



Financial Inclusion: Challenges and Opportunities The Case of Lebanon

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I. Introduction

The growing global concern about the importance of promoting financial inclusion has witnessed tremendous interest from global and national policy makers. Despite all the efforts culminating in the establishment by the United Nations of the 2015 Millennium Development Goals (MDGs), followed by the 2030 Sustainable Development Goals (SDGs), around two billion adults still lack access to formal financial servicesⁱ.

Thus, the global community decided to explicitly fight financial exclusion through global initiatives as the Financial Inclusion 2020 (FI2020) and the Addis Ababa Action Agenda (AAAA). Initiated by the Center for Financial Inclusionⁱⁱ in 2013, the FI2020 project aims at mobilizing stakeholders around the world to achieve full financial inclusion using the year 2020 as a focal point for action. The FI2020 project aims at achieving six main goals: (1) clearer agreement among major players about the path to full inclusion, (2) greater unity among policy makers and financial service providers (FSPs), (3) creation of new relationships to promote cooperation in a neutral setting, (4) better understanding of the role of microfinance in financial inclusion, (5) growth of political will to achieve financial inclusion by 2020, and (6) greater emphasis in financial inclusion on quality and the hard-to-serve. The Addis Agenda was adopted by the member states of the United Nations at the Third International Conference on Financing for Development in 2015. The AAAA strongly commits to strengthening financial inclusion and stresses on the importance of designing regulatory and policy frameworks across all financial intermediation that (1) encourage full and equal access to formal financial services for all, (2) promote lending to micro-, small and medium-sized enterprises (MSMEs), (3) increase and diversify lending and financial tools for increased access, and (4) promote capacity building on financial literacy and inclusion. The Addis Agenda also includes commitments aimed at facilitating the flow of international remittances, emphasizing the relationship between remittances and inclusive finance.

The majority of the Arab countries did not commit to these global initiatives, while the Arab region is reported to having the lowest level of financial inclusion in the world (around 14% according to the last survey of 2014ⁱⁱⁱ). Hence the importance of adopting a regional financial inclusion initiative that would focus on addressing the specific challenges of the Arab region while taking into consideration the priorities of each country, and foster coordination and knowledge-sharing between them to capitalize on their opportunities to advance financial inclusion in their respective countries.

This paper discusses the challenges and opportunities to enhance financial inclusion. In the first section, we present the challenges facing financial inclusion. In the second section, we discuss the main financial inclusion priorities of Banque Du Liban (BDL). The third section describes the policies set by BDL to address these priorities, and conclude with a proposed vision vis-à-vis the role of fintech in advancing responsible financial inclusion.

II. Financial Inclusion Challenges

With the rapid growth in the financial industry, the proliferation of financial innovations, extensive population mobility, globalization and advancements in telecommunication, global access to financial services sounds easier. Yet, this evolving financial landscape is accompanied with a widespread transfer of risks to citizens. In fact, the growing global imbalances, the rising income inequality, the contraction of international capital flows and credit rationing post-2008 global financial crisis, the deterioration of confidence in the financial and banking system caused by misconduct scandals of the too-big-to-fail institutions, the de-risking produced by increasing regulatory burdens such as anti-money laundering, counter terrorism financing and tax evasion regulations, the rise of shadow banking, and the increasing complexity of financial products, contribute to expanding financial exclusion.

In addition to these global challenges, financial exclusion is largely due to a two-sided information asymmetry in financial markets. On one side, there is a lack of transparency in the supply of financial products and services abused by financial service providers. On the other side, financial service providers cannot observe real financial needs and qualities of consumers. Following this approach, the major obstacles to financial inclusion can be grouped into two categories: demand factors and supply factors.

Demand factors include financial inclusion barriers related to the demographic, socio-economic, societal, educational, physical and psychological characteristics of the excluded population (see Table 1).

