://siteresources.worldbank.org/CFPEXT/Resources/IF-for-Development-Solutions.pdf>

Torres, T. P. (2015). AXA eyes composite license in 2017. Retrieved February 13, 2018, from <https://beta.philstar.com/business/banking/2015/11/30/1527559/axa-eyes-composite-license-2017>, November 30.

Tuli, N., & Jenkins, C. (2017). Insurance and Reinsurance in India: Overview. Thomson Reuters Practical Law. Retrieved March 9, 2018, from [https://uk.practicallaw.thomsonreuters.com/6-504-6467?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&bhcp=1](https://uk.practicallaw.thomsonreuters.com/6-504-6467?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1), June 1.

U.S. Securities and Exchange Commission. (2016). Regulation Crowdfunding: A Small Entity Compliance Guide for Issuers. Retrieved February 7, 2018, from <https://www.sec.gov/info/smallbus/secg/rccomplianceguide-051316.htm>, May 13.

Vila J. (2013). Draft Working Paper 3: The State of the SME Sector-the manufacturing SME sector in Bangladesh: An Overview. Bangladesh INSPIRED, June.

ANNEXES

Annex 1:

Brief on Digital Financial Services in Bangladesh

Digital Financial Services is an emerging tool for making online financial transactions in Bangladesh which is mostly regulated by the Bangladesh Bank. Bangladesh Bank has promulgated the enabling statute for the sector namely, Bangladesh Payment and Settlement Systems Regulations, 2014. Other than the Bangladesh Bank; BTRC, Ministry of Post and Telecommunication have also regulatory oversight on the industry.

A1.1 Industry Configuration

Bangladesh has opted for a bank led model in DFS. The entities providing DFS are banks, payment system operators or PSOs and payment service providers (PSPs). The PSPs are entities that can operate a range of financial transaction services. In an ideal world with tech-supported real time flow of information and connectivity across all operators, those financial services may be captured in the idea of a digital wallet, where value can be stored independently of other monetary mediums

with storage value. They have to be at partly owned by a scheduled bank. A ramification of the bank led model may be that the money value is always in reference to the money deposited with the DFS provider either directly through cash to digital balance or through reference to the balance at the bank accounts. This precludes or has at least precluded until now the value stored and measured through balances carried with MNOs.

A1.2 Intra-Industry Configuration

The PSOs have limited areas of operation in terms of the services they can provide. It may be said that the distinction or the boundary conditions between the PSO and the payment service providers (PSPs) is not that concrete and nor is it well understood by the industry operators. The payment service providers have retail outlets consisting of their service supply chain made up of retail agents and the dealers and distributors who provide services to the end customers in face-to-face interaction. There is significant overlap in the regulatory requirements that PSOs and the payment service providers are subject to, especially as pertaining to AML and ATF regulations. It may be useful to characterize the PSOs as a subset of payment service providers. In other words, the payment service providers can provide the services that PSOs can but the reverse cannot be said to be true.

There are at present two types of payment service providers: those having banking interfaces and the other without a banking interface. With the former, the balances or the digital money has to come through the agents who process the paper money from the end customers and convert that into digital money, in a process colloquially known as cash-in. In the latter category the end customers can credit their balances through instructing their banks to transfer the funds from their transaction accounts maintained with the bank to the mobile wallets. So, in one case handling paper money is a given, whereas in the other case, handling paper money is an option that can be exercised by the end customer in lieu of or in conjunction with bank transfer mechanism. The bank transfers can and are indeed done over the internet that is through internet banking.

A1.3 Parties to the Transactions

In all DFS transactions, there has to be at least one party with a DFS account. The DFS accounts are made or opened by the DFS entities after they acquire the KYC information from the would-be account holder and after they make the limited triangulation on the data that resides with disparate data sources including the MNOs and the national ID card repository.

The transactions can be between the account holder and the e-merchant, between two account holders (P2P or B2B) or between an account holder and a non-account holder. In the latter case, the non-account holder receives the fund through an agent, the modality being applicable in the case of payment service providers only. DFS providers are enabling person-to-business or P2B payments by acquiring or registering businesses known as e-merchants.

A1.4 Delivery Channel

In terms of reach, the PSOs can offer service to entities who/which have bank accounts maintained with banks that have CBS and issue bank cards, whether through international PCI or their own local cards. In the early stage of the industry, the service was almost exclusively focused on enabling customers to send money to their peers. This addressed the absence of bank accounts to the unbanked population. And in any case the bank branches in rural areas are often miles away from their residence or business of the receiving or remitting person. Now foreign remittance is being channelled through the DFS, and this appears, at least to be a grey area in terms of regulatory cover.

Dependence of people on the agents is admittedly coming down, as customers become confident in carrying out DFS transactions on their own. Many services provided by the agents like payment of utility bills can be done by the account holders using MFS, Mobile Apps, though at present many customers continue to depend on the agent for availing these services. Using the SMS Banking services, the customers can avail mini bank statements, alerts and promotional offers.

In the absence of retail agents, the PSOs can popularize their service through promotion and advertisements. The digital wallet operators also can and indeed have been seen to offer promotional rates in conjunction with e-merchants and / banks and / PCI.

