Law, Social Justice, Economic Development, and Modern Banking
Sector Legal Reform: Taking in the 'Excluded'

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LAW, SOCIAL JUSTICE, ECONOMIC DEVELOPMENT, AND MODERN BANKING SECTOR LEGAL REFORM: TAKING IN THE ‘EXCLUDED’

JOSEPH J NORTON*

AN INTRODUCTORY TRIBUTE TO PROFESSOR ROBERTO MACLEAN

Over the past four decades, God has blessed me with the intervention into my life of several very special people whom I would consider ‘mentors’—individuals who have made a significant enrichment to my career and personal development. One such special person is Roberto MacLean, with whom I have had the great pleasure and honour of working as a colleague and of enjoying as a friend for over the past two decades. If there is one word I would ascribe to Roberto, it would be ‘passionate’. Indeed, Roberto is a man of not only perpetual enthusiasm and optimism, but of boundless ‘love’ that he brings to the ‘table of life’. Whether the subject is the law, history, nature, archaeology, religion, poetry, music, good food and wine, good company—whatever would be before him—Roberto would bring a special contagious passion. Even more importantly, he would bring this special passion to the people with whom he came into contact in his sojourn through life—his family, friends, work colleagues and students. In our current era of technical specialists, Roberto stands out as a true humanist of enormous integrity and of a deep concern about the world he lives in and the diverse humans who populate our globe.

Whenever I would feel overwhelmed by the mundaneness and specialization of my own work and profession, I could always look to Roberto for inspiration and hope. Though a consummate lawyer and international-class

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legal scholar with an enormous breadth of real life experience (Law Dean, Judge, Central Banker, Ambassador, Judicial Specialist, Arbitrator), Roberto would weave the positive importance of law as a most positive human and even more so a Divine creation for the betterment of our local and global society. For Roberto, law is not about obstacles or rigid rules, but about a vibrant societal fabric that is (or should be) always linked to societal improvement and especially to social justice. One would only have to listen to Roberto in one of his student seminars, public lectures or private conversations to hear these same resounding notes of passion and hope. To Roberto, we are all on the same ‘Ark’ travelling the same voyage of life. And, though, Roberto is a great realist who knows and who can see the great pains and hardship of our individual and collective lives—in the past, present and future—he always sees the voyage as a most worthwhile one where good people, with good ideas and particularly good hearts prevail ultimately. In this communal voyage, law—good laws, good legal systems, good lawyers, good law teachers—would serve as both vibrant glue and an honest compass for finding and keeping the good path.

Thank you Roberto for being such a good and kind mentor to me—and in sharing your passion, your hope and your wonderful humour with me over the years, and I look forward to sharing many more good years with you, Renee and your family.

I. INTRODUCTION

Approximately two-thirds of the world’s population is effectively excluded from mainstream banking/financial sectors of their respective countries, thus, precluding them from an ability to meet basic financial needs, from any realistic prospects of wealth creation and foregoing the mainstream financial system in these countries from more fully maturing in the sense of contributing more fully to the developmental needs of these countries. Thus, a critical, foundational issue that needs to be addressed respecting banking reform issues in developing countries is that of ‘inclusion’—inclusion of the ‘excluded’ in an equitable manner.

The primary proposition being set forth in this chapter is that, notwithstanding the plethora of global banking sector reform over the past two decades, the equitable and accessible provision of banking services has never found its way to being considered a core component to modern banking sector legal reform and assessment in the developing world. As such, before one can sensibly talk about a viable banking/financial sector framework in a developing country, there needs to be developed a reasonably broad user base. In effect, the banking and financial system of the developing country needs to come to be accessible to the ‘excluded’: serving just the
needs of the top of economic pyramid is short-sighted and, in the long-term, counterproductive. While this conclusion seems to be obvious, it is only most recently that the International Financial Institutions (IFIs), particularly the World Bank, have begun to more systematically address these fundamental deficiencies in developmental legal reform agendas respecting the banking/financial sector.¹

From this author's perspective of over two decades of study and practical involvement with financial sector reform in developing, transitioning and emerging economies, he is of the considered view (i) that the modern banking/financial sector law reform policies and infrastructures process is really of relatively recent vintage; (ii) that the reform process has been largely crisis-oriented and reactive by necessity and has become driven largely by the industrialized-country systemic objectives of prevention of financial crises and related contagion, the fostering of global financial stability and (more recently) also the maintenance of financial sector integrity; and (iii) that this 'first generation' of reform has never had the 'luxury' of being clearly thought through in terms of how developmental factors such as access, equality and user protection can be incorporated into the overall financial sector legal reform processes in an integrated and coherent manner so as favourably to impact and to promote the United Nations' Millennium Development Goal of alleviation of poverty.²

It is the general view of this author that the future banking/financial sector legal policy and infrastructure reform process for the IFIs and others in the economic development arena should systematically and thoughtfully undertake this reform process within or alongside a complementary frame-

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¹ Certain abbreviations and acronyms used in this article include: AML—anti-money laundering; BSCS or Basel Committee—Basel Committee on Banking Supervision or Basel Committee; BIS—Bank for International Settlement; CAS—World Bank's Country Assessment Strategies; CGAP—Consultative Group for Assisting the Poorest; CTF—counter-terrorism financing; EBRD—European Bank for Reconstruction and Development; EU—European Union; FATF—Financial Action Task Force; FSA—Financial Sector Assessment; FSAP—Financial Sector Assessment Program; FSLC—IMF's Bank Financial Sector Liaison Committee; FSF—Financial Stability Forum; G7—Group of 7; G8—Group of Eight; G-10—Group of Ten; G-20—Group of Twenty; GATS—General Agreement on Trade in Services; IADI—International Association of Deposit Insurers; IAIS—International Association of Insurance Supervisors; IASC—International Accounting Standards Committee; IFAC—International Federation of Accountants; IFA—International Financial Arrangement; IFC—International Finance Corporation; IFI—International Financial Institution; IMF—International Monetary Fund; IOSCO—International Organization of Securities Commissions; JF—Joint Forum; LVP—Legal Vice Presidency of the World Bank; MFI—Microfinance Institutions; NIFA—New International Financial Architecture; OECD—Organization of Economic Cooperation and Development; RFI—Regional Financial Institution; ROSC—Reports on Observance on Standards and Codes; SME—Small and Medium-sized Enterprises; WB or World Bank—International Bank for Reconstruction and Development; WTO—World Trade Organization.

work and context of meaningful and relevant economic-social development policy objectives, including the object of making the financial base broader and more inclusive. Quite simply, such reform should be coordinated, on the policy, implementation and assessment levels, with the broader economic development objectives and policies of the particular developing country. 3

Part II of this chapter will attempt to evaluate banking sector legal reform efforts as to developing countries over the past decade and a half. Part III will consider selective recent efforts of the World Bank in addressing the access and equity issues respecting the banking sector. Part IV will consider two current developments of relevance: the rise of microfinancing and the efforts to engage private industry cooperative efforts. Part V will provide some concluding reflections on the importance of the legal infrastructural, institutional and policy reorientation dimensions of such reform efforts.

II. EVALUATING BANKING SECTOR LEGAL REFORM FOR DEVELOPING COUNTRIES: THE PAST DECADE AND A HALF

Banking sector legal reform as a mandate for domestic and international financial authorities of developing countries is clearly of recent vintage, and is largely the reactive by-product of the concern of the major industrialized countries over financial crises and the quest for global financial stability during the 1990s, 4 the earlier collapse of the Soviet Empire and the new 'transitioning economies, the enlargement of the European Union and the ongoing onslaught of economic globalization—each of which are interconnected in various ways'. 5 More specifically, this reform over the past decade has been largely driven by the G7/G8 grouping of industrialized countries.

3 As will be pointed out throughout this paper, modern 'financial sector development' is not necessarily consistent with or supportive of what should be a developing country's broader 'economic development' planning and policies. cf T Thorsten, A Demirguc-Kunt, and M Soledad Martinez Peria, Reach Out: Access and Use of Banking Services Across Countries, World Bank, Development Research Group, Finance Team, Policy Research Paper 3754 (Washington, DC, 2005).

