Banking Law Reform and Users-Consumers in Developing Economies: Creating an Accessible and Equitable Consumer Base from the 'Excluded'

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Banking Law Reform and Users-Consumers in Developing Economies: Creating an Accessible and Equitable Consumer Base from the “Excluded”

JOSEPH J. NORTON*

SUMMARY

I. INTRODUCTION ........................................................................................................... 790

II. EVALUATING BANKING SECTOR LEGAL REFORM FOR DEVELOPING COUNTRIES: THE PAST FIFTEEN YEARS ............................................................... 792
   A. Modern Banking Sector Legal Reform as G7/G8 Mandated and as Part of NIFA ..................................................................................................................... 792
   B. NIFA and the Role of International Standards: An Industrialized Country Initiative ........................................................................................................... 795

III. WORLD BANK’S NEW AGENDA ON FINANCIAL ACCESS AND EQUITY ISSUES .................................................................................................................. 798
   A. The Country Studies ............................................................................................. 800
   B. FSAPs: One Possible Supporting Pillar for the “Next Generation” of Financial Sector Legal Reform ................................................................. 804

IV. TWO CURRENT DEVELOPMENTS OF SIGNIFICANCE: MICROFINANCING AND PRIVATE INDUSTRY PARTICIPATION .................................................... 806
   A. Microfinancing .................................................................................................... 806
      1. Background ..................................................................................................... 807
      2. Improvement of Microfinance ..................................................................... 807
      3. The Regulatory Reform .............................................................................. 809
   B. An Example of Non-Regulatory Public-Private Initiative: The Case of South Africa ................................................................................................. 810
      1. Background ................................................................................................... 811

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I. INTRODUCTION

The subject-matter of this article was originally conceived of as consumer protection issues in banking sectors of developing countries. In first approaching this topic area, the author had on his “industrialized country hat” which automatically assumes that there preexists a broad consumer base from which to work. But in stepping back and putting on his “developing country legal reform hat,” the author came to realize that approximately two-thirds of the world’s people are effectively excluded from the mainstream banking and financial sectors of their respective countries, thus denying them an ability to meet basic financial needs and any realistic prospects of wealth creation, and foregoing the mainstream financial systems in these countries from more fully maturing in the sense of contributing more fully to the developmental needs of these countries. As such, what consumer base would exist in a developing country would only encapsulate the top of the socioeconomic pyramid of that country. Thus, the critical, foundational issue that needs to be addressed respecting consumer banking issues in developing countries is that of “inclusion.”

The primary proposition being set forth in this article 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 been a core component of modern banking sector legal reform and assessment in the developing world. As such, before one can sensibly talk about a viable banking and financial sector framework in a developing country, a reasonably broad user (i.e., consumer) base needs to be developed. In effect, the banking and financial system of the developing country needs to become accessible to the “excluded”: serving just the top of the economic pyramid is shortsighted and, in the long term, counterproductive. Once a broad and equitable base is established, a developing country can sensibly and effectively address the formulation of an adequate consumer protection framework so that new entrants and those still remaining outside the mainstream financial sector are not discriminated against or treated unfairly. While these conclusions seem 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. Certain abbreviations and acronyms used in this article include: anti-money laundering (AML); Basel Committee on Banking Supervision; Bank for International Settlements (BIS); World Bank’s Country Assistance Strategies (CAS); Consultative Group to Assist the Poor (CGAP); counterterrorism financing; European Bank for Reconstruction and Development (EBRD); European Union; Financial Action Task Force; Financial Sector Assessment (FSA); Financial Sector Assessment Program (FSAP); Financial Stability Forum (FSF); Group of 7 (G7); Group of Eight (G8); Group of Ten (G10); Group of Twenty (G20); General Agreement on Trade in Services; International Association of Deposit Insurers (IADI); International Association of Insurance Supervisors (IAIS); International Accounting Standards
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 that: (i) the modern banking and financial sector law reform policies and infrastructures process is of relatively recent vintage; (ii) this reform process has been largely crisis-oriented and reactive by necessity and has become driven largely by industrialized countries' systemic objectives of preventing financial crises and related contagion, fostering global financial stability, and more recently, maintaining financial sector integrity; and (iii) 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 that promotes the United Nations' Millennium Development Goal of alleviating poverty.  

It is the general view of this author that the future banking and financial sector legal policy and infrastructure reform process of the IFIs and others in the economic development arena should systematically and thoughtfully undertake this reform process within, or alongside of, a complementary framework and context of meaningful and relevant economic-social development policy objectives, including the object of making the financial base broader and more inclusionary. 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.  

Part II of this article will attempt to evaluate banking sector legal reform efforts as to developing countries over the past decade and a half. Part III will consider recent selective 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's 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.