Mainstream person-to-business transactions have started to come under the DFS. Whereas

previously merchants only accepted POS payments other than cash, now they often have DFS in addition to POS options for the customers. These e-merchants are most often retail customers in upscale urban metropolitan areas. To what extent merchants in rural and semi-urban areas are accepting DFS payments is not well known. Here we can see a graded or duality of e-merchants. In one category is the menu-based e-merchants, where the payment modality is admittedly more defined and secured. In the other category are the e-merchants that are receiving payments as a "transfer" mechanism, as like any other P2P transaction. In the latter case, some human interactions are admittedly required and the payer doesn't have the electronic invoice as he gets in the case of POS, internet-based transactions settled through PSOs. The payer would see the transaction reflected in his account statement and also get a text confirmation though.

The payments received by the PSO companies are held by them for a period and they release the funds to the e-merchants from time to time, depending on the policy of the PSO company and the terms of the contract entered into by the e-merchants and the PSO. There appears to be a gap here in regulatory clarity and / the resources available to the e-merchants to enforce the terms. There appears to be hesitation on part of merchants as to what assurance they may have that their sales proceeds lying at the hands of the PSO companies would be forthrightly handed over to them. The payments made to the e-merchants by the digital wallet operators are credited to their accounts on a real time basis.

A1.5 Technology Interface

The payment service providers work through MNOs. The customer interface is through a USSD mechanism. Whereas the PSOs' customer interface is the internet, customers interface through PSOs' web portals or the mobile applications installed at the mobile handsets,

tablets used by the customers. There is a layer of operators invisible to the user who provide access to the MNOs between the DFS and the MNOs. These are a very limited number of specialized server operators who play a crucial role in maintaining round the clock secure access to the MNOs' servers.

A1.6 The Current Market

The most prominent of the e-merchants as defined by the number of transactions and transaction volumes in terms of taka are probably the public sector utility companies, and some government services like passport and ID card fees payment portals. The utility companies have opened up to a wide array of payment mechanisms and their individualised bills or invoices can be settled by either PSOs or the payment service providers in addition to more traditional modes. The government's fees mechanism where they are open to DFS, are limited to PSOs only. One emerging application is in disbursing salary through DFS accounts.

Some entities including those in the public sector are piloting the mechanism, but by and large, salary disbursement through DFS has not achieved scale.

Another area, where DFS is becoming popular, is paying the MNOs for their service charge. As the majority of the population actively use MNO services, this is a very large market affording the DFS opportunity for further penetration. At the same time, as MNOs are providing more services especially internet coverage, the market itself is expanding steadily at least in terms of unique users and services accessed by the users.

A1.7 Emerging Market Segments

On the financial service market, all major insurance companies have provided the DFS option for their customers to pay their premiums. Some NGOs are piloting microfinance loan disbursements through payment service providers, but they have not been very popular. One reason for hesitation of the loanees is the fees that they have to pay for the digitized transaction. Most of the government's receipts and payments from and to the individuals, at the national or local stage, are still outside the DFS mechanism. New entrants in finance providers, who can provide the loans through DFS or new investment platforms where cash

surplus individuals can invest over the internet though DFS have not taken off in the country.

The relative market size of the PSOs and the payment service providers at the present is quite lopsided. The combined turnover of the PSOs is a tiny fraction of the combined turnover of the payment service providers. It is moot that publicly available vetted information on the turnover and key business indicators like the number of unique clients acquired and serviced in a given period by the DFS providers are hard to come by.

A1.8 Cost side of the equation

The PSOs are able to make the transactions through their interface with the payment card industry actors. International or global PCI actors predominant in the market are, the MasterCard, Visa and American Express. There are local

cards that some banks have brought out but the local PCI actors have not gained the traction that global PCI counterparts have. The PCI actors get a pro rata amount on the transactions. Between the PCI and the issuing

Bank the transaction cost to the end user can come between 2.0% to 3.5%. The PSOs have been able to provide a lower transaction charge on some transaction types depending on the end user characteristics like students transacting with his education institute. The transaction charges in the country are admittedly high in relation to their counterparts operating in the advanced economies.

The payment service providers on the other hand have to provide cash handling mechanism which has its substantial antecedent complexity, and admittedly for that reason are having to bear high operational costs. Their high operational costs are being passed down to the end users.

A1.9 Future Outlook

The Bangladeshi DFS users have to pay high transaction charges, which have ramifications for the development of the ecommerce sector and the realisation of the digital transformation goal that the government is committed towards. On the brighter side, the transactions volume of the PSOs are increasing, the number of e-merchants, e-commerce transactions are all increasing and there are more active operators in the DFS industry. Some payment service providers have started to provide interest on the e-wallet balance which in the

long term will likely make the wallets more popular and that in turn bring economy of scale to the operators, which one may expect to benefit the users, by providing more product options and lower price. In some cases, like traffic ticket transactions the payments now are only made through DFS, which brings transparency to the payment's movement. Operators are experimenting and piloting with wider technology platforms including Block Chain. Overall, there can be significant growth in the DFS industry in the coming years.

Rest of this annex presents selected summary statistics on progresses made in DFS.