4 In fact, when one reviews the annual intergovernmental Communiqués of the G-7/G-8 from the 1975 through the mid-1990s, one notes, by conspicuous absence, that the financial sector infrastructure (including its legal dimensions) is left unintended. Macro-economic issues of global significance were the rule of the day for the annual agendas.

5 It is true one can find specific anecdotal examples of financial law-related reforms during the 1960s and 1970s but these were largely one-off and isolated reforms designed to facilitate a certain development project. An IFI-related example was in the early years of the European Bank for Reconstruction and Development (EBRD) which views itself more as an International Finance Corporation (IFC)-type of commercially oriented development institution: in the 1990s any institutional or legal reform in its mandate countries was specifically project-focused. It was only, by the mid 1990s that the EBRD set-up a law reform component of its
A. Modern Banking Sector Legal Reform as G7/G8 Mandated and as Part of NIFA

In terms of becoming a major concern of the IFIs, banking sector and other financial sector legal reform as to developing countries began to gain credence and to take shape as part of the G-7/ G-8 invention of the notion of a 'New International Financial Architecture' (NIFA) a decade or so ago. The NIFA in fact is a misnomer of sorts and in some sense a public relation ploy to dress-over an ongoing quandary of what to do with an international financial 'non-system'. Yet, even if no true 'architecture' ever pre-existed to be replaced by NIFA and though NIFA is itself probably not a true architecture or system, there did come to exist through the NIFA a working-base from which a new architecture and a next generation of banking/financial sector legal reform could be developed.

NIFA, as it has unfolded through the various G7/G8 annual Summits over the past decade, has endeavoured to coordinate and to direct a wide grouping of different, though related, international bodies that had their own 'mandates,' 'jurisdictions' and 'powers': (i) multilateral agencies (IMF, WB, BIS, OECD) (ii) policy formulation groups (G7/G8, G10, G20) and (iii) international regulatory and standard setting authorities and arrangements (IFAs) (Basel Committee, IAIS, IOSCO, IASC, JF, FSF). In addition, in various and increasing ways, NIFA has brought into the 'equation' the General Counsel’s Office and tended to look at more generic law reform issues, such as a model secured transaction law. See, eg, J Norton and M Andenas (eds), Secured Transactions and Emerging Economies (Kluwer, 1997). Also, see generally J Norton, Financial Sector Law Reform in Emerging Economies (London: BIICL, 2003).

6 Inaugurated in 1975 by the then Heads of the French and German Governments for the purpose of creating a more meaningful forum for Heads of State Summits of the major industrialized countries, the G-8 (until from 1976 until 1998 when Russia was fully admitted, the G-7) has met annually to consider the major global macro-economic and political issues. See the major G-8 information centre website maintained by the University of Toronto: http://www.g8.utoronto.ca (accessed 21 Sept 2006).


8 Norton, ibid 180–2.


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private financial industry sectors. 12 As such, NIFA might be viewed as an evolving policy construct, moving towards a new ‘governance structure’ reflecting a ‘public–private partnership’ among governments, financial sector authorities, international financial institutions and private international financial institutions in the search for grounding a stable, but viable global financial environment. However, the main focus of this ‘public–private partnership’ is, for the most part, on global financial stability issues and on deepening financial markets but not on broadening such markets in terms of greater financial inclusion or the serving of the economic-social development needs of the majority of the population of developing countries.13

At its 1994 Naples Summit, the G-7 Heads of State made financial sector reform issues a major agenda item for its 1995 Halifax Summit.14 But, it was really not until the Birmingham (1998), Cologne (1999) and Okinawa (2000) Summits that the NIFA begins to be fleshed-out.15 The G7 Finance Minister Reports in Cologne (June 1999) and Okinawa (June 2000) specifically followed up, in some detail, on the following NIFA components:

- Strengthened Macroeconomic Policy for Emerging Economies
- Strengthened and Reformed IFIs
- Accurate and Timely Informational Flows and Transparency
- Strong Financial Regulation in Industrial Countries
- Strong Financial Systems in Emerging Markets
- Exchange Rate Policies
- Sound Accounting Standards
- Legal Infrastructure
- Corporate Governance
- Anticorruption/Money Laundering
- Technological Innovation/Adaptation
- Risk Management.

12 Virtually all the involved international bodies directly or indirectly involved the financial industries sectors (as they are direct subjects of such standards) in their devising, revising and implementing international financial sector standards.
15 For a copy of the various Heads of State and Related Communiqués from the various Summits from 1975-2006, see generally http://www.g7.utoronto.ca/summit/index.htm (accessed, 12 Oct 2006).
An integral dimension of all this would be a significant 'law-based dimension' evolving around 'global principles and standards setting' (codes) as to the following:16

- Banking Regulation
- Capital Markets Regulation
- Insurance Supervision
- Corporate Governance
- Financial Conglomerates
- Payment, Settlement and Custody Mechanisms
- Pension Funds and Collective Investment Schemes
- Accounting and Auditing Standards.

Though the G-7 singled out treatment of emerging economies as to financial sector reforms, when one reads through all this, the bottom line appears to be that these economies needed to adopt and to implement the existing and unfolding 'international standards and best practices,' with the IFIs playing a major role (directly and/or indirectly) in the implementation, transmission and related technical assistance processes. Otherwise, the focus of the G-8 Heads of State and Finance Ministers at Birmingham, Cologne and Okinawa as to developing countries was mainly in the context of debt alleviation for the poorest of the developing countries and on how to integrate the developing world into the 'global environment.' The underlying assumption appears to be that sustained global growth, increased trade and investment liberalization will bring increased economic growth for developing countries and a strengthened international financial system will foster such global growth.17

From 2000 to the present, the G-8 appears to have been absorbed by a proliferating range of international political and security crises. As to financial sector reform, the use of Financial Sector Assessment Programs (FSAPs) and greater IFI cooperation is encouraged and there is increased concern as to financial crimes, corruption and fighting terrorism financing.18 Debt relief for the poorest countries gained further and more detailed traction with the 2005 Gleneagles Summit.19

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16 The FSF oversees these standards and codes and has compiled the series of key standards and codes into a working Compendium. See FSF, Compendium of Standards at http://www.fsforum.org/compendium/about.html (accessed 19 Oct 2006).
In retrospect, the thrust of the G7/G8 financial sector reform mandates over the past decade can be seen as geared to the following policy concerns:

- Financial crises avoidance and resolution
- Financial stability
- Financial services liberalization
- Regional and global cooperation.

More recently, the financial sector reform is also driven by industrialized-country concern for financial sector integrity which notion has come to embrace the following:

- Anti-money laundering (eg, drug dealing and other criminal activities)
- Combating terrorism financing (‘September 11’)
- Anti-corruption
- Corporate governance of financial institutions
- Transparency and Accountability
- Greater Availability of Information-Enhanced Disclosure.\(^2\)

While one can reasonably and in good faith, as does the World Bank and the other IFI’s, rationalize to itself and to the outside world that these focal points are directly related to the economic development processes of developing countries, the truth is that these concerns have been engendered as a result of direct industrialized-country interests and that in many of these instances the interconnection with substantive development goals of poverty reduction is indirect and in some instances quite tenuous at best.\(^2\)

All this being observed, the bottom line is that the role of the IFIs in the financial sector reform area over the past decade has been mandated largely by the G7/8 global policy determinations and ‘directives.’