Table 1- Demand factors of financial exclusion

- Limited financial literacy and financial capability of both individuals and MSMEs
- The fear of refusal to access by the FSPs (low self esteem)
- Bad past experience with an FSP
- Concern about costs and the perception of excessive banking fees
- Lack of collateral
- Fear of seizures
- Lack of proof of legal identity
- Lack of general literacy
- Lack of credit or banking history
- Over-indebtedness
- Low, limited or unstable income (poverty)
- Prevalent informal sector
- Disadvantaged social groups and people with restricted mobility
- Located in under-developed, rural or remote areas
- Low levels of consumer awareness on the need to budget
- Lack of planning attitude, especially planning for retirement
- The sense of mistrust in FSPs' motives
- The growing appetite for digital financial services of the young population
- Online mistrust by the old people and the fear of loss of financial control
- Lack of investment literacy and investment culture
- Psychological, religious and cultural barriers

Supply factors relate to obstacles that are not dependent of the customers, rather to the financial service providers and the regulators (see Table2).

Table 2- Supply factors of financial exclusion

- Limited interest from FSPs (low value and high transaction cost)
- Limited understanding of client diversity and excluded client needs
- Inadequate conditions and documentation requirements attached to financial products
- Minimum balance requirements
- Non-convenient timing
- Long processes
- Limited transparency of products' cost structures
- Non-attractiveness of the products or unclear marketing methods
- Non-availability in under-developed, rural and remote areas
- Physical barriers for disabled people
- Restriction of access through the traditional process of risk management
- The absence of a specific risk-based approach and specialized staff to handle the excluded or the under-banked
- Inadequate financial client protection
- Inadequate regulatory framework for microfinance providers
- The lack of developed capital markets and adequate funding for MSMEs
- The lack of segregated data on financial exclusion and monitoring
- The lack of partnerships between financial players: FSPs, businesses, internet service providers, and mobile network operators (inter-operability)

A survey by the Center for Financial Inclusion^{iv} reports that limited financial literacy and inadequate client protection are the top obstacles to financial inclusion in the Arab region. The regional initiative should, therefore, support Arab countries and capitalize on economies of scale and experience in alleviating at least the common difficulties. At the same time, the initiative should push towards fewer disparities within and across the countries, by tailoring the implementation of the joint programs to fit the socio-economic, demographic, legal and institutional specificities of each country.

III. Banque Du Liban's Financial Inclusion Priorities

The portrayed challenges exert a pressure on central banks and other policy makers for setting their priorities in advancing financial inclusion in their countries. BDL's citizen-centered financial inclusion strategy serves four fundamental priorities: good and responsible governance, sustainable development, customer empowerment, and social wealth.

First, the importance of financial inclusion lies in fostering good and responsible governance and financial stability through (1) stimulating responsible demand for formal financial products and services and their effective use by individuals and MSMEs, (2) promoting good governance and transparency in the economic and financial systems, (3) promoting good

practices and trust in the financial consumer protection procedures, and (4) reducing shadow banking.

Second, financial inclusion contributes to sustainable economic development and economic growth through (1) fostering decentralization, (2) reducing unemployment and supporting business activities, (3) improving agricultural, industrial, and technological productivity, (4) promoting equal income creation and distribution among individuals, as well as sectors (namely productive sectors), and regions, (5) improving the balance of payments and reducing public deficit, and (6) reducing brain drain.

Third, financial inclusion contributes to building a generation of economically - and financially - capable citizens through (1) encouraging personal budgeting, spending plans, and good money management habits, (2) growing households savings, (3) safeguarding against over-indebtedness and encouraging responsible lending, (4) helping people to manage risks and absorb financial shocks, (5) promoting retirement planning and the importance of insurance, and (6) enhancing citizens' comprehension of fiscal mechanisms and the importance of sound public finance.

Fourth, financial inclusion promotes economic citizenship and trust in the national economic-financial system, specifically through (1) supporting social entrepreneurship, (2) encouraging impact investing, (3) fostering the development of sound, fair, and transparent financial markets that bring up new resources for local enterprises namely MSMEs, and (4) promoting the culture of contribution and attracting more foreign development investments and investments from the Lebanese diaspora.