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. But cf., Thorsten Beck, Asli Demirguc-Kunt and Maria Soledad Martinez Peria, Reaching Out: Access To and Use of Banking Services Across Countries (World Bank Policy Research Working Paper No. 3754, Oct. 2005).
II. EVALUATING BANKING SECTOR LEGAL REFORM FOR DEVELOPING COUNTRIES: THE PAST FIFTEEN YEARS

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 byproduct of the major industrialized countries' concern over financial crises and the quest for global financial stability during the 1990s,\(^5\) the new transitioning economies arising from the collapse of the Soviet Union, the enlargement of the European Union, and the ongoing onslaught of economic globalization—each of which are interconnected in various ways.\(^7\) More specifically, this reform over the past decade has been largely driven by the G7/G8 grouping of industrialized countries.

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 sectors, legal reform as to developing countries began gaining credence and taking shape as part of the G7/G8\(^6\) invention of the notion of a New International Financial Architecture.\(^7\) NIFA in fact is a misnomer of sorts and in some sense a public relations ploy to dress over an ongoing quandary of what to do with an international financial "non-system."\(^8\) Yet, even if no true "architecture" had existed to be replaced by NIFA, and though NIFA is itself probably not a true architecture or system, a working base did come to exist through the NIFA, from which a new architecture and a next generation of banking and financial sector legal reform could be developed.

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4. In fact, when one reviews the annual intergovernmental Communiqués of the G7/G8 from 1975 through the mid-1990s, one notes, by conspicuous absence, that the financial sector infrastructure (including its legal dimensions) is left unattended. Globally significant macroeconomic issues 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 isolated reforms designed to facilitate a certain development project. An IFI-related example was in the early years of the EBRD, which views itself more as an International Finance Corporation-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 General Counsel's Office, but the component tended to look at more generic law reform issues, such as a model secured transaction law. See, e.g., EMERGING FINANCIAL MARKETS AND SECURED TRANSACTIONS (Joseph J. Norton & Mads Andenas eds., 1998).

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 G8 (known as the G7 from 1976 until 1998, when Russia was fully admitted) has met annually to consider the major global macroeconomic and political issues. See the major G8 Information Centre website maintained by the University of Toronto, available at http://www.g8.utoronto.ca.


8. Norton, supra note 7, at 180-82.
NIFA, as it has unfolded through the various G7/G8 annual summits over the past decade, has endeavoured to coordinate and direct a wide grouping of different, though related, international bodies that have their own mandates, jurisdictions, and powers: (i) multilateral agencies (IMF, WB, BIS, OECD);9 (ii) policy formulation groups (G7/G8, G10, G20);10 and (iii) international regulatory and standard-setting authorities and arrangements (IFAs) (Basel Committee, IAIS, IOSCO, IASC, JF, FSF).11 In addition, in various and increasing ways, NIFA has brought the private financial industry sectors into the equation.12 As such, NIFA might be viewed as an evolving policy construct moving towards a new governance structure which reflects a public-private partnership among governments, financial sector authorities, international financial institutions, and private international financial institutions in the search of a stable, 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 rather than on broadening such markets in terms of greater financial inclusion or serving the socioeconomic development needs of the majority of the population of developing countries.13

At its 1994 Naples Summit, the G7 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 began 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;

12. Virtually all of the international bodies involved directly or indirectly included the financial industry sectors (as they are direct subjects of such standards) in their devising, revising, and implementing of international financial sector standards.
An integral element of all this would be a significant law-based dimension evolving around global principles and standards setting (codes) as to the following:

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

Though the G7 singled out treatment of emerging economies as to financial sector reforms, the bottom line appears to be that these economies needed to adopt and implement the unfolding "international standards and best practices," with the IFIs playing a major role (directly and indirectly) in the implementation, transmission, and related technical assistance processes. Otherwise, the focus of the G8 heads of state and finance ministers at Birmingham, Cologne, and Okinawa as to developing countries was mainly on debt alleviation for the poorest of the developing countries and on integration of 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 that a strengthened international financial system will foster such global growth.

From 2000 to the present, the G8 appears to have been consumed with a proliferation of international political and security crises. As to financial sector reform, the use of Financial Sector Assessment Programs and greater IFI cooperation is encouraged, and there is increased concern as to financial crimes, corruption, and fighting terrorism financing. Debt relief for the poorest countries gained traction with the 2005 Gleneagles Summit.

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16. See infra notes 20-22 and accompanying text.
17. 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, available at http://www.fsforum.org/compendium/about.html.
19. Id.
This author suggests that 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 Crisis Avoidance and Resolution;
- Financial Stability;
- Financial Services Liberalization; and
- Regional and Global Cooperation.

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

- Anti-Money Laundering (drug dealing and other criminal activities);
- Combating Terrorism Financing;
- Anti-Corruption;
- Corporate Governance of Financial Institutions;
- Transparency and Accountability; and
- Greater Availability of Information and Enhanced Disclosure.\(^\text{22}\)

While one can reasonably and in good faith rationalize 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 industrialized country interests, and that in many of these instances the interconnection with substantive development goals of poverty reduction is indirect and sometimes tenuous at best.\(^\text{23}\)

That said, the bottom line is that the role of the IFIs in the area of financial sector reform over the past decade has been mandated largely by the G7/G8 global policy determinations and directives.