**B. NIFA and the Role of International Standards: An Industrialized Country Initiative**

As alluded to above, the G7/G8 also directed a number of international

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\(^2\) For example, having a ‘Basel-compliant’ banking systems is a good goal for all countries—developed and developing—but for a developing country it does not really get to the core issue of how the banking and financial system should best be structured to serve optimum country-specific economic-social development needs. Also, while of key concern to the United States and other highly industrialized efforts in their so-called ‘global war on terrorism’, it is quite dubious that the amount of efforts development banks now spend on the areas of anti-money laundering and counterterrorism financing produces an real development benefits that would justify the cost and effort.
organizations to develop agreed international prudential standards (codes) necessary to be implemented in order to encourage and to improve confidence in and viability of domestic financial systems. The aim of such standards was to promote sound financial institutions, to minimize systemic risk and to encourage savings and investment activity through increased confidence in financial markets, both domestically and internationally. It must be noted at the outset, however, that these international principles and standards were to be just that: minimum internationally-agreed upon guidelines that leave latitude in their implementation.\(^2\)

The G-7 Finance Ministers were impressed with the work over prior years by the Basel Committee and IOSCO on developing ‘international standards for prudential supervision’ of banks, securities firms and markets and payments and settlements systems. The Ministers particularly approved joint Basel Committee IOSCO work on ‘market risk’ and capital adequacy, derivatives and futures exchanges—all sophisticated areas of concern for the industrialized countries. The Ministers also recognized the cooperation among the bank, securities and insurance supervisors through the Joint Forum (JF) and recommended better vehicles for increased institutional cooperation. With hindsight, one can see from this thread the subsequent increased importance and spread of ‘international standards and codes’ and the later formation of the international standards coordinator, the Financial Stability Forum (FSF).\(^2\)

Quite clearly, the development of international banking standards by the Basel Committee long ante-dates the emergence of the NIFA. In fact, the Ministers of Finance and Central Bank Governors of the ‘Group of 10’\(^2\) in 1974 became concerned with possible development of international bank supervisory standards as a result of the inter-related insolvency of two small international banks (the German Bankhaus Herstatt and the American Franklin National Bank) due to excessive exchange rate risks and the lack


\(^2\) ibid.

\(^2\) The G-10 Group came about in 1974 as a consequence of the establishment in 1962 of the General Agreement to Borrow (GAB) pursuant to decision of the Executive Board of the International Monetary Fund (IMF). The Group was informally established with the support of the IMF, OECD, the Bank for International Settlement (BIS), by the finance ministers of Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, United Kingdom, and United States for the primary purpose of intergovernmental consulting regarding implementation of calls upon the lines of credit extended to the IMF under the GAB—the scope of such consultation being broadened over the years. Subsequently, Switzerland has become an active member of the Group, rendering the ‘G-10’ designation a misnomer. The G-10 Group operates through the respective finance ministers on the highest level, but also on specific subject-matters through various ad hoc committees. See generally Group of Ten homepage at http://www.oecd.org/document/32/0,2340,en_2649_34115_36191264_1_1_1_1,00.html (accessed 17 Oct 2006).
of any coordinated supervision by the concerned regulatory authorities to address this problem, and established in 1975 what is now the Basel Committee. The Central Bank Governors were not, as to this incident, concerned about any specific systemic crisis, but it dawned on them that in the new 1970s era of global floating exchange rates that there were increased international risks for banking institutions and that there was no agreed mechanism for co-coordinating cross-border supervision of such institutions. In addition, the Bank of England Governor was becoming concerned that ‘capital adequacy’ of banking institutions was turning into an issue of international import: traditionally, bank regulators/supervisors were primarily concerned with institutional liquidity. As such, the first tasks of the Basel Committee came to be consideration of cross-border supervision and capital adequacy. The objects of this focus were international banks of the industrialized countries comprising the membership of the Basel Committee.

During the 1980s, the Basel Committee did produce a revised framework ‘Concordat’ for attempting to allocate international bank supervisory authority among the host and home regulator/supervisor: a rather sketchy version had been quietly put together in 1975. This framework was to be revised on several further occasions during the remainder of the 1980s and the 1990s, largely as a reaction to specific bank failures that exposed the framework as inadequate. Also, during the mid-1990s it became apparent that ‘international banking institution’ was an incomplete notion for supervision of the large industrialized banks as they tended to operate more and more within the structure of banking/financial ‘conglomerates.’ Thus, a supervisory framework for dealing with these conglomerates also was developed. This in turn, led to consideration of the issue of the ‘lead regulator’ as to such conglomerates.

25 Reference to the founding mandate for the Basel Committee from the Governors of the Central Banks of the G-10 countries can be found in a Press Communiqué of the G-10 Central Bank Governors of 12 Feb 1975 issued through the BIS.
26 See Norton—above n 11, ch 4 section II A.
27 See discussion of role of Committee by WP Cooke, the Chair of the then Chair of the Basel Committee, in ‘Basle Supervisors Committee’ (Committee document for external distribution) (21 June 1984).
The most significant efforts of the Committee during the 1980s to the present have been on risk-based capital adequacy standards. After extended, and at times contentious, internal deliberations a risk-based ‘Capital Adequacy Accord’ was promulgated by the Committee in 1988. While a non-binding, non-official document, this Accord soon (through a complex, informal and uncoordinated transmission matrix) became the international benchmark for bank capital adequacy within the developed world and then developing world. Prior to this Accord, the capital approach taken by most bank regulators/supervisors was a basic initial capitalization requirement and then an on-going requirement of some form of fixed capital-based ratio (eg, capital to assets). At the time, the 1988 Accord was thought to be a most complex approach, while today it is considered a basic, rudimentary framework, when compared to what the Committee has proposed currently in the form of the Basel II Accord.

In a sense, the 1988 Capital Accord was an ‘opening of Pandora’s box’ as to the future formulation of international bank standards. Once a risk-based approach became the guiding measure, it then became logical for the Basel Committee to delve into a range of other risks, such as to exchange rates, interest rates, other market-based risks, and operational risks. These all resulted in a series of other detailed Committee pronouncements. Moreover, beginning in the late 1980s and continuing on to today, the Committee became concerned with money laundering and, more recently, related counter-terrorism regulatory standards. Further, in the later part of the 1990s, the Committee also began to address more formal issues of institutional governance as to banking institutions.

Under the NIFA context, international standards and codes have evolved, have increased as to subject-matter and continue to be refined/revised on the basis of global and industrial country experiences and expectations. In this sense, they represent the key model components for a country’s ‘modern’ financial system. They may be utilized for multi-purposes: for example, unilaterally by a country in reforming its domestic financial system, may comprise a part of IMF and Bank ‘conditionality’ programmes, may be employed by an IFI in requested technical assistance

35 See Norton, Capital Adequacy, above n 33.
37 See, eg, Initiatives by the BCBS, IAIS and IOSCO to combat money laundering and the financing of terrorism—Update (2005)
38 See, eg, Basel Committee, Enhancing corporate governance for banking organizations (1999), as replaced by a Feb 2006 revision.
Taking in the 'Excluded' packages, may used by the LMF in its ROSC-macro-economic surveillance efforts, and may be used by the Bank more flexibly in assessing domestic country financial sector infrastructures for development purposes. But, for whatever purpose used, on-the-ground reform work over the past decade plus has shown repeatedly that the application of standards and codes is a top-down model, that each country’s situation is *sui generis*, and that these standards and code have not been designed as developmental-access instruments.39

III. WORLD BANK'S NEW AGENDA ON FINANCIAL ACCESS AND EQUITY ISSUES

Inherently, the IFIs/RFIs represent an enormous repository of accumulated knowledge concerning policies, theories, issues and practices concerning the Developing World: they are in a real sense socio-economic and legal development knowledge banks. As such, they should be in the best position to help influence and guide the much needed connection between financial sector development and meaningful economic development goals respecting their client developing country members. This is often easier said than done for a variety of overriding practical reasons. For example, these RFI/IFIs tend to be complex bureaucracies, as to whose limited human and financial resources there is enormous internal and external competition. These institutional demands have expanded exponentially over the past several decades covering not simply traditional macro-economic development concerns but also a very broad range of micro-economic matters, macro and micro-financial sector concerns, human capital development issues (the encapsulating one of which is poverty alleviation), societal dilemmas such as gender issues, global human migration and fundamental human rights concerns. As can been seen, financial sector issues is only one of so many pressing demands upon IFI/RFI resources.

Moreover, coherent and forward-looking institutional priority-setting by the IFI/RFIs is most difficult, time-consuming and often contentious. Further, these various institutions may have differing mandates and approaches to their mandates. Historical collaboration among these institutions has been marginal at best. In addition, as discussed above, the IFI/RFI focus on financial sector reform generally and on the legal-institutional aspect thereof particularly is a relatively recent ‘add-on’ dimension of these institutions mandated by the G7/G8 and arising in large part as a reaction to financial crises, the need for global financial stability and concerns over money-laundering and terrorist financing abuses of financial systems. In addressing these financial sector demands, the IFIs/RFIs have largely

looked to industrialized-country standards and standard-setting and have engaged in large measure staff and consultants drawn from the industrialized world (people having significant financial sector experience in their developed country environment but little, if any, development background and experience).