IV. Banque Du Liban's Financial Inclusion Strategy

Banque Du Liban has always been proactive in launching initiatives that contribute to achieve its vision of an inclusive responsible and sustainable financial system. Its non-conventional policy tools that combine the prospects of the economy with the needs of the society have proven to be successful in expanding the socio-economic wealth of the Lebanese citizens, increasing employment, advancing entrepreneurship and innovation, stimulating the productive sectors, safeguarding monetary and economic stability and sustaining economic growth. Those include:

1. Supporting the real economy through credit incentives

The Lebanese government and BDL support local private sector projects in the industrial, touristic, agricultural, IT development and handicrafts sectors through interest subsidized loans to finance new projects or the expansion of existing ones. To date, around 19,067 loans were granted totaling USD 7.12 billion. Their distribution by economic sector, in terms of value (and number of loans), is as follows: 58.8% (53.8%) for the industrial sector, 11.4% (28.8%) for the agricultural sector and 29.8% (17.4%) for the touristic sector.

BDL introduced new credit incentives in 2009 for Lebanese banks to finance new projects or expand existing ones in all economic sectors except real estate development. To date, this scheme reached 3,094 beneficiaries with USD 1.7 billion in loans.

In 2013, BDL introduced a new stimulus package in the form of soft loans extended to Lebanese banks in order to boost lending activity and fuel economic growth. Through this package that has been renewed on an annual basis since 2013 and has amounted to more than USD 5.8 billion to date, BDL has been supporting the various economic sectors through subsidized credit. These credit incentives support fostering traditional sectors through productive loans; development of human capital and entrepreneurship through education, research and development and knowledge and innovation loans; reinforcement of the middle class through housing loans; and preservation of the environment through renewable energy and other green incentives. The package proved to be successful contributing around in 50 percent of real GDP growth.

The stimulus package encompasses subsidized microcredits, which are subsidized loans granted through micro-credit institutions to individuals and micro-enterprises employing four people or less, in order to help them start or develop their business in industrial, service, touristic or commercial sectors. To date (2013-2017), around USD 60 million micro-credit loans were granted to 4,134 beneficiaries.

These incentives, together with the exemption of banks from reserve requirements and government loan subsidies, have led to the injection of almost USD 14 billion over the last five years to support economic activity.

2. Enabling new sources of funding from capital markets

BDL issued intermediate circular no.331 in 2013 on equity financing to boost knowledge economy and SMEs financing, which allows banks to benefit from interest-free facilities granted for their participation in the capital of startup companies, incubators and accelerators, and venture capital companies. So far, this initiative enabled Lebanese banks to invest around USD 400 million in the equity capital of firms working in the knowledge economy. To date, the Lebanese knowledge economy has attracted 800 startups, created 8,000 jobs, and increased national wealth by around USD 1.5 billion. BDL expects this sector to grow by around 7-9% per year for the coming three years.

In 2013, the Capital Markets Authority has set the framework and rules if the work and establishment of crowdfunding companies in Lebanon. Crowdfunding consists of startup companies and MSMEs raising small amounts of capital from a large number of investors to finance, usually through the Internet. Two companies currently operate under this regulation in Lebanon.

3. Reinforcing financial consumer protection and confidence

BDL issued several regulations aiming at protecting both the consumers and the FSPs, where the latter were required to avoid excessive leveraging, to maintain high liquidity levels, to build adequate provisions against doubtful operations and abide by international standards on risk management, transparency and capitalization requirements.

In 2013, BDL issued intermediate circular no.325 to regulate electronic banking and financial operations.

In 2013, the Banking control commission of Lebanon established the Consumer Protection Unit.

In 2015, BDL issued basic circular no.134 setting the principles of carrying out banking and financial operations with clients.

In 2017, BDL issued an intermediate circular (no.458) on easing banking operations for customers with special needs and those with visual impairment in particular through the use of Interactive Teller Machines (ITMs) and talking Automated Teller Machines (ATMs).

4. Enhancing the financial capabilities of citizens, educators and FSPs staff

BDL is committed to raise awareness among the young population on the role and functioning of the financial and banking sectors through hosting summer internships for university students. Over the last three years, an average of 800 students was trained every year. The total number of students hosted at BDL head office and its regional branches reached more than 9,000 over the period 2011-2017.

In 2014, BDL established the Money Museum accessible to all, where it regularly receives school students to learn about the history of the Lebanese Lira using games and interactive learning tools.

BDL partnered between 2010 and 2015 with the ministries of finance and education to build capacity of 400 economics and civic education teachers in public schools on economics and financial topics reaching more than 144,000 students all over Lebanon.