Table A1.1 Mobile Financial Service

Mobile Financial Service	2014	2015	2016	2017
Total No. of Banks with License	28	28	25	28
Total No. of Banks Started Operation	20	20	18	18
No. of Agents (in thousand)	410	561.2	710.03	786
No. of Registered Customers (in million)	16.7	31.8	41.08	58.8
No of Transactions (in million)	-	114.8	133.73	166
Transaction Amount (in billion)	85.23	161.2	232.1	285.70

Source: Bangladesh Bank Annual Reports

Table A1.2 Number of ATM & POS

Delivery Channel	2014*	2016	2017
ATMs (in Thousand)	6.2	8.3	9.2
POS (in Thousand)	22.1	30.4	34.9

* as of December

Source: BB Annual Reports

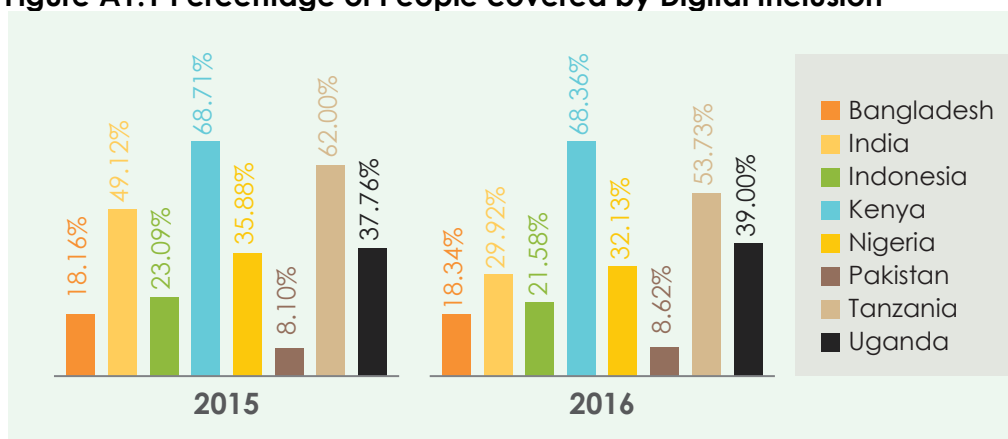
Table A1.3 Agent Banking

Agent Banking	2015	2016	2017 (June)
Total No. of Banks with Agent Banking Approval	9	12*	17
Total No. of Banks Started Operation	4	10*	13
Agent Outlets	118	2601**	3224
No. of Accounts (in million)	N/A	0.54**	0.87
Balance (in billion)	N/A	3.8**	6.5

Note: * as of June 2016, **as of December 2016

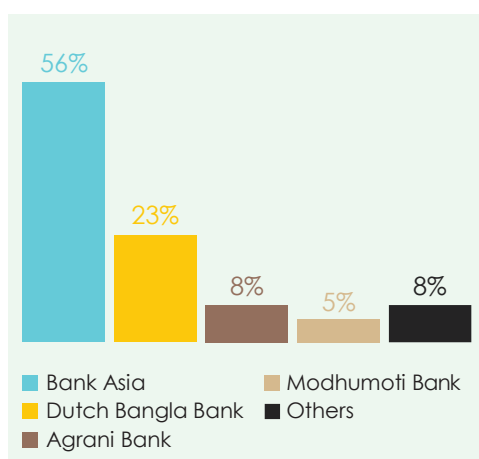
Source: BB Annual Reports

Figure A1.1 Percentage of People covered by Digital Inclusion



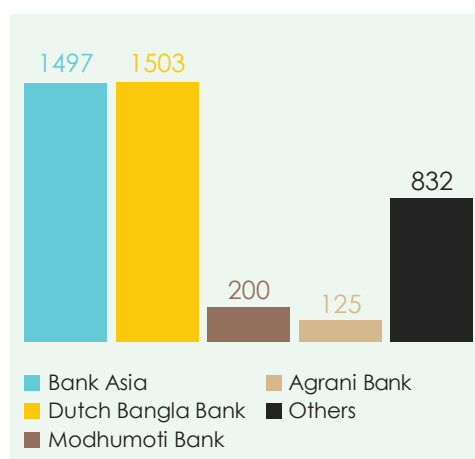
Source: Intermedia

Figure A1.2 Bank's share in total Number of Agents



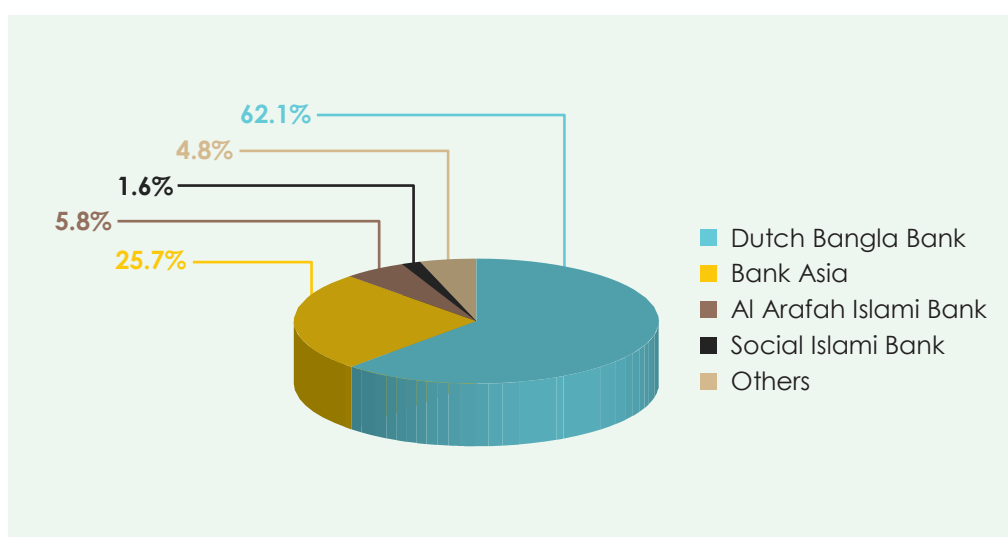
Source: Financial Inclusion Department, Bangladesh Bank (as of Oct- Dec 2017)