A bright light in this quagmire is that most recently the IFIs/RFIs, in particular the World Bank, are beginning to focus in a more comprehensive way on the ‘missing component’ to viable banking/financial sector legal reform in developing countries: the inclusion of the mass of the excluded developing world population. Through this focus reorientation, it may be possible for these institutions to better set and develop their own internal priorities in this area of reform and then to be of greater assistance to their developing country members in assisting them effectively to develop and to coordinate meaningful policies, institutions and legal infrastructure respecting more relevant, accessible and equitable financial sectors.

In this context, it is of significance that the World Bank dedicated its entire World Development Report 2006 to the theme of ‘Equity and Development’, 40 This Report, the work-product of the Bank’s staff, considers equity in terms of ‘two basic principles’: equal opportunity and avoidance of deprivation of income. The Report ‘highlights that legal and regulatory frameworks and equitable justice systems can do much to level the playing field in the political, economic and socio-cultural domains, but they can also reinforce existing inequalities’. In addition, in anticipation of this Report the Bank’s Legal Vice Presidency (LVP), then under Hon Roberto Dañino, perceptively held an extended high-level, forerunner conference in December 2005 on ‘Law, Equity and Development’. The primary purpose of this event was to explore ways the LVP and the Bank should best be approaching matters of legal and justice reform, including how to move the LVP forward to the next generation of financial sector legal reform. 41 This event was followed up and expanded upon by another major World Bank Conference in Spring 2006 on a wide range of issues concerning ‘access and equality’ in economic and financial development. 42

For present and illustrative purposes, this Part III highlights two other significant developments at the World Bank with respect to financial sector access issues. First, the Bank recently has commissioned a series of reports concerning access to financial services in Latin America; hopefully these and other country reports from the Bank will provide a good comparative

40 This Report, a late 2005 co-publication of the Bank and Oxford University Press.
41 This conference was held on 1–2 Dec 2005 at the IFC in Washington, DC.
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data and policy base for the Bank and its LVP to begin to formulate a 'next generation' approach to bank/financial sector legal reform respecting developing countries. The second Bank development is the expanded actual and potential role the Bank, with the IMF, is beginning to make of its FSAPs and related country Financial Sector Assessments (FSAs) for purposes of fostering financial sector access and equity.

A. The Country Studies

The thematic strand that unifies the four World Bank studies discussed below, which previous studies have glossed over, is that the definition of financial access must be broadened. The definition is now seen not only to include the ability for small businesses or individuals to obtain loans, but to include holding a checking or savings account, debit or credit cards, being able to pay for services at a branch or ATM instead of only at a downtown office, and having access to investment opportunities. These studies all examine the methods of savings and how cultural, environmental, and socio-economic factors come into play in creating poverty. Government policies, such as excessive reserve requirements, play a large role in reinforcing cycles of poverty. Further, these studies also find that access to technology can play a large role in alleviating those cycles of poverty by allowing easier access to services to the poor. These four studies are the following:

1. *Poverty Reduction and Growth: Vicious to Virtuous Circles*,\(^43\) which examines the essential question of how cycles of poverty reinforce themselves and what policies can be put into place to break those cycles;
2. *Access to Financial Services in Brazil*,\(^44\) which examines specific issues in Brazil and highlights their implications to government policy;
3. *Access to Financial Services in Colombia: the 'Unbanked' in Bogota*,\(^45\) which examines the issues of the 'unbanked' in Bogota; and
4. *Urban Unbanked in Mexico and the United States*,\(^46\) which compares the differences between access to financial services for the poor in both countries.

\(^{43}\) Guillermo Perry, *Poverty Reduction and Growth: Vicious to Virtuous Circles* (World Bank 2005) ('Circles').

\(^{44}\) Anjali Kumar, *Access to Financial Services in Brazil* (World Bank 2005) ('Brazil').


1. Vicious to Virtuous Circles

Written in 2005, this study explores in depth the search for pro-poor growth. It is well known that increases in growth can increase income to the poor and alleviate poverty.

The reverse thesis has not been sufficiently explored, and provides the thesis for this study: that poverty may be part of the reason for a region’s poor growth performance, creating vicious circles where low growth results in high poverty and high poverty in turn results in low growth. The more novel thesis of the report is that Latin America’s persistent poverty may itself be impeding the achievement of higher growth rates, which implies that there are reinforcing vicious circles that keep the poor in poverty and unable to contribute to national growth.

In light of the study’s findings, the question about whether financial policies should emphasize pro-growth or pro-poor can be answered simply, ‘Yes.’ Strategies that do not focus on growth ignore the greatest means governments and institutions have at their disposal for improving human well-being. At the same time, these same institutions and governments must take account of the constraints facing the impoverished so that they can fully participate in any growth, and thereby also contribute back to the wave of growth. This study describes the process of redressing these constraints brings to light under-examined dimension of policy analysis that might be called pro-growth poverty reduction.

This study shows that in order to achieve the greatest reduction in poverty, the relative emphasis on growth versus redistribution should vary depending on the individual country’s initial conditions. Poor countries such as Bolivia, Haiti, and Honduras and relatively equal countries that, bluntly put, have little to distribute, need first and foremost high and sustained growth, even at the expense of some increases in inequality. The paper compares this kind of growth to the growth recently experienced in China. In contrast, relatively richer and more unequal countries most of Latin America, and especially Argentina, Brazil, Colombia, and Mexico—need both higher growth and significant redistribution in order to begin the process of the reduction of poverty.

The poverty traps described in chapter six of this Brazil study, apply to both national and regional areas equally. Regional traps must take into account that within countries, labor does not move freely. This creates large wage gaps of up to 50 per cent from region to region.47

Bringing the historical discussion above into the present, this study shows that roughly half of the stark difference in income inequality between Latin America and contemporary Organization for Economic Co-operation

47 Circles, above n 43, at 122.
and Development (OECD) countries results from differences in returns to factors of production—the result of the unequal distribution of human and other capital in Latin America. But the other half results from the generally non-progressive nature of Latin America’s system of transfers. More important, although Latin American public expenditures underwrite large, progressive items (basic education and health), they also fund large regressive items (subsidies to pensions, tertiary education, and energy), which offset the progressive spending. The study’s conclusion is that a country’s financial history is not its destiny. The decline in Latin America’s income position in the last 50 years while the OECD member nations demonstrated the ability to sharply reduce inequality during the same period demonstrates that choices of policies and institutions can lead to major improvements along both dimensions. This study finds that policies such as increased access to education and infrastructure have had direct positive impacts on growth, inequality, and poverty reduction. Other policies, such as trade opening, have had positive effects on growth but have tended to increase inequality and even poverty in the short run. These short-term issues can be mitigated by better policy considerations, so that in the long run these pro-growth policies will lead to more financial equality.

2. Access to Financial Services in Brazil

The objective of the present study is to identify ways of expanding access that acknowledge the risks and costs involved but provide measures to mitigate their impact. Brazil’s financial system is by far the largest in Latin America. Beyond its sheer size, the overall depth of financial intermediation in Brazil, at almost 140 per cent of gross domestic product, is greater than that of its large neighbours in the region such as Mexico or Argentina, despite their higher average per capita income. Despite the size of Brazil, concern about financial exclusion increased over the last decade, with the number of banks in decline since the late 1990s. Only some 60 million, or approximately one-third, of Brazil’s population has a bank account.

Brazil’s policies which attempt to provide credit to the poor have a high cost. The high costs of these programmes have another unintended result: the government’s large borrowing needs have a negative impact on private credit. Large reserve requirements add to implicit taxation. Some more conservative estimates suggest that concessions and support could amount to several billion Reals. Unfortunately, Brazil’s policies themselves also may be ineffective at reaching the poorest and most in need of financial access.