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

As alluded to above, the G7/G8 directed a number of international organizations to develop and implement international prudential standards ("codes") in order to encourage and improve confidence in and viability of domestic financial systems. Such standards were aimed at promoting sound financial institutions, minimizing systemic risk, and encouraging savings and investment activity through increased confidence in financial markets, both domestically and


23. For example, having "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 be structured to serve optimum country-specific socioeconomic development needs. Also, while of key concern to the U.S. and other highly industrialized countries' 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 any real development benefits that would justify the cost and effort.
internationally. It must be noted at the outset, however, that these international principles and standards were to be just that: minimum internationally accepted guidelines that leave latitude in their implementation.\textsuperscript{24}

The G7 Finance Ministers were impressed with the prior work of the Basel Committee and IOSCO on developing “international standards for prudential supervision” of banks, securities firms, and markets, as well as payment and settlement systems. In particular, the Ministers approved joint Basel Committee/IOSCO work on market risk and capital adequacy, as well as derivatives and futures exchanges—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 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.\textsuperscript{25}

Quite clearly, the development of international banking standards by the Basel Committee long predates the emergence of the NIFA. In fact, in 1974 the Ministers of Finance and Central Bank Governors of the “Group of 10”\textsuperscript{26} became concerned with possible development of international bank supervisory standards in response to the interrelated insolvencies of two small international banks (the German Bankhaus Herstatt and the American Franklin National Bank) that had resulted from excessive exchange rate risks and the lack of coordinated supervision by the concerned regulatory authorities to address this problem. Therefore, in 1975, they established what is now the Basel Committee.\textsuperscript{27} Regarding this incident, the governors of the Central Bank were not concerned about any specific systemic crisis. However, it dawned on them that there was no established mechanism for coordinating cross-border supervision of banking institutions that faced increased international risks in the new 1970s era of global floating exchange rates.\textsuperscript{28} In addition, the governor of the Bank of England 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 were to consider 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.\textsuperscript{29}

During the 1980s, the Basel Committee produced 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.\textsuperscript{30} This framework was revised on several occasions during the remainder of the 1980s and the 1990s, largely as a reaction to specific bank failures exposing the framework's inadequacies.\textsuperscript{31} Also, during the mid-1990s, it became apparent that the "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 and financial "conglomerates." Thus, a supervisory framework for dealing with these conglomerates also was developed.\textsuperscript{32} This, in turn, led to a consideration of the issue of the "lead regulator" as to such conglomerates.\textsuperscript{33}

The most significant efforts of the Committee from the 1980s to 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.\textsuperscript{34} 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 and then-developing world.\textsuperscript{35} Prior to this Accord, the capital approach taken by most bank regulators/supervisors was a basic initial capitalization requirement and then an ongoing requirement of some form of fixed capital-based ratio (e.g., capital to assets).\textsuperscript{36} 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 the Committee's current proposal, the Basel II Accord.\textsuperscript{37}

In a sense, the 1988 Capital Accord opened Pandora's box as to the future formulation of international bank standards. Once a risk-based approach became the guiding measure, it became logical for the Basel Committee to delve into a range of other risks, such as exchange rates, interest rates, and other market-based and

\begin{itemize}
  \item 29. See W.P. Cooke in Basle Supervisors Committee (June 21, 1984) (providing discussion of role of Committee in document for external distribution).
  \item 31. See, e.g., DOUGLAS ARNER, FINANCIAL STABILITY, ECONOMIC GROWTH AND THE ROLE OF LAW (forthcoming 2007).
  \item 36. See, e.g., JOSEPH JUDE NORTON & SHERRY CASTLE WHITLEY, BANKING LAW MANUAL, ch. 3 (1995).
\end{itemize}
operational risks. These activities resulted in a series of other detailed Committee pronouncements. Beginning in the late 1980s and continuing on to today, the Committee became concerned with money laundering and related counterterrorism regulatory standards. Then, in the late 1990s, the Committee began to address the issues of institutional governance more formally as to banking institutions.

Under the NIFA context, international standards and codes have evolved, increasing as to subject-matter and continuing to be refined on the basis of global and industrial country experiences and expectations. In this sense, they represent the model components for a country's "modern" financial system, and they may be utilized for multiple purposes. For example, an individual country may use international standards to reform its domestic financial system. These codes and standards may also comprise a part of IMF and Bank "conditionality" programs. Additionally, they might be employed by an IFI in fulfilling requests for technical assistance packages. Or, they might be used by the IMF in its ROSC-macroeconomic surveillance efforts, or, more flexibly, by the Bank to assess domestic financial infrastructures for development projects. No matter what the application, on-the-ground reform work over the past two decades has shown repeatedly that the introduction of standards and codes is a top-down model, that each country's situation is sui generis, and that these standards and codes have not been designed as developmental access instruments.

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

Inherently, the IFIs/RFIs represent an enormous repository of accumulated knowledge of policies, theories, issues, and practices concerning the Developing World. They are in a real sense socioeconomic 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 developing client countries. This is often easier said than done for a variety of overriding practical reasons. For example, these RFI/IFIs tend to be complex bureaucracies, with enormous internal and external competition over their limited human and financial resources. These institutional demands have expanded exponentially over the past several decades, covering not simply traditional macroeconomic development concerns, but also a broad range of microeconomic 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 are only one of many pressing demands upon IFI/RFI resources.