Figure A1.3 Bank's share in Number of Outlets under Agent Banking



Source: Financial Inclusion Department, Bangladesh Bank (as of Oct- Dec 2017)

Figure A1.4 Bank's share in Number of Accounts (Agent Banking)



Source: Financial Inclusion Department, Bangladesh Bank (as of Oct- Dec 2017)

Table A1.4 Number of Agents and Outlets (Agent Banking)

Serial	Bank's Name	Agent			Outlets		
		Urban	Rural	Total	Urban	Rural	Total
1	Dutch Bangla Bank	170	421	591	229	1274	1503
2	Bank Asia	69	1371	1440	75	1422	1497
3	Al Arafah Islami Bank	9	73	82	11	101	112
4	Social Islami Bank	0	6	6	1	65	66
5	Modhumoti Bank	0	200	200	0	200	200
6	Mutual Trust Bank	7	43	50	7	43	50
7	NRB Commercial Bank	1	2	3	30	485	515
8	Standard Bank	1	17	18	1	17	18
9	Agrani Bank	6	119	125	6	119	125
10	First Security Islami Bank	0	15	15	0	15	15
11	Midland Bank	0	5	5	0	5	5
12	The City Bank	3	9	12	3	17	20
13	Islami Bank	0	29	29	0	29	29
14	Premier Bank	1	0	1	1	1	2
Total		267	2310	2577	364	3793	4157

Source: Financial Inclusion Department, Bangladesh Bank (as of Oct- Dec 2017)

Table A1.5 Trends in ATMs and Online Banking

Online Banking Summary	Shared		No. of Total Branches	No of Branches with Online Coverage	Percentage of Online Branches
	Own	Shared			
2015*	7749	77601	9458	7100	75.06
2016*	8870	87596	9760	7054	72.27
2017**	9296	101232	9876	7750	78.47

* As of December; ** As of September, Source: Review Report of Banks & FI, BB

Table A1.6 Use of Internet Banking

Internet Banking Summary	No. of Total Accounts	No. of Accounts facilitated with Internet banking	% of Accounts facilitated with Internet Banking
2017**	99,047,968	1,996,480	2.02
2016**	95027335	1932178	2.03
2015**	79114396	1629772	2.06

* As of December; ** As of September, Source: Review Report of Banks & FI, BB

Annex 2:

Circulars and Guidelines Reviewed (partial)

A2.1: Act, Guidelines and Circulars Reviewed

Table A2.1.1: List of Act, Guidelines and Regulations Reviewed

SL No.	List of the Guidelines	Date Issued	Reference No.	Type
1	Amendment of Guidelines on Mobile Financial Services for the Banks	20.12.2011	DCMPS (PSD) Circular Letter No.11	Guideline
2	Anti-Terrorism Rules, 2013	09.04.2015	BFIU Circular Letter No. 03	Rules
3	Anti-Terrorism (Amendment) Act 2013	12.06.2013	Act No. 22 of 2013	Amendment
4	Anti-terrorism Act, 2009	24.02.2009	Act No. 16 of 2009	Act
5	Bangladesh Bank Guidance Notes on Prevention of Money Laundering	16.09.2012	BFIU Circular No. 04	Guidance Notes
6	Bangladesh Payment and Settlement Systems Regulations, 2014	15.05.2014	PSD Circular No. 02	Regulation
7	Bangladesh Securities and Exchange Commission (Alternative Investment) Rules, 2015	22.06.2015	No. BSEC/CMRRCD/2015-343/171/Admin/59	Rules
8	Financial Institute Regulation, 1994	09.11.1994	-	Regulation
9	Financial Institution Act, 1993	30.08.1993	Act No. 27 of 1993	Act
10	Guideline on ICT Security for Banks and Non-Bank Financial Institutions	May 2015.	DFIM Circular No. 11	Guideline
11	Guidelines on Environmental & Social Risk Management (ESRM) for Banks and Financial Institutions in Bangladesh	08.02.2017	SFD Circular No. 02	Guideline
12	Guidelines on Prevention of Money Laundering & Combating Financing of Terrorism for Capital Market Intermediaries	Not Dated	-	Guideline
13	ICT Act 2006	08.10.2006	Act No. 39 of 2006	Act
14	Information Security Policy Guideline	06.04.2014	-	Guideline

SL No.	List of the Guidelines	Date Issued	Reference No.	Type
15	Insurance Act	18.03.2010	Act No. 13 of 2010	Act
16	Micro Credit Regulatory Authority Act, 2006	16.07.2006	Act No. 32 of 2006	Act
17	Money Laundering & Terrorist Financing Risk Management Guidelines	10.09.2015	BFIU Circular Letter No. 05	Guideline
18	Money Laundering Prevention (Amendment) Act 2015	26.02.2015	Act No. 25 of 2015	Amendment
19	Money Laundering Prevention Act 2012	20.02.2012	Act No. 5 of 2012	Act
20	Money Laundering Prevention Rules, 2013	09.04.2015	BFIU Circular Letter No. 03	Rules
21	National Insurance Policy	2014	-	Policy Paper
22	Prudential Guidelines for Agent Banking	18.09.2017	BRPD Circular No. 14	Prudential Guideline
23	Regulatory Guideline for Issuance of Registration Certificate for Providing Telecommunication Value Added Services (TVAS) in Bangladesh	Not Dated	Draft	Draft Guideline
24	Regulatory Guidelines for Mobile Financial Service (MFS) in Bangladesh (Revised: Version 03)	July 2015.	Draft	Regulatory Guideline
25	The Insurance Corporation Act	23.06.1973	Act No. 06 of 1973	Act
26	The Insurance Corporations (Amendment) Act,	11.08.1984	Ordinance No. 51 of 1984	Amendment
27	The Insurance Corporations (Amendment) Ordinance	13.02.1990	Act No. 06 of 1990	Amendment
28	Evidence Act 1872	15.03.1872	ACT NO. I OF 1872	Act
29	Bankers' Books Evidence Act, 1891.	01.10.1891	ACT NO. XVIII OF 1891	Act