As an example of the costs and failure of Brazil’s policies is the National Program to Strengthen Family Agriculture (PRONAF) which is estimated to cost R$1.1 billion. The largest 2 per cent of borrowers receive 57 per cent of loans in agriculture, whereas the smallest 75 per cent of borrowers
receive only 6 per cent of credit. As illustrated by the analysis of rural finance programmes, many such programmes fail to reach their intended targets, instead being captured by a few, to the detriment of broad-based access.

There is a role for more proactive government policies toward access to financial services; however, the success of these policies will be the greatest if they are backed by fundamental changes in overall approach to access. This approach must be delivered through broad-based financial sector reforms that limit constraints on the price and quantity of credit. Finally, these policies must reduce the role given to the relatively small number of public institutions charged with their delivery in order to ensure fair access.

3. Access to Financial Services in Colombia: The 'Unbanked' in Bogota

Supported by the Colombian Bank Association, this study finds that access to financial services is a determinant in a country's development, which access to financial services translates into progress. The study quotes Ross Levine's statement that 'No shortage of evidence exists to suggest that the level of financial development is a good indicator of economic growth, capital accumulation and of the technological change of the future economy.'

The study takes a specific look at the financial situation in Bogota, looking at what life is like outside the formal financial system, for one family who moved to Bogota in the 1950s, attempted to build their home through 'self-help' ended up paying twice the cost of their home.

The study is harshly critical of the continuation of the government's tax on financial transactions, originally intended to be a temporary solution to the banking crisis in Columbia. The tax has now been made a permanent one, and has been increased from 0.2 per cent to 0.4 per cent. Financial exclusion in the country has created significant welfare losses, has created a declining savings rate, and has created a financial system that caters to the wealthy through monthly fees that equal 5-10 per cent of the minimum wage.

The study states the thesis that an effective financial sector reduces the cost of information sharing between economic agents and that the current trend does not look positive for the country. Though the 'unbanked' are often paid by check, they have no access to financial institutions, and are forced to pay large check cashing fees and to do business in remote central bank locations. Further, to obtain credit, every individual or small business must approach potential lenders one by one to obtain the amount and terms that they require.

48 Brazil, above n 44, at 280.
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The costs that these factors represent constitute an inhibiting factor for growth in general. This has created an alternative system whereby many individuals save and borrow primarily through friends and family, and their primary savings is tied to home ownership. This alternative method cuts off their financial resources from the nation or region which stagnates growth.

4. The Urban Unbanked in Mexico and the United States

This study examines how impoverished households in the United States and Mexico obtain basic financial services. This study examines the efforts that the private sector and government have taken in order to provide access to those services, both in terms of cost and quality. The differences between the ways in which the unbanked in the United States and Mexico provide an instructive contrast, which provides commentary on how policies can be effective and how policies must differ, based on different cultures of saving and investing.

A further argument to link broader coverage of financial services to economic growth comes from the private sector. The savings and loan crisis experienced in the United States in the 1980s did not in fact cause a major sector collapse: this has been attributed to the fact that the US banks had spread their businesses over a wider gamut, depending on a variety of population sectors, not just the wealthy. This can be contrasted with the similar situations experienced in Mexico and in Colombia that did cause major financial crises. Experience also shows that financial institutions catering to low-income clients can be good businesses. Recent studies by the US Federal Reserve have favourably compared the profitability of investments under the Community Reinvestment Act credits to commercial investments. These studies have also shown the profitability of community development financing institutions is favourable to other start-up banks.

The differences between the unbanked in Mexico and the United States are striking. One study showed that while in the United States where there are multiple alternatives; cheque-cashing services can often charge a fee of 2–3 per cent. In Mexico, where there are few practical alternatives, there are no fees for cheque-cashing services. This shows that significant differences exist and any approach to solving issues must take into account those differences: there is no one-size-fits-all solution.

It should come as no surprise that the challenges the impoverished face in obtaining financial assistance is at best difficult and at worst impossible. The collective observations of these four studies reaffirms that although the poor face challenges, there is much work that can be done to alleviate the severity of these cycles of poverty. There are very common policies that can

be implemented across Latin America which would go a long way to improving the situation that the unbanked in those countries face.

B. FSAPs: One Possible Supporting Pillar for the 'Next Generation' of Financial Sector Legal reform.

Coming out of the 1998 Birmingham and 1999 Cologne G-8 Summits were mandates for the IFIs concerning both the internal evaluation of the effectiveness of their IFI reform programmes/projects and more broadly to develop assessment mechanisms concerning the condition of the financial sector as a whole and recommendations for reform. The policy thought is that identification of financial system strengths and vulnerabilities will help promote financial stability and to reduce the potential for crisis. These mandates have led to the enhancement of IMF surveillance mechanisms, to the establishment of independent internal offices, and to the establishment of a joint IMF-Bank Financial Sector Assessment Program (FSAP), beginning with a joint pilot programme in 1999. Based on the initial success of the pilot programme, the joint FSAP programme was refined and formalized on an ongoing basis, with this initiative being coordinated through a IMF-Bank Financial Sector Liaison Committee (FSLC).

As conceived, the FSAP . . . is widely recognised by participating countries and by the international community as an important instrument for diagnosis of potential vulnerabilities and analysis of development priorities in the financial sectors of member countries. . . . One objective of the FSAP is to help countries map a transition to a more diversified and competitive financial sector without creating vulnerabilities. A well-functioning financial services sector is essential for sustained economic development and poverty reduction. The existence of a wide and diversified set of sound, well-managed institutions and markets also reduces the likelihood and magnitude of a financial crisis. [emphasis added]

Thus, from its inauguration, in order to accommodate the differing institutional missions of the IMF and the Bank, the FSAP initiative has been articulated in terms of bifurcated objectives: (i) financial crisis prevention and financial stability and (ii) economic development and poverty reduction. This author suggests that these objectives are not necessarily co-extensive or fully compatible. Further, this author would note that in terms of the

53 ibid at 4.
Bank's mandate, these objectives gloss over what a 'well-functioning financial services sector' should mean in terms of economic development and poverty reduction. Moreover, the causal linkage between the 'modern' financial sector model envisioned by the FSAP criteria and instruments and actual 'poverty reduction' has never been empirically substantiated. This being said the Bank's stated FSAP objective possible might be able to provide the context within which to determine how best the FSAP process can be utilized as a catalytic and supportive vehicle for the 'next generation' of financial sector reform.

Functionally, an FSAP is requested voluntarily by a country and is normally effected over several joint IMF-Bank team missions. Upon completion, the team prepares an aide-memoire presenting the findings. This non-published, confidential document will be used by the IMF to prepare a Financial Sector Stability Assessment (FSSA) for presentation to its Executive Board, and is often used also in connection with the Fund's surveillance role under its biennial 'Article IV consultations'. The Bank staff will use the aide-memoir to put together a Financial Sector Assessment (FSA) for its Executive Board.

The FSAP itself entails three main components: (i) systematic analysis of financial soundness indicators (FSIs) and stress tests; (ii) assessments of standards and codes; and (iii) assessment of the broader financial stability framework, including systemic liquidity arrangements, governance and transparency, and financial safety nets and insolvency regimes. The FSAP work has come to support the IMF's role in the standards and code area and to support the Bank's development efforts (particularly as to technical assistance), including as to its Country Assistance Strategies (CAS).

The FSAP is separate from but substantively linked to the IMF's role as to Reports on Observance of Standards and Codes (the ROSC initiative). According to the Bank, there are three reasons for its participation in the ROSC initiative:

1. the structural and institutional underpinnings of a market economy are an important complement to sound macroeconomic policies for both successful integration with the world economy and for sound development;
2. implementation of standards can assist countries establish these foundations, in turn contributing to domestic and international financial stability; and

54 IMF & World Bank FSAP, above n 52, p 25.
55 These are not published. Prior to March 2003, FSAP teams prepared more lengthy FSAP reports.
(3) partnership with the IMF provides the basis for a comprehensive approach and broad-based effort for the implementation of standards.