41. See generally NORTON, supra note 7.
Coherent and forward-looking institutional priority-setting by the IFI/RFIs is difficult, time-consuming, and often contentious. These various institutions may have differing mandates and approaches to these mandates. Historically, collaboration among these institutions has been marginal at best. In addition, as discussed above, the IFI/RFI general focus on financial sector reform and specific focus on the legal-institutional aspect thereof 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. In addressing these financial sector demands, the IFIs/RFIs have largely looked to standards of industrialized countries, engaging in large measure staff and consultants drawn from the industrialized world (people, incidentally, having significant financial sector experience in their country, 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 and financial sector legal reform in developing countries: the inclusion of the 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. This will allow them to be of greater assistance to their Developing Country members in developing and coordinating meaningful policies, institutions, and legal infrastructure with a view to building 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." This Report, the work-product of the Bank's staff, considers equity in terms of "two basic principles": equal opportunity and avoidance of income deprivation. 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 sociocultural domains, but 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 approach matters of legal and justice reform, including how to move the LVP forward to the next generation of financial sector legal reform. 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.

For illustrative purposes, Part III highlights two other significant developments at the World Bank with respect to financial sector access issues. First, the Bank recently commissioned a series of reports concerning access to financial services in

43. Id.
44. Id.
45. This conference was held on Dec. 1-2, 2005 at the IFC in Washington, DC.
Latin America. Hopefully, these and other country reports from the Bank will provide a good comparative 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 that the Bank, with the IMF, is beginning to make of its FSAPs and related country Financial Sector Assessments 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 also to hold checking and savings accounts, utilize debit and credit cards, pay for services at a branch or ATM instead of only at a downtown office, and gain access to investment opportunities. These studies all examine the methods of savings and how cultural, environmental, and socioeconomic factors come into play in creating poverty. Government policies, such as excessive reserve requirements, play a large role in reinforcing cycles of poverty. Further, the studies find that access to technology can play a large role in alleviating cycles of poverty by allowing the poor easier access to services. These four studies are the following:

*Poverty Reduction and Growth: Virtuous and Vicious Circles,* which examines the essential question of how cycles of poverty reinforce themselves and what policies can be put into place to break those cycles;

*Access to Financial Services in Brazil,* which examines specific issues in Brazil and highlights their implications to government policy;

*Access to Financial Services in Colombia: The "Unbanked" in Bogotá,* which lie outside the formal economy and why inclusion is necessary to economic development and progress in Colombia and

*Urban Unbanked in Mexico and the United States,* which compares the differences between access to financial services for the poor in both countries.

1. *Virtuous and Vicious Circles.* Written in 2005, this study explores in depth the search for pro-poor growth. It is well known that such 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 vicious circles exist 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, implying that there are reinforcing vicious circles keeping the poor in poverty and from contributing to national growth.52

In light of the study’s findings, the question of 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 that governments and institutions have at their disposal for improving human well-being. These same institutions and governments must also take into account the constraints facing the impoverished to enable the poor to fully participate in any growth, thereby contributing back to the wave of growth. This study describes the process of redressing these constraints and brings to light an under-examined dimension of policy analysis that might be called pro-growth poverty reduction.53

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.54 Poor countries with relative equality, such as Bolivia, Haiti, and Honduras, “have little to distribute [and] need first and foremost high and sustained growth, even at the expense of some increases in inequality.”55 The paper compares this kind of growth to the growth recently experienced in China.56 In contrast, countries with relatively greater wealth and inequality, including much of Latin America—particularly Argentina, Brazil, Colombia, and Mexico—need both higher growth and significant redistribution to begin the process of reducing poverty.57

The poverty traps described in chapter six of this study apply to both national and regional areas equally.58 Regional traps must take into account that within countries, labor does not move freely. This creates large wage gaps of up to fifty percent from region to region.59

This study shows that the disparity in income inequality between Latin America and contemporary Organisation for Economic Co-operation and Development countries is due in part to “differences in returns to factors of production—the result of the unequal distribution of human and other capital in Latin America.”60 Another reason for this disparity is “the generally unprogressive nature of Latin America’s system of transfers.”61 Countries in Latin America heavily fund both progressive and regressive programs, which offset each other.62 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 fifty years, compared with the OECD member nations’ sharp reductions in inequality during the same period, demonstrates that choices of policies and institutions can lead to major improvements along both dimensions.63

52. See id.
53. See id.
54. Id. at 4.
55. Id.
56. Id.
57. PERRY ET AL., supra note 47, at 4.
58. See generally id. at 103-26.
59. Id. at 138.
60. Id. at 4.
61. Id.
62. Id. at 5.
63. PERRY ET AL., supra note 47, at 4.
For example, increased access to education and infrastructure has encouraged growth, inequality, and poverty reduction; other policies, such as trade opening, have encouraged growth while increasing inequality and 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 while acknowledging the risks and costs involved and providing measures to mitigate their impact. The largest financial system in Latin America is Brazil; "beyond its sheer size, the overall depth of financial intermediation in Brazil, at almost 140% of gross domestic product, is greater than those of its large neighbors in the region such as Mexico and Argentina, despite their higher average per capita income." With numerous banks in decline since the late 1990s, concern about financial exclusion has increased over the last decade despite Brazil's size. An estimated sixty million, or approximately one-third, of Brazil's population have bank accounts.