Table A2.1.2: List of Circulars Reviewed

SL No.	Circular No.	Date Published	Reference No.	Department	Remarks
1	BFIU Circular Letter No. 01	16.01.2017	-	BFIU	Issuance of "Uniform Account Opening Form & KYC Profile Form" for Banks
2	BFIU Circular Letter No. 01	16.01.2017	BFIU Circular No. 10; 28.12.2014	BFIU	Issuance of Uniform Account Opening Form & KYC Profile Form for Banks
3	BFIU Circular Letter No. 02	15.03.2015	-	BFIU	Introduction of Uniform Account Opening Form & KYC Form for Financial Institutions
4	BFIU Circular Letter No. 02	15.03.2015	-	BFIU	Introduction of Uniform Account Opening Form & KYC Form for Financial Institutions
5	BFIU Circular Letter No. 04	20.09.2017	-	BFIU	Issuance of "Uniform KYC Profile Form" for Insurance Companies
6	BFIU Circular No. 16	10.09.2015	-	BFIU	Master Circular regarding Instructions to be followed by the Insurance Companies on preventing Money Laundering & Terrorist Financing
7	BFIU Circular No. 18	19.10.2015	-	BFIU	Master Circular regarding Instructions to be followed by Capital market Intermediaries on preventing Money Laundering & Terrorist Financing.

SL No.	Circular No.	Date Published	Reference No.	Department	Remarks
8	BFIU Circular No. 20	17.09.2017	-	BFIU	Instructions to be followed by the institutions engaged in the mobile financial services for prevention of money laundering, terrorist financing and proliferation financing.
9	BFIU Circular No. 20	17.09.2017	-	BFIU	Instructions to be followed by the institutions engaged in the mobile financial services for prevention of money laundering, terrorist financing and proliferation financing.
10	BRPD Circular Letter No. 07	17.09.2017	PSD Circular No. 05; 09.12.2013	BRPD	Directives on Agent Banking Operation
11	BRPD Circular Letter No. 11	02.06.2014	BRPD Circular Letter No. 07;24.03.2014	BRPD	Directives on Agent Banking Operation
12	BRPD Circular No. - 35	29.12.2010	BRPD Circular No. 24; 03.08.2010	BRPD	Amendment in Guidelines on Risk Based Capital Adequacy (RBCA) for Banks
13	BRPD Circular No. 08	15.04.2014	BRPD Circular No. 35, 29.12.2010	BRPD	Mapping of SME Rating Scales of the External Credit Assessment Institutions (ECAIs) with Bangladesh Bank's SME Rating Grades
14	BRPD Circular No. 08	01.11.2011	BRPD Circular No. 35, 29.12.2010	BRPD	Bank account for small life insurance policy holders
15	BRPD Circular No. 09	22.06.2017	BRPD Circular No 05; 14.06.2016	BRPD	Re-fixation of Rate of Interest on Agricultural and Rural Credit

SL No.	Circular No.	Date Published	Reference No.	Department	Remarks
16	BTRC/SS/GP- Others (446)/ 2013-612	04.11.2013	-	BTRC	Directives for Airtime uses of Mobile Financial Services (MFS)
17	DFIM Circular No. 02	31.01.2012	DFIM Circular No. 11; 19.09.2011	DFIM	Investment in Capital Market by Financial Institutions
18	FID Circular Letter No. 01	28.02.2017	GBCSRD Circular No. 01; 14.05.2014	FID	Incentive Rebate Policy for "200 Crore Taka Refinance Scheme
19	FID Circular No. 01	15.11.2017	-	FID	Second Small and Medium Sized Enterprise Development Project (SMEDP2)
20	PSD Circular No. 01	11.01.2017	PSD Circular No. 07; 27.11.2014 , PSD Circular Letter No. 01; 01.09.2013	PSD	Instructions regarding Mobile Financial Services Operation
21	PSD Circular No. 06	05.11.2017	PSD Circular No. 01; 11.01.2017	PSD	Instructions regarding Mobile Financial Services Operation
22	SMESPD Circular Letter No. 03	30.10.2017	-	SMESPD	Allowing Grace Period against Short, Medium & Long-Term Loan in favor of Cottage, Micro & Small Entrepreneurs
23	SMESPD Circular Letter No. 05	06.09.2010	SMESPD Circular Letter No. 05; 15.02.2010	SMESPD	Group Lending to SME Women Entrepreneur

Notes:

BFIU = Bangladesh Financial Intelligence Unit
 BRPD = Banking Regulation and Policy Department
 DFID = Department of Financial Institutions and Markets
 FID = Financial Inclusion Department
 PSD = Payment System Department
 SFD = Sustainable Finance Department
 SMESPD= SME& Special Programs Department

Annex 3:

List of Stakeholders Consulted

Table A3.1: List of Stakeholders of Initial Consultation

Name	Designation	Institution	Date of Consultation
Mr. AtiqunNabi	Executive Director	INAFI Asia	03.12.2017
S. M. ZiaulHoque	General Manager, Operation	Pragati Life Insurance Limited	05.12.2017
M. J. Azim	Managing Director and CEO	Pragati Life Insurance Limited	05.12.2017
Zubair Ahmed	CEO	Hishab Co.	10.12.2017
Shawkat Hossain	Managing Director	BD Venture Limited	14.12.2017
Hridoy Islam	Research Analyst	Bangladesh SME Corporation Limited	17.12.2017
Naba Nashit Tareque	Lead	Agri Business Booster Bangladesh	17.12.2017
Md. FirozKabir	Head of Agent Banking - FID	Dutch Bangla Bank Limited	18.12.2017
Ali Tareq Parvez	Deputy Senior Vice President	Green Delta Insurance	19.12.2017
Kazi Tanvir Hussain	Assistant Vice President	Green Delta Insurance	19.12.2017
Md. Rezaul Karim	Executive Vice President	Green Delta Insurance	19.12.2017
Maruf Hossain	Assistant Vice President	Green Delta Insurance	19.12.2017
Md. Arifur Rahman Noyon	Senior Executive Officer	Green Delta Insurance	19.12.2017
Mr. Sarder Akhter Hamed	SEVP & Head of MSME	Bank Asia Limited	20.12.2017
Wahida Anjum	Senior Manager, Consumer Banking	Eastern Bank Limited	20.12.2017
Mohiuddin Rasti Morshed	Chief Executive	Mind Initiative Ltd.	21.12.2017
Md. Al Beruni	Portfolio Manager, Corporate Finance	Mind Initiative Ltd.	21.12.2017
Sinha Ibna Humayun	Manager, Brand & Product Development	aamra Payment Network	27.12.2017
Akhter Zahir Shamim	Senior Manager, R&D and Pre-Sales	aamra Payment Network	27.12.2017

Table A3.2: Focus Group Discussion

Name	Designation	Institution	Date of FGD
Md. Atiqun Nabi	Executive Director	INAFI Bangladesh	24.01.2018
Aftabur Rahman Jafree	CEO	Ghashful	24.01.2018
S M Ziaul Hoque	General Manager	Pragati Life Insurance	24.01.2018
KaziTanvir Hussain	Assistant Vice President	Green Delta Insurance	24.01.2018
Md. Rafiqur Rahman	Company Secretary	Phoenix Insurance Limited	24.01.2018
Faizul Hamid	Managing Director	Cloud Well	05.02.2018
Ashish Chakraborty	COO	SSL Wireless	05.02.2018
Hridoy Islam	Research Analyst	Bangladesh SME Corporation Ltd.	05.02.2018
Zubair Ahmed	CEO	Hishab	05.02.2018
Shahadat Khan	CEO	Surecash	05.02.2018
Zahirul Islam	Assistant Vice President	Surecash	05.02.2018

Table A3.3: List of Regulators Consulted

Name	Designation	Institution	Date of Consultation
Abu Farah Md. Naser	General Manager	BRPD	25.02.2018
Lila Rashid	General Manager (G)	PSD	25.02.2018
Shah Zia UlHaque	Joint Director	PSD	25.02.2018
Gokul Chand Das	Member	IDRA	25.02.2018
Abul Kashem Md. Fazlul Hoque	Director-3 (Law, Innovation and Project)	IDRA	25.02.2018
A.K.M Shahiduzzaman	Director General (Law and Licensing)	BTRC	26.02.2018
Lt. Col. Mohammad Azizur Rahman Siddiqui	Director (Systems and Service)	BTRC	26.02.2018
Prof. Dr. Swapan Kumar Bala	Commissioner	BSEC	14.03.2018
Md. Zakir Hossain Chowdhury	General Manager and Operational Head	BFIU	23.05.2018
Kamal Hossain	Joint Director	BFIU	23.05.2018
Khandakar Asif Rabbani	Deputy Director	BFIU	23.05.2018

Table A3.4: List of Experts Consulted

Name	Designation	Institution	Date of Consultation
K A M Majedur Rahman	Managing Director/CEO	Dhaka Stock Exchange	10.03.2018

Annex 4:

Sampling Frame

Broad Category	Round 1				Round 2				Round 3		
	Green		Amber	Total	Green		Amber	Total	Green	Amber	Total
	Winner	Non-Winner			Winner	Non-Winner					
Lending	2	6	12	20	0	6	10	16	17	10	27
Insurance Product	0	0	0	0	2	1	0	3	2	1	3
Alternative Finance	1	3	12	16	3	5	7	15	6	6	12
Transaction Digitisation	1	2	1	4	2	3	5	10	4	4	8
Capacity Development/ BDS	3	1	14	18	1	5	4	10	7	15	22
Credit Rating/Evaluation Digitisation	1	1	3	5	0	1	0	1	4	0	4
Total	8	13	42	63	8	21	26	55	40	36	76

Annex 5:

Matrix of Actions

Theme	Issues	Why relevant or important	Actions	Remarks
Insurance	Life insurance company cannot offer non-life product and vice-versa	Composite insurance can be more attractive for MSEs	If any composite product has the potential of enhancing financial inclusion, IDRA may consider piloting it within a regulatory sandbox approach, and the new guideline under process may include such provision. Additionally, to allow for experimentation with alternative regulatory regimes, capacity building within the regulatory authority, that is, enhancing research capacity inside the IDRA is essential.	There is a need to simultaneously address capacity development within IDRA
	Alleged strict actuary requirements especially when it comes to hiring a foreign actuary	Given the serious shortage of actuary professionals in Bangladesh, offering innovative insurance product is difficult since it requires actuary certification	Regulators may allow for relaxing requirements in cases of engaging a foreign actuary at least until there are adequate number of certified actuaries are in practice to provide the service.	Promoting often requires deviating from standards set within a skewed market power. The industry may initiate exchanges on alternatives.
	Lack of detailed investment guideline	An effective collaboration with MFIs seems possible if insurance companies can invest the insurance premiums in MFIs. MFIs will consider this to be a cheaper substitute for bank loans.	Detailed investment guideline for insurance premiums (i.e., guideline for asset management of the insurance company) needs to be developed	Contracts between insurance companies and partner MFIs may set the terms in ways to address the concern. Often, changes are not needed.
Agent banking	Agent cannot open accounts; complex licensing procedure for agents; the requirement of dedicated premises	It is an alternative delivery channel to reach out to the segment of the population who are un-served or underserved	Based on our interviews and FGDs with the stakeholders, we understand that there has been low penetration under agent banking due to stiff competition with MFS firms and wider application of ICT making agent banking less attractive. The Study team does not think that the current regulations are too constraining for the expansion of agent banking.	There is a need to revisit the future of agent banking before putting too much effort on regulations in the specific field.
	Comprehensive and rigid KYC requirements	Comprehensive and rigid KYC norms may discourage people to open bank accounts and as a result hinder financial inclusion	Regulators should revisit the concerns and make the basic requirements simpler and stick to those which are useful in the authority's regular monitoring exercises	It is also important to bring transparency and clarity to the 'requirements' so that confidentiality is not compromised in the name of a non-transparent requirement
	Low transaction limit on P2P transactions	Because of additional requirements for opening accounts as business entities, many, MSEs which are also under single proprietorship or self-employed, have their accounts as private individuals. It is alleged that businesses of this group of people are adversely affected by the limits, even when those are on P2P.	The regulatory authority may like to find ways to encourage these people to open accounts as business entities, which may require relaxed fiscal measures; or alternatively, to relax the limits with increased real time monitoring	The technology permits and programmes may be designed to set alarms whenever transactions through an account get suspicious.

Theme	Issues	Why relevant or important	Actions	Remarks
Alternative investment	Except venture capital, equity financing, and impact investment, the SEC AI Rules (2015) does not cover any other form of alternative investment	Some other form of alternative investment such as Crowd funding has the potential to improve financial inclusion	Given the debacles in the capital market, there is a good case for finding alternative routes to mobilise small savings targeted to finance specific MSEs, and 'crowdfunding' is worth considering as an alternative. Current rules & regulations do not permit non-discriminatory engagement in such activities. A regulatory sandbox approach may be undertaken to test the viability of crowdfunding.	It is in the domain of SEC, which will require an initial nod from the Ministry of Finance, preferably through having the scope included in the guideline.
Alternative investment	Except venture capital, equity financing, and impact investment, the SEC AI Rules (2015) does not cover any other form of alternative investment	Some other form of alternative investment such as Crowd funding has the potential to improve financial inclusion	Given the debacles in the capital market, there is a good case for finding alternative routes to mobilise small savings targeted to finance specific MSEs, and 'crowdfunding' is worth considering as an alternative. Current rules & regulations do not permit non-discriminatory engagement in such activities. A regulatory sandbox approach may be undertaken to test the viability of crowdfunding.	It is in the domain of SEC, which will require an initial nod from the Ministry of Finance, preferably through having the scope included in the guideline.
Digitisation of financial transfer	MFS firms cannot lend	Allowing MFS firms to lend may increase the momentum of financial inclusion since they have a large and effective network	Given the very limited number of success stories regarding MFS lending and the fact that allowing Fintech/MFS firms to extend loans would imply a complete paradigm shift in terms of loan regulations which would need the involvement of multiple regulatory bodies, the Study recommends no change in current regulation. However, the issues to be addressed in a tripartite contract between banks, MFS providers and the telecom/internet service providers need greater transparency and better enforcement.	An ICT guideline with BTRC and BB coordinating with other regulatory agencies is the first entry point for change.
	No VAS guideline	Due to lack of VAS guideline, MNOs allegedly have a greater bargaining power with content providers most of which are MSEs	Detailed Value-Added Service (VAS) guideline with special emphasis on revenue sharing issues between MSEs and MNOs need to be developed. The guideline should ensure that MNOs are not able to exploit MSEs. Additionally, we recommend probing into establishing patents for Contents so that the CPs are empowered. There may also be measures, pursued in collaboration with NBR, to protect a local CP market since growths in MSEs in IT sectors has high social benefits.	BTRC already sent a guideline for ministry's approval
	Lack of clear privacy guideline	Privacy guideline is required to provide direction as to how data can be used/stored	It is strongly recommended that the ICT ministry develops a detailed privacy and ICT guideline	-
	Only banks can sell POS machines	This often makes it difficult for SMEs to obtain POS machines because commercial banks are not generally interested to sell machines to entities that will not generate sufficiently large transaction value. The process requirement to obtain POS machines from commercial banks is also pretty complex.	The Study team does not think that this regulation needs to be changed since the usage of POS will very likely be limited in the long run with potential increase in online payments, MFS payments and with the advent of more modern technology-based payment systems such as QR based mobile payments.	-
	Data can be stored only in Bangladesh Bank (BB) sanctioned digital storage facilities	It would be cheaper and easier for Fintech/MFS firms if they were allowed to store data in privately owned clouds such as Amazon and the like	In all likelihood, BB has this digital storage regulation in place to counter money laundering and terrorist funding. Such regulation seems justified and important in order to protect national security.	-