However, the FSAP, at least for the Bank, selectively and more flexibly utilizes particular codes and standards (in consultation with the host country), may deal with standards not formally under the ROSC (e.g., creditors' rights and corporate insolvency, deposit insurance and bank insolvency), and will deal with cross-sectoral issues. In recent years, the Bank has been attempting to integrate the FSAP, FSA and ROSC processes into its evolving development agenda. Notably, this integration effort has begun to address the developmental context of the overall financial legal infrastructures and issues of access.

The FSAP process for the Bank has its limitations in addressing the developmental context and content of the 'next generation' of financial sector legal reform. The process is a joint institution effort, has divergent overall objectives, is conducted by a joint institution team, and is a complex technical process. However, the FSAP is also a flexible data-gathering process that most probably can be better and more broadly utilized by the Bank and its LVP in evaluating, revising and prioritizing its financial sector reform policy objectives and related technical assistance. Certainly, this is well worth serious consideration by the Bank and its LVP and the IMF.

IV. TWO CURRENT DEVELOPMENTS OF SIGNIFICANCE: MICROFINANCING AND PRIVATE INDUSTRY PARTICIPATION

In selectively looking at recent developments in the financial access area as to developing countries, two potential institutional developments are worth noting for present purposes: (i) the rise of microfinancing and (ii) private banking industry initiatives in South Africa.

A. Microfinancing

With the recent Nobel Peace Prize award to Muhammad Yunus of the Grameen Bank in India for his and his bank's work with developing microfinance products for the poor and expanding the use of such product on a commercially viable basis,\(^5^7\) it seems microfinance is a new discovery. The reality, however, is that microfinancing has been around at least since the 1950s, having a very spotty record of success until more recent times.\(^5^8\) The


\(^{58}\) See CGAP's extensive website on microfinancing at http://cgap.org/portal/site/cgap (accessed 24 Sept 2006).
Taking in the 'Excluded'

recently formed consortium of donor countries affiliated with the World Bank, the Consultative Group for Assisting the Poorest (CGAP) has brought microfinancing into the mainstream of the IFI development agenda.

1. Background

Microfinance, along with credit and national savings structures for small and medium sized enterprises (SMEs), has come to be viewed as of major importance for enhancing the social and economic impact of the financial sector of developing countries. Microfinance today is seen as a vital tool against poverty since it directly provides to low-income people the tools to build assets, increase and protect their source of income, and reach self-sufficiency. For example, in Latin America (which will be the geographic focus of this Subpart IV. A), microfinance institutions (MFIs) started to be established in the 1980s with the arrival of non-governmental organizations (NGOs) making loans to poor ‘microentrepreneurs’. In 1992, the Bolivian NGO, PRODERM, converted into the first regulated MFIs in Latin America: BancoSol, a regulated commercial bank.

Today, it is probably safe to argue that Latin America has the longest tradition of commercially viable microfinance. In fact, competition tends to be intense in some countries, especially in urban areas, and interest rates in some countries have declined dramatically as a result of that competition. For instance, in Bolivia market pioneer BancoSol charged a combination of interest and fees equivalent to a 65 per cent annual percentage rate when it began operating as a bank in 1992. Today, Banco Sol operates in a highly competitive environment and has brought its interest rate down to 22 per cent. In addition, leading institutions are increasingly offering a variety of additional financial services to their clients, including savings vehicles and management of international and domestic funds transfers.

2. Improvement of Microfinance.

Despite some degree of market penetration to date and a variety of financial services offered in some Latin American countries, there remains significant opportunities in larger Latin American countries where little microfinancing currently is occurring (eg Mexico and Brazil), in secondary cities, and in rural areas. Despite media hype, only a small percentage of

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61 Ibid.
SMEs currently have access to formal financial services in Latin America.\(^{62}\) Even in Chile, which has one of the most developed financial markets of the continent, only large and well-established firms have access to the range of financial instruments available.\(^{63}\)

The large number of excluded people in Latin America will gain access only if financial services for the low-income people are integrated into all three levels of the financial system: micro (financial service providers), meso (support services and infrastructure) and macro (legislation, regulation, and supervision).\(^{64}\) Therefore, it will be necessary to coordinate public and private reforms in order to enhance the equality and access of financial systems.

First, it is important to understand client demand and to translate this into high-quality, affordable, and convenient financial services offered by a range of providers.\(^{65}\) Today, microfinance is about building sound domestic financial intermediaries that can provide services to low-income clients on a permanent basis. Sustainability ensures that low-income clients have permanent access to services.\(^{66}\) Second, to ensure sustainability, it is necessary to have a strong financial infrastructure (the meso level), which includes a complex and varied set of systems and instruments consisting of systems that allow for electronic payments and service providers such as auditors, raters, consulting services, information and point-of-sale technology vendors, specialized technical support, and professional associations.\(^{67}\) Accurate, standardized, and comparable information on financial performance is imperative for integrating microfinance into the financial system.\(^{68}\)

Finally, the government (the macro level) needs to offer a policy environment that allows competitive and diverse financial service providers to flourish. The key actions for governments are to maintain macro-economic stability, to avoid interest rate caps, and to refrain from distorting the market with unsustainable, subsidized, high-delinquency loan programmes. Governments can also adjust banking sector regulation and supervision to facilitate microfinancing while also protecting low-income people's deposits. Governments can further support financial services by improving the legal framework for contract enforcement and collateral rights, ensuring practically and legally feasible systems of land titling, and ensuring that

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\(^{64}\) See Brigit Helms, above n 60, at 13.

\(^{65}\) ibid at 140.

\(^{66}\) ibid at 55.

\(^{67}\) ibid at 140.

\(^{68}\) ibid at 73.
Taking in the 'Excluded'

3. The Regulatory Reform

The pressure for regulatory reform has been building on several fronts in Latin America since 1995. Such pressure has led some countries in the region to create new types of financial institutions, precisely for the purpose of enabling non-profit foundations to transform into financial intermediaries.\(^7\)

In Bolivia, for example, a special law governing private financial funds (FFPs) permits NGOs to transform into specialized regulated financial institutions allowed to mobilize deposits and intermediate government funds. The minimum capital required is only around $1 million compared with about $3 million for banks (as of April 2005). FFPs are subject to the same (if not stricter) prudential supervision as banks and are monitored by the same Banking Superintendency. The Superintendency requires all deposit-taking institutions (including FFPs) to submit their financial statements on a daily basis, an administrative burden that may discourage FFPs from entering into more remote rural areas with weak telecommunications infrastructure.\(^7\)

There are two situations in which it may be appropriate to create a new type of institution to facilitate the transformation of non-profit microcredit foundations into licensed and supervised financial intermediaries:

1. If the minimum capital requirement for existing institutional forms is very high it could prevent mature and well-managed foundations from entering the formal financial system; and
2. If the existing institutional form has the lower minimum capital requirement is severely limited in the type of operations it can carry out—particularly in the area of savings mobilization—then it may simply be unattractive form of institution for those microcredit foundations that want to enter the formal financial system.\(^7\)

In some Latin America countries, the bad, predatory reputation of finance companies has sometimes been mentioned as a reason to create a new

\(^{69}\) ibid at 92.


\(^{71}\) See Brigit Helms, above n 60, at 88.

\(^{72}\) See Tor Jansson, above n 70, at 6.
institutional form for non-profit foundations that want to transform into formal financial intermediaries.\textsuperscript{73}

Creating new institutions for microfinance, even when well-justified and structured, is not enough to provide a regulatory framework for microfinance. The first and perhaps most important step to this end is to design appropriate regulations for microlending as such, in which the regulation should be guided by three principles: (a) flexibility, (b) simplicity, and (c) automaticity—flexibility in interest rates, collateral and internal credit processes; simplicity in client documentation, loan delinquency and recuperation of collateral; and automaticity in portfolio classification, loan loss provisions and write-offs. In conjunction, such basic rules provide room for innovation; lower the regulatory costs of compliance and subject microlending to a strict recognition of revenues, expenses and risks.\textsuperscript{74}

Finally, although the regulatory framework is relevant, it constitutes solely part of the story. The remaining part is supervision. Since most of the regulatory initiatives are still quite recent (apart from Bolivia and Peru), supervisory authorities have not yet developed effective processes, tools and practices of supervision.\textsuperscript{75} Ineffective supervision may be worse than none at all, since the low-income clients could be led into a false sense of security.\textsuperscript{76} Achieving the proper mix of regulations and supervisory practices that foster a competitive and sound microfinance is the key, and it will require a sustained commitment on the part of supervisory authorities.\textsuperscript{77}

Developing countries that are pursuing reforms to improve microfinance need to analyse all levels of the financial system and not cause distortion in other areas or destabilize the financial system as a whole. Importantly, the private sector should be brought to the table to participate in the microfinance process, seeing such participation as a commercial opportunity and not as a money-loser or subsidized competition. The government, in turn, should foster competition and facilitate chartering of financial institutions specialized in lower income.