In 2014, BDL issued basic circular no.103 that specifies the scientific, technical and ethical qualifications required for performing key managerial and compliance-related functions in the banking and financial sectors.

BDL publishes user-friendly pamphlets and guides dedicated to the general public with the aim of facilitating their understanding of the mission of BDL and its main regulations.

V. Banque Du Liban's Financial Inclusion Strategy

Banque Du Liban's strategy aims at promoting affordable, timely, and adequate access to regulated financial products and services, and broadening their responsible use by all segments of the population through the implementation of existing and innovative policies and actions. This strategy will advance socio-economic and financial well-being for citizens, as individuals and MSMEs, stimulate sustainable development, support economic growth, and foster financial stability.

BDL's financial inclusion strategy will build on and extend the existing opportunities to attain new goals – the BDL's Financial Inclusion Goals (FIGs, see Table 3) through the implementation of forward-looking sustainable solutions.

Table 3- BDL's Financial Inclusion Goals (FIGs)

1. Greater citizens' understanding of the national monetary policy and the economic-financial system and their related risks and challenges.
2. Better understanding, healthier choice and use of formal financial products and services by individuals, better segment-tailored supply from banks, and innovative financial products and channels, coupled with improved financial consumer protection practices.
3. Improved budgeting habits, long-term saving, retirement planning, and money management skills for individuals.
4. Enhanced capacity of banks and other regulated financial institutions to develop products and channels to finance MSMEs, and improved business and technical skills of MSMEs in all market sectors.
5. Fostered responsible investment attitude and promoted impact investing, coupled with developed financial markets and empowered investment capabilities of both MSMEs and investors.

In addition to its efforts aiming at securing efficient payment systems, automatizing credit reporting system and encouraging banks to spread outside the big cities, BDL is planning a three-dimensional action:

(i) **Financial regulation** through modernizing the financial infrastructure and financial markets and introducing new evidence-based policies and reforms in favor of easier access, simplified use and more compatible supply of formal financial products and services – including digital financial services for all;

(ii) **Financial education** through establishing educational programs tailored to the needs of the various social segments of society, as well as, awareness raising sessions for specific target audiences at critical life stages, such as the youth and the old people. In order to further enhance individuals' and MSMEs' financial capabilities, BDL is developing an interactive digital financial inclusion platform, featuring pedagogical materials, interactive edutainment tools, and financial and money management kits, that will serve enacting effective communication and exchanging best practices and data between stakeholders;

(iii) **Financial consumer protection** through improving existing procedures and practices at the FSP level, as well as more adequate guidance for the consumers of financial products and services.

Achieving BDL's FIGs would contribute to addressing the previously portrayed challenges on both the demand and the supply sides, and attaining the preset fundamental priorities. Maintaining an effective monitoring and evaluation system, nurturing productive coordination between players at national, regional and international level, and prioritizing the solutions among the key target audiences are the fundamental catalysts of any financial inclusion strategy.

a. Monitoring and evaluation

BDL's financial inclusion strategy has set a list of key performance indicators to measure and monitor progress in extending financial inclusion in Lebanon to both individuals and MSMEs. They capture the degree of (1) access to formal financial services, (2) use and (3) quality of formal financial services including digital services, as well as (4) understanding of financial concepts, financial risks, financial products and services needed to make informed and responsible financial decisions. The collection of disaggregated data of these indicators is crucial and requires the establishment of a new reporting framework between BDL, the FSPs, and the payment network operators that takes into consideration the various clusters. In terms of financial capabilities' evaluation and monitoring, segment- and country-level surveys will be carried out on a regular basis in coordination with stakeholders from the public sector, private sector and civic society. Collecting a robust financial inclusion database will not only enable evaluation of implemented activities and monitoring of financial inclusion in the country, but also and foremost, support effective evidence-based policy-making.

b. Key enablers

The implementation and the delivery of BDL's financial inclusion strategy require the coordination of a number of government agencies not only financial regulators (including Central Bank, Capital Markets Authority and Banking Control Commission) but also ministries (including Ministry of Finance, Ministry of Education and Higher Education, Ministry of Economy and Trade, Ministry of Interior, Ministry