Theme	Issues	Why relevant or important	Actions	Remarks
Digitisation of financial transfer	Retention of hard copies of KYC documents	This imposes a substantial amount of cost burden on the firm both in terms of rent and employee time, which in turn gets translated into higher transaction cost	While proper and complete KYC requirements are desirable to ensure national security, MFS firms should not need to maintain hard copy KYC records. Abolishing this requirement will reduce a significant amount of rental cost and free up a lot of employee time, which in turn will help reduce transaction cost charged to the MFS clients.	According to an MFS representative, digital records have always been enough to answer any KYC related question to a bank or regulator.
	Lack of interoperability among MFS firms	Due to lack of interoperability among the different MFS firms, horizontal expansion of MFS is limited	BB should make sure that interoperability of MFS is established within a specific deadline. Following Tanzania's successful example, industry inputs need to be considered in order to make interoperability effective.	While some of the regulators are hopeful to establish interoperability among MFS firms by the end of 2018, progress with the guideline is unclear.
Overall	Lack of consistency in KYC requirements	KYC requirements are different for different services which constraints an effective partnership between institutions (say MFS and Bank)	A consistent set of KYC requirements should be developed. It could be tiered, i.e., some basic KYC requirements for all services, and seeking additional information related to the services offered	Since multi-dimensional concerns exist with regards to information collection and their use, an exclusive look into it, addressing concerns of multiple groups of clients, may be a worthwhile first step.
	Lack of coordination among various ministries and various regulatory bodies	Innovative financing may involve multiple regulatory bodies	It is very important to have a coordination cell which will ensure a strong collaboration between/among several regulators. For the specific purpose of promoting innovative finance, a project to tie in initiatives of BB (PSD in particular) and BTRC (with ICT ministry) may be worth undertaking.	Institutional barriers are often the outcomes of conflicting interests in the market. It is therefore important to understand those and identify common grounds for collaboration.
	Lack of understanding some innovative financing tools	Lack of understanding may result in rejection of some innovative products or financing tools	Some organs of regulators may consider establishing research cells which can spend more time in research activities rather than being in operations.	-
	Lack of effective set of rules to promote innovative products	An effective set of rules is essential for promoting innovative financial products	To come up with an effective set of rules to promote innovative products while ensuring consumer protection, regulators can consider introducing a regulatory sandbox approach following the examples of UK, Singapore, Australia, Hong Kong and Canada. A regulatory sandbox will provide a platform where firms will be allowed to experiment with innovative products where certain regulations are relaxed within the platform.	This will be done under a controlled environment, and under the close supervision of the regulators. If the experiment is successful, it can be scaled up and some regulatory changes can be advised.

Annex 6:

Additional regulatory issues concerning agent banking discussed in connection to international experience

Issue: Agent compensation

In most countries, agent compensation depends on negotiations between the bank and the agent. However, almost in all the countries, regulation prohibits the agent from charging the customers directly for providing agent services (Tarazi and Breloff, 2011). Bangladesh is no different in this respect. Like most countries, in Bangladesh also, the bank has to establish a fees, charges and commission structure for the agent and ensure that the agent collects fees, charges and commission payable to the bank as specified in the schedule of charges only (Bangladesh Bank, 2017). Although our interviews with Dutch-Bangla Bank Ltd and Bank Asia revealed that agents at present generally take 1% from the loans sanctioned by the banks, we did not find any regulation that imposes such restriction.

While charging a fee for agent services is prevalent today, it was not always the case. For

example, regulators in India initially did not allow banks or agents to charge any fee to the customers (Tarazi and Breloff, 2011). Later on, they realised that such prohibition would make agent banking nonviable and therefore, lifted the restriction in 2009 (Reserve Bank of India, 2009).

There are rare instances where agents are allowed to practice some discretion regarding the fees, they charge their customers. For example, in the Philippines, one electronic money service provider allowed agents to charge between 1 and 3 percent of the transaction amount. While this practice rewarded the agents, the lack of uniform fees in all likelihood resulted in customer confusion and may have contributed toward a very limited success in spreading agent banking in the Philippines (Tarazi and Breloff, 2011).

Issue: Agent exclusivity

As Tarazi and Breloff (2011) point out, countries vary in their regulations regarding agent exclusivity. Some countries prohibit agent exclusivity, e.g., Fiji, Pakistan and the Maldives. Regulators in these countries hold such prohibition will allow agent banking to penetrate a greater number of remote areas, foster competition and prevent large banks from monopolizing the best agents and locations. Regulators in some other countries allow exclusivity because it provides greater incentives to the banks to enter into agent banking and prevents potential underinvestment by minimising spill-over effects (later entrants getting the benefits of first mover's investments on identifying, screening, training and recruiting agents). For example, although regulatory frameworks in Brazil, Columbia and Peru do not

explicitly address the question of exclusivity, exclusive contracts between banks and agents are prevalent in these countries. India's case on the other hand is a bit different. Although regulation permits an agent to serve multiple banks, at one retail point or outlet, only one bank can be represented. Regulators in Bangladesh initially imitated the Indian regulation (Bangladesh Bank, 2013: see guideline 6.1) but have come away from that practice more recently. According to the recent BB prudential regulation guidelines for agent banking, an agent is explicitly prohibited from entering into a contract with more than one bank (Bangladesh Bank, 2017: see guideline 15.1).