\textbf{B. An Example of Non-Regulatory Public—Private Initiative:  
\textit{The Case of South Africa}}

South Africa, as all developing countries, faces the general challenge of providing basic financial services to the poor. Specifically, the country is searching for ways to reduce the entrenched inequality of incomes, economic opportunities, and access to services left over from years of apartheid. Ironically, apartheid did leave South Africa with a developed
banking system that served the dominating white population. The ‘trick’ is how to bring this banking sector into the developmental agenda of the country. With over half of the South African population living on a $2 or less day, it is imperative that the major financial institutions help redress the historically weak system of services for lower income people.

Facing impending regulation (ie, a community reinvestment—type of legislation similar to that in the United States), the South African financial sector recently has responded to this demand for the expansion of access to financial services to a broader segment of the population in the form of the Financial Sector Charter (‘the Charter’), a negotiated document adopted by the financial sector in October 2003 and brought into effect on 1 January 2004. The Charter represents an important private sector response to the broader challenges of transformation within, and transformation initiatives by the financial sector.

1. Background

As mentioned above, South Africa has a well-developed and highly sophisticated formal banking system. At the end of 2004, there were 38 registered banks in South Africa. For historical reasons, a large proportion of the South African population has not been adequately served by the formal banking system. The poorest sectors of the population and rural areas mostly, have fallen outside of the net of the services provided by the formal banking system. Prior to the adoption of the Charter, the major banks were pressurized to extend financial services, including credit for low-income housing to the poorest sectors of the South African population and to desist from discriminatory lending practices. However, the Government’s response to the challenge of expanding access to financial services and access to housing finance for low income households has, from an early stage, been characterized by the search for constructive partnerships between the private sector and the public sector: a partnership where on one hand the State would take measures to encourage the resumption of payments for goods and services, and reinstate the rule of law, whereas on the other hand the private sector would support the Government in its

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81 ibid. See also above n 78.
efforts to bring about financial stability. In pursuing the goal of partnership with the private sector, it would seem as though there has been an almost studious avoidance of prescription to the private sector while at the same time maintaining subtle and overt pressure on the private sector lending institutions to participate more meaningfully in the transformation process. The two major legislative acts, ie Home Loan and Mortgage Disclosure Act\textsuperscript{82} and the draft Community Reinvestment Bill, 2002,\textsuperscript{83} were developed by the Government but never actually got implemented. This further tends to reinforce the notion that the Government preferred to operate within a collaborative as opposed to a prescriptive framework with the financial sector.

2. Responding to the Challenge: The Financial Sector Charter

The Charter identifies a number of challenges facing the domestic financial sector, major among those being the Sector’s ‘inadequate’ response to increasing demand for access to financial services. The expansion of access to financial services is seen as ‘fundamental to BEE and to the development of the economy as a whole.’ The broad Charter commitment assumed in paragraph 8 of the Charter is to ‘increase effective access to first order retail financial services to a greater segment of the population within LSM 1–5’.\textsuperscript{84}

It is important to understand the two key concepts ‘effective access’ and ‘first order financial resources’ used in the Charter commitment. The concept of ‘effective access’ as utilized in the Charter has five dimensions:

1. service infrastructure and appropriate human resources must be located within a distance of at least 20 km from potential users; the range of products must be sufficiently diverse; non-discrimination;

2. the products offered must be appropriate and affordably priced; and the products must be structured and described in an way that is easily accessible;\textsuperscript{85}

3. first-order retail financial services as defined in the Charter include: ‘transaction products and services, which serve the function of day-to-day purposes;’

\textsuperscript{82} Act 63 of 2000; it should be noted that the act has not come into operation yet.

\textsuperscript{83} GN 23423 Government Gazette, 17 May 2005.

\textsuperscript{84} The Financial Sector Charter, 1 Jan 2004, S Af, at ¶ 8.3; LSM 1–5 refers to the Living Standards Measure designed by the South African Advertising Research Foundation. Included in LSM 1–5 are persons whose average household income ranges between R879 & R2472 (from SAARF AMPS 2004); see http://www.saarf.co.za. (accessed 15 Nov 2006).

\textsuperscript{85} See above n 84, at ¶ 2.22.
Taking in the 'Excluded'  

(4) savings products and services, which serve the function of providing 'a basic and secure means of accumulating funds over time'; credit for low-income housing;\(^6\) and  

(5) insurance products and services, which provide a cushion against defined first order basic risks.\(^7\)

These provisions, and indeed the Charter as a whole, effectively depict the process of forming a constructive partnership between the Government and the private sector to meet the challenges of transformation.

Additionally, the broad Charter commitment referred to above is made more concrete by a set of specific undertakings which can broadly be divided into two categories: those whose implementation is sector centric in that the responsibility for their implementation rests solely with the Sector (sector centric undertakings) and those whose implementation depends on negotiated arrangements reached with the Government and other actors (collaborative undertaking). Furthermore, the Charter parties undertake to establish, in collaboration with the Government, a monitoring and review mechanism 'for the ongoing evaluation and review of the financial sector's initiatives on access'. This strengthens the notion of a partnership between the sector and the Government.

3. Implementation Mechanisms

In terms of the Charter, an independent body, the Charter Council with a broad mandate to oversee the implementation of the Charter is to be established.\(^8\) The Charter Council is required to undertake periodic reviews of the implementation of Charter and it is empowered to make decisions regarding the implementation of the Charter in its second term (2009-14).\(^9\) The Charter Council is to be comprised of industry association representatives\(^9\) and 'all others'. Government representatives and

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\(^6\) It should be noted that low income housing in the context of first order financial services is aimed at households with a stable income of at least R500 per month but below R7500 per month.

\(^7\) See above n 84, at ¶ 2.27, the examples of the first order risks mentioned are death and associated funeral costs; household insurance and health insurance.

\(^8\) ibid at ¶ 15.1.1.

\(^9\) See ¶ 15.1.1 read with ¶ 4.3.

other interest groups are among the 'other' interest groups to be represented on the Charter Council. The Charter Council is specifically required to 'fairly reflect the interests of all the financial institutions'. This suggests that there was a concern that the independent body might undermine such interests.

The decision-making mechanism in the Charter Council is consensus. This may be a mechanism for ensuring that the interests of financial institutions are not undermined in the Charter Council. It seems, however, that consensus is the primary but not the exclusive mode of decision making within the Charter Council. An absolute consensus requirement would imply the possibility of institutional paralysis in circumstances where Charter Council fails to reach consensus, especially on matters of importance. It is contemplated that a dispute-breaking mechanism will be agreed within the Charter Council. The possibility of arbitration or mediation also exists as an alternative to an internally agreed dispute-breaking mechanism. This suggests that it might be possible to have definitive outcomes on contentious issues arising out of the deliberations of the Charter Council. The possibility of definitive outcomes in contentious issues tends to lessen the institutional implications of the consensus requirement.

The Charter requires each financial institution to report on an annual basis to the Charter Council on its progress in implementing the provisions of the Charter. Financial institutions are required to publish an annual report for general information. This annual report is to include an audited scorecard and an account of the progress that the institution has made in discharging the non-quantified responsibilities set out in the Charter.