Brazil's policies, which attempt to provide credit to the poor, have a high cost. These costs 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 Reais. Unfortunately, Brazil's policies themselves may also be ineffective in reaching the poorest and those most in need of financial access.

An example of the cost 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 top two percent of borrowers receive fifty-seven percent of loans in agriculture, whereas the lowest seventy-five percent of borrowers receive only six percent of credit. As illustrated by the analysis of rural finance programs, many such programs fail to reach their intended targets, instead they are captured by a few individuals, 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, the role given to the relatively small number of public institutions charged with delivering these policies must be reduced 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 and that access to financial services translates into progress. The study quotes Ross Levine's statement that "[n]o shortage of evidence exists to suggest that the level of financial

64. Id.
65. Id.
66. KUMAR, supra note 48, at xxviii.
67. Id. at xxi.
68. Id. at xxii.
69. Id. at 280.
70. Id.
71. See generally Solo & Manroth, supra note 49.
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 and what life is like outside the formal financial system. For example, one family who moved to Bogota in the 1950s attempted to build their home through self-help and 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 that was originally intended to be a temporary solution to the banking crisis in Colombia. The tax has now been made a permanent one and has been increased from 0.2% to 0.4%. Financial exclusion in the country has created significant welfare losses, a declining savings rate, and a financial system that caters to the wealthy through monthly fees that equal 5-10% of the minimum wage.

The study explains 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. As a result, they are forced to pay large check cashing fees and 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.

The costs of these factors inhibit 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 and hinders 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. It also examines the efforts that the private sector and government have taken to provide access to these services, both in terms of cost and quality. The different ways in which the unbanked operate in the United States and Mexico provides an instructive contrast, illustrating how policies can be effective and how policies must differ based on cultural differences in saving and investing.

The differing private sector approaches by the U.S. and Mexico illustrate the link between broader coverage of financial services and economic growth. The savings and loan crisis experienced in the U.S. in the 1980s did not cause a major sector collapse because U.S. banks had spread their business over a wider gamut and depended on a variety of population sectors in addition to the wealthy. This can be contrasted with the similar situations experienced in Mexico and 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 U.S. Federal Reserve have favorably compared the profitability of investments under the Community Reinvestment Act credits to commercial investments. These studies have also shown the profitability

72. Id. at 10 (citing Ross Levine, Financial Development and Economic Growth: Views and Agenda, 35 J. ECON. LITERATURE 688 (1997)).
73. Id. at 7.
74. Dr. Mauricio Herra-Baquero, financial and economic development law expert, of the Externado University Law faculty in Bogota has advised the authors of these subsequent events.
of community development financing institutions as favorable to other start-up banks.⁷⁵

The differences between the unbanked in Mexico and the United States are striking. One study showed that in the United States, where there are multiple alternatives, check cashing services can often charge a fee of 2–3%.⁷⁶ In Mexico, where there are few practical alternatives, there are no fees for check cashing services.⁷⁷ 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.

Consider the above studies; the challenges facing the impoverished in obtaining financial assistance are 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 common policies that can be implemented across Latin America which would go a long way to improving the situation 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 G8 Summits, the IFIs received mandates to both internally evaluate the effectiveness of their IFI reform programs, and more broadly to develop assessment mechanisms concerning the condition of the financial sector as a whole with recommendations for reform. Underlying the policy is the thought that identification of financial system strengths and vulnerabilities will help promote financial stability and 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-World Bank Financial Sector Assessment Program (FSAP), beginning with a joint pilot program in 1999.⁷⁸ Based on the initial success of the pilot program, the joint FSAP program was refined and formalized on an ongoing basis, with this initiative being coordinated through an IMF-World Bank Financial Sector Liaison Committee.⁷⁹ As conceived, the FSAP

... is widely recognized 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

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⁷⁶ Caskey et al., supra note 50, at 8, 22.

⁷⁷ Id. at 41.


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.\textsuperscript{80}

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.\textsuperscript{81} This author suggests that these objectives are not necessarily coextensive nor fully compatible. Further, this author would note that in terms of the 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 might 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, FSAP is requested voluntarily by a country and is normally effected over several joint IMF-Bank team missions.\textsuperscript{82} Upon completion, the team prepares an aide-memoir presenting the findings.\textsuperscript{83} 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 for its Executive Board.\textsuperscript{5}

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.\textsuperscript{85} 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 its Country Assistance Strategies.

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

\textsuperscript{80} Id. at 4, para 1.

\textsuperscript{81} G7 Finance Ministers, supra note 18.

\textsuperscript{82} Id. at 25.

\textsuperscript{83} These are not published. Prior to March 2003, FSAP teams prepared more lengthy FSAP reports.

\textsuperscript{84} The author has been advised by a World Bank official experienced with FSAPs that this is the procedure that has been internally developed.

\textsuperscript{85} On the nature and workings of the FSAPs, see generally World Bank/IMF, \textit{FINANCIAL SECTOR ASSESSMENT: A HANDBOOK} (2005).
- "[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[;]
- "[I]mplementation of standards can help countries establish these foundations, in turn contributing to national and global financial stability[;]
- "[P]artnership with the IMF provides the basis for a comprehensive approach and broad-based effort on the implementation of standards."86

However, the FSAP, at least for the Bank, utilizes particular codes and standards selectively and more flexibly (in consultation with the host country), and 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.87 In recent years, the Bank has been attempting to integrate the FSAP, FSA, and ROSC processes into its evolving development agenda.88 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 institutional effort with divergent overall objectives. It 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 looking selectively 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 products on a commercially viable basis,89 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

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87. Id. ch. 5.
88. Id. ch 4.
more recent times. The recently formed Consultative Group for Assisting the Poorest, a consortium of donor countries affiliated with the World Bank, 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 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 Part IV(A)), microfinance institutions started being established in the 1980s with the arrival of non-governmental organizations (NGOs) making loans to poor “microentrepreneurs.” In 1992, the Bolivian NGO, PRODERM, was converted into the first regulated MFI 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 sixty-five percent annual percentage rate when it began operating as a bank in 1992. Today, BancoSol operates in a highly competitive environment and has brought its interest rate down to twenty-two percent. In addition, “leading institutions are increasingly offering a variety of financial services to their clients, including savings 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 is currently occurring (e.g., Mexico and Brazil), in secondary cities and in rural areas. Despite media hype, only a small percentage of SMEs at the moment have access to

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90. For a discussion on microfinancing, see generally the CGAP’s extensive website on the matter, available at http://cgap.org/portal/site/cgap.


92. See bancosol.combo/en/historia.html. In addition, on this site there is a separate link “historiamicro.e.pdf” that contains a detailed discussion of the history of microfinance in Latin America. Though some trace this development to the 1960s creation of ACCION International, then a student-run NGO in the shantytowns of Caracas, Venezuela, the actual practical development really began in the 1980s.


95. Id.
formal financial services in Latin America.\textsuperscript{96} 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.\textsuperscript{97}

The large number of excluded people in Latin America will gain access only if financial services for 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).\textsuperscript{98} Therefore, it will be necessary to coordinate public and private reforms in order to enhance the equality and access to 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."\textsuperscript{99} 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.\textsuperscript{100} Second, to ensure sustainability, it is necessary to have a strong financial infrastructure (the meso level), which includes a complex and varied set of procedures and instruments "consist[ing] 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."\textsuperscript{101} "Accurate, standardized, and comparable information on financial performance is imperative for integrating microfinance into the financial system."\textsuperscript{102} 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 maintaining macroeconomic stability, avoiding interest rate caps, and refraining from distorting the market with unsustainable, subsidized, and high-delinquency loan programs. 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 tax systems do not discriminate against different types of institutions engaged in microfinance."\textsuperscript{103}

\footnotesize{
\begin{itemize}
\item \textsuperscript{98} See HELMS, supra note 94, at 13-14.
\item \textsuperscript{99} Id. at 140.
\item \textsuperscript{100} Id. at 56.
\item \textsuperscript{101} Id. at 140.
\item \textsuperscript{102} Id. at 73.
\item \textsuperscript{103} Id. at 92.
\end{itemize}
}
3. The Regulatory Reform

"[T]he pressure for regulatory reform has been building on several fronts in [Latin America] since 1995."104 Such pressure has led some countries in the region to create new types of financial institutions, precisely for the purpose of enabling nonprofit foundations to transform into financial intermediaries.105

Bolivia, for example, has a special law governing private financial funds or Fondos Financieros Privados (FFPs) that permits NGOs to become specialized financial institutions.106 As of April 2005, the minimum capital for these NGOs required was only $1 million, while the minimum capital required for banks was $3 million.107 Like banks, FFPs are subject to prudential supervision and are monitored by the Banking Superintendency.108 "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."109

There are two situations in which it may be appropriate to create a new type of institution to facilitate the transformation of nonprofit microcredit foundations into licensed and supervised financial intermediaries. First, 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. Second, if the existing institutional form that 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 an unattractive form of institution for those microcredit foundations that want to enter the formal financial system.110

In some Latin America countries, "[t]he bad reputation of finance companies has sometimes been mentioned as a reason to create a new institutional form for non-profit foundations that want to transform into formal financial intermediaries."111

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: flexibility, simplicity, and automaticity—flexibility in interest rates, collateral and internal credit processes; simplicity in client documentation, loan delinquency and recuperation of collateral; and automaticity in portfolio

105. Id.
106. See HELMS, supra note 94, at 88, Box 5.6.
107. Id.
108. Id.
109. Id.
110. See Jansson, supra note 104, at 6.
111. Id. at 6.
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.”

Finally, although the regulatory framework is relevant, it constitutes only 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.” “Ineffective supervision may be worse than none at all, because poor (and other) clients could be lulled into a false sense of security.” “Achieving the proper mix of regulations and supervisory practices that foster competitive and sound microfinance” is the key, and it “will require a sustained commitment on the part of supervisory authorities.”

Developing countries that are pursuing reforms to improve microfinance need to analyze all levels of the financial system, avoid distortion in other areas, and maintain the stability of 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 segments of the population.

B. An Example of Non-Regulatory Public-Private Initiative: The Case of South Africa

South Africa, as a developing country, 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. In the author’s view, 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 $2 per day or less, it is imperative that the major financial institutions help redress the historically weak system of services for lower-income people.

Facing impending regulation (i.e., 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). This negotiated document was adopted by the financial sector in October

112. Id. at 8.
113. Id.
114. Id.
115. See HELMS, supra note 94, at 87.
116. See Jansson, supra note 104, at 8.
2003 and brought into effect on January 1, 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 thirty-eight 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. Mainly the poorest sectors of the population and rural areas 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 pressured 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. The state would take measures to encourage the resumption of payments for goods and services, reinstating the rule of law, whereas the private sector would support the government in its 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. Two major legislative acts, the Home Loan and Mortgage Disclosure Act and the draft Community Reinvestment (Housing) Bill of 2002, were developed by the Government but never actually implemented. This failure to implement legislation further reinforces 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 Sector, primarily the Sector’s “inadequate” response to the increasing demand for access to financial

120. Tito Mboweni, supra note 117.
122. Id.; see also Marcus, supra note 119.
124. Draft Community Reinvestment (Housing) Bill, 20002, Gazette 23423, Notice 747 (May 17, 2002).
services. The expansion of access to financial services is seen as "fundamental to [Black Economic Empowerment] BEE and to the development of the economy as a whole." The broad 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." It is important to understand the two key concepts—"effective access" and "first order financial resources"—used in the Charter. The concept of "effective access" as utilized in the Charter has five dimensions: 1) Financial service infrastructure must be located within 20 kilometers of potential users; 2) The range of products must be sufficiently diverse; 3) The products must be offered non-discriminatory; 4) The products offered must be appropriate and affordably priced; and 5) The products must be structured and described in an way that is easily accessible.

"First-order retail financial services" as defined in the Charter include: 1) Transaction products and services, which serve the function of day-to-day purposes; 2) Savings products and services, which serve the function of providing "a basic and secure means of accumulating funds over time"; 3) Credit for low-income housing; and 4) Insurance products and services, which provide a cushion against defined first order basic risks.

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 impact of [the financial sector's initiatives] on access." This strengthens the notion of a partnership between the sector and the Government.

3. Implementation Mechanisms

An independent council with a broad mandate to oversee the implementation of the Charter is to be established. The Charter Council is required to undertake

125. See Financial Sector Charter, supra note 118.
126. Id. para. 8.1.
127. Id. para. 8.3. LSM 1-5 refers to the Living Standards Measure designed by the South African Advertising Research Foundation; see generally http://www.saarf.co.za.
128. See The Financial Sector Charter, supra note 118, para. 2.22.
129. 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 R$500 per month but below R$7500 per month. Id. paras. 2.27.3, 2.34.3.
130. See id. para. 2.27 (examples of the first order risks mentioned are death and associated funeral costs, household insurance, and health insurance).
131. Id. para. 8.6.
132. Id. para. 15.1.1.
periodic reviews of the implementation of the Charter and is empowered to make decisions regarding the implementation of the Charter in its second term (2009-2014).33 The Charter Council is to be comprised of industry association representatives and other interested parties.34 Government representatives and 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,” suggesting that there was a concern that the independent body might undermine such interests.35

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 exclusive, mode of decision making within the Charter Council. An absolute consensus requirement would imply the possibility of institutional paralysis in circumstances where the Charter Council fails to reach consensus, especially on matters of importance. The Charter states that a dispute breaking mechanism will be agreed upon within the Charter Council, including the possibility of arbitration or mediation.36 This suggests that it might be possible to have definitive outcomes on contentious issues arising out of the deliberations of the Charter Council, lessening the institutional implications of the consensus requirement.

The Charter requires each financial institution to report its progress in implementing the provisions to the Charter Council on an annual basis.37 Financial institutions are required to publish an annual report for general information.38 This annual report is to include an audited scorecard and an account of the progress that the institution has made in discharging the unquantified responsibilities set out in the Charter.39

Although the Charter is non-binding in a hard, formal sense as it sets aspirational goals and standards of conduct, 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. The Charter parties have already begun to implement some of the provisions of the Charter relating 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.40 An important development in this regard was the creation and

133. See id. paras. 15.1.1., 4.3.
135. See The Financial Sector Charter, supra note 118, para. 15.1.1.
136. Id.
137. See id. para. 15.2.1.
138. Id, para 15.2.2.
139. See id. para. 15.2.4.
launch, on October 25, 2004, of the Mzansi Account by the major banks together with Postbank (a government institution). The Mzansi Account is designed specifically to meet the needs of previously ignored communities. The first set of quantitative data on the Mzansi Account suggests that it is a runaway success. According to the data, as of February 2005, over half a million Mzansi 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 collaborate with the Government in implementing the Charter's provisions vindicate 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 financial sector's initiatives in response to the Charter have proven successful thus far 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 and Regional Financial Institutions (RFIs) has historically been a world of economists, a large portion of whom are macroeconomists, while law and lawyers traditionally have played a very minimal role. But, during the 1990s, the IFIs/RFIs came to learn and appreciate the importance of the legal-institutional infrastructure of a country in supporting the domestic financial system by: 1) establishing the requisite institutional and administrative capacities; 2) developing the desired supporting linkages between the public and private sectors; 3) putting in place clear rights, responsibilities, and liabilities of parties in a transaction; 4) maintaining the appropriate incentives and adequate information that espouse market forces; and 5) providing adequate and fair means to enforce legal obligations and claims effectively.

This author recognizes that for over a 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 (e.g., as to the legal aspects focusing on the importance of property and contract rights and remedies, secured transactions, corporate governance, and corporate and bank insolvency; and as to the institutional aspects focusing on modern administrative, enforcement, and judicial bodies). Such legal-institutional and infrastructural

143. Id.
144. Id.
146. In the latter part of the 1990s and currently, the World Bank has been most active in the area of judicial reform.
reforms are indeed a prerequisite to a sound foundation for building a viable financial sector. However, these reforms fail to consider what a country wishes its financial system to embrace, the base of participants to include, or what policies, institutions, and additional legal infrastructure to implement in order to achieve these developmental objectives.

For the legal system to achieve these objectives, key legislation needs to be put into place, i.e., 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/regulations 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. 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.147

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.

The lack of legal remedies in the case of non-compliance can paralyze the market and discourage foreigners from investing in emerging markets. The uncertainty surrounding the outcome of legal procedures and processes also inhibits the robustness of financial markets.148

Other key components for building modern international financial best practices/standards might include the twelve key standards set out by the Financial Stability Forum.149 All these reform components serve to strengthen and deepen the stability base of the preexisting financial sector, which is only representative of the top of the socioeconomic pyramid. However, they are not designed to broaden the financial sector base.

As mentioned above, the G7/8 views the “robustness” of a financial system is 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:


149. See NORTON, supra note 11, ch. 2; but cf., FSF, Compendium of Standards, available at http://www.fsforum.org/compendium/about.html.
[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.150

This would entail improving the infrastructural aspects of the financial system, namely, the legal and judicial framework, accounting and disclosure standards, and 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 on, the IFI resources and personnel at a time when they are being pressured to react to ongoing, immediate financial crises.151 Yet, the deepness of this reform process is not directed toward broadening the reform base to be more inclusive as to access or as to serving true developmental objectives.

What is rightly asserted by Claessens and Perotti now seems self-evident for those who have been involved with financial sector reform: the relationships between inequality and finance seem to be becoming clearer at the beginning of the twenty-first century. Important research conducted so far has suggested that to reduce inequality, financial systems need to be broadened, not just deepened. "Financial reform will only reduce inequality . . . if it improves access to growth opportunities for more individuals. Reforms thus need to broaden, not just deepen financial systems."152 Certainly, in logically and pragmatically following through on Sen's paradigm of "choice (freedom) and development," choice presupposes meaningful and effective "access."153 Access, in turn, presupposes the existence of suitable supporting governmental policies and financial sector infrastructure, which presumes the presence of appropriate, supporting policies, institutions, legal infrastructure, and legal instruments.

However, the need to broaden is not simply about creating greater access to the financial system for the currently disenfranchised population, but should also address 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. The financial system should also be systemically structured in terms of suitable development policy to provide appropriate institutions, laws, and instruments for accommodating the poor, low-income, and 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 to determine what new institutions, laws, regulations, and instruments might be required. To achieve all this in a coherent, sequenced, and long-term sustainable

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 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 socioeconomic development. Nor can such a system provide a broad, stable platform for achieving stability with robust and sustained growth in the financial sector.

As indicated in the first paragraph of this Article, this author originally had intended to address in detail the types of protection banking and financial sector users-consumers in developing countries might require, until it became apparent that the more fundamental need was the creation of a suitable user-consumer base, which is currently lacking in developing countries. Should there also be consumer protection in the financial sector of developing economies? Certainly, the answer must be yes. In creating greater access to the financial sector, consumer protection should be achieved in an equitable manner, and part of this equity needs to be the assurance that both new users-consumers and those not yet included are fairly treated and protected from predatory, overreaching, and abusive practices (formal and informal). The provision of such protection should not be viewed as an afterthought or as a subsequent level of reform, but should be an integral and contemporaneous part of the access-equity financial sector reform agenda.