Although the Charter is non-binding in a hard formal sense as it is a 'soft' document that sets aspirational goals and standards of conduct, yet this does not undermine its importance. The primary value of the Charter lies in the voluntary assumption by private parties of part of the responsibility for making transformation work within a framework of collaboration and partnership with the public sector. Already, the Charter parties have begun to implement some of the provisions of the Charter in relation to the expansion of financial services to low and moderate income households. In recent times, some of the major banks have begun to open operating units in townships and remote rural areas. An important development in this regard, was the creation and launch on October 25, 2004 of the Mzantsi Account by the major banks together with Postbank (a government institu-

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91 See above n 84 at ¶ 15.1.1.  
92 ibid.  
93 ibid.  
94 See above n 84, at ¶ 15.2.1.  
95 See above n 84, at ¶ 15.2.4.  
Taking in the ‘Excluded’

The Mzantsi Account is designed specifically to meet the needs of previously ignored communities. The first set of quantitative data on the Mzantsi Account suggests that it is a runaway success. According to the data, as at February 2005, over half a million Mzantsi Accounts had been opened. Furthermore, an average of six thousand accounts was being opened across the country each day.

In sum, the adoption of the Charter and the apparent impetus of the Sector to implement its provisions and to collaborate with the Government in its implementation within a framework of partnership are a vindication of the Government’s partnership seeking approach in dealing with the banking sector to achieve the extension of financial services and housing finance to low to moderate income borrowers/depositors. The initiatives of the financial sector based on the Charter initially have proven successful and indicate a real potential for the meaningful extension of financial services.

V. CONCLUDING OBSERVATIONS: THE NEED FOR A SUITABLE LEGAL-INSTITUTIONAL INFRASTRUCTURE AND POLICY REORIENTATION

The world of the IFIs/RFIs has historically been a world of economists (a large portion of who are macro-economists): law and lawyers traditionally have played a very minimal role. But the IFIs/RFIs have come to learn and to appreciate incrementally during the 1990s the importance of the legal-institutional infrastructural framework of a country in supporting the domestic financial system by establishing the requisite institutional and administrative capacities; in developing the desired supporting linkages between the public and private sectors; in putting in place clear rights, responsibilities and liabilities of parties in a transaction; in maintaining the appropriate incentives and adequate information that espouse market forces; and in providing adequate and fair means to enforce legal obligations and claims effectively.

This author recognizes that over the past decade institutions such as the World Bank and the IMF have expended considerable efforts on ‘deepening’ financial sector legal-institutional infrastructure reform in developing countries (eg, as to the legal aspects focusing on the importance of property and contract rights and remedies, secured transactions, corporate gover-

nance and corporate and bank insolvency;\textsuperscript{99} and as to the institutional aspects focusing on modern administrative, enforcement and judicial bodies).\textsuperscript{100} Such legal-institutional infrastructural reforms are indeed a prerequisite to having a sound foundation for building a viable financial sector. However, these reforms do not take into consideration from a developmental perspective what a country wishes its financial system to embrace, what base of participants the country wishes to include and what policies, institutions and additional legal infrastructure will be needed to achieve these developmental objectives.

For the legal system to achieve these objectives, certainly key legislation needs to be put into place: ie, at a minimum, modern contract, corporate, bankruptcy, private property and commercial laws, as well as modern banking and investment securities laws (and, even, most probably, a basic asset securitization law). These latter legal provisions specifically governing financial activities need to be ‘rule-based’ and transparent while preserving a required degree of flexibility necessary to adapt to innovations and changing market conditions. The financial legislation/regulation should promulgate disclosure of information so as to enable market forces to discipline the activities of financial institutions and ‘market players’. Clarity of entry and exit standards of financial institutions reduces uncertainty within the financial markets. In addition, a ‘well-defined’ exit policy is especially imperative, since this is the time when the market is likely to act rashly and to cause self-fulfilling bank runs.\textsuperscript{101}

In addition, administrative and judicial procedures need to be sufficiently clear and to be backed-up with quality enforcement entailed to them. The problem for many emerging economies is the lack of any effective administration and enforcement. Thus, ensuring that enforcement is carried out extends the appropriate incentives for market participants to act normatively. Two specific priorities are seen as improving the enforcement of financial contracts:

(1) Effective means to take possession of collateral exist; and
(2) Revision and updating of legal codes are carried out to reflect new market realities.

\textsuperscript{100} eg, in the latter part of the 1990s and currently, the World Bank has been most active in the area of judicial reform. Professor MacLean was a driving force behind this initiative.
The lack of legal remedies in the case of non-compliance also can paralyse the functioning of the market and can discourage foreigners from investing in emerging markets. The uncertainty surrounding the outcome of legal procedures and processes also inhibits the robustness of financial markets.\footnote{102}

Other key components for building ‘modern’ international financial best practices/standards might well include the following:\footnote{103}

- Transparency, Accountability and Disclosure
- Market Structure
- Corporate Governance
- Stakeholder Oversight
- Stakeholder Protection
- International Surveillance, Oversight and Data Assembly and Dissemination
- Sound Regulation and Supervision
- Market Discipline
- Sound Accounting Standards and Practices.

All these reform components serve to strengthen and to deepen the stability base of the pre-existing financial sector, which in reality is only representative of the top of to economic-social pyramid. However, they are not designed in themselves to broaden the financial sector base.

As mentioned above, the G-7/8 views the ‘robustness’ of a financial system as an essential characteristic of a stable system. To promote this, the G10 Working Group has identified three crucial actions that should be taken by each country according to their specific situation:

1. Creation of an institutional setting and financial infrastructure necessary for a sound ‘credit culture’ and effective market functioning;
2. Promotion of the functioning of markets so that owners, directors, investors and other actual and potential stakeholders exercise adequate discipline over financial institutions; and
3. Creation of regulatory and supervisory arrangements that complement and support the operation of market discipline.\footnote{104}

\footnote{104} \textit{cf.} inter alia, Working Party on Financial Stability in Emerging Market Economies, Financial
This would entail the improvement of the infrastructural aspects of the financial system: namely, the legal and judicial framework, accounting and disclosure standards, and the market structure. When viewed in this way, financial legal sector reform becomes a deep, complex and long-term matrix of reform efforts, presenting truly awesome challenges for and demands up the IFI resources and personnel at a time when they were being pressured to react to ongoing, immediate financial crises. Yet, again the deepness of this reform process is not directed toward broadening the reform base to be more inclusionary as to access and otherwise as to serving true developmental objectives.

It now seems self-evident for those who have been involved with the financial sector reform area what is rightly asserted by Claessens and Perotti:

The relationships between inequality and finance seem to become clearer at the beginning of the 21st Century. Important research conducted so far has suggested that to reduce inequality, financial systems need to be broadened not only deepened. . . . Financial reform will only reduce inequality . . . if it improves access for more individuals with growth opportunities. Reforms thus need to broaden, not just deepen financial systems.

Certainly, in logically and pragmatically following through on Sen’s paradigm of ‘choice (freedom) and development’, choice presupposes meaningful and effective ‘access’. This, in turn, presupposes the existence of suitable supporting governmental policies and financial sector infrastructure, which presumes, in turn, the presence of appropriate, supporting policies, institutions, legal infrastructure and legal instruments.

However, the need ‘to broaden’ is not simply about creating greater access for the currently disenfranchised population to the financial system, but needs also to be about broadening the financial system itself so that it is not structurally geared only to the elite economic, business and social elements of a developing country’s society, but is also systemically structured in terms of suitable development policy to provide appropriate institutions, laws and instruments to accommodate the poor, low-income and


Taking in the ‘Excluded’

other excluded elements of the country’s population. For instance, it becomes critical to identify the particular sectors of a society that need priority development (e.g., agriculture, small business, housing, social safety net components, etc.), to assess the extent the existing financial sector and institutions might be better utilized in furthering such developmental objectives and the best means thereof, and to determine what new institutions, laws, regulations, and instruments might be required. To achieve all this in a coherent, sequenced, and long-term sustained manner is indeed an enormous challenge for any country and for the supporting IFIs/RFIs.

But, without having a financial system that is relevant to a country’s developmental stage and objectives and that is designed to bring in and to serve the excluded in meaningful ways, a country’s financial system cannot effectively contribute to optimum, meaningful, and sustainable economic and social development and cannot provide a broad, stable financial platform for achieving financial stability with robust and sustained growth in the financial sector. At the end of the day, economic legal development, whether in the banking sector or otherwise, is about people and attempting to better their lives and to bring a greater degree of social justice to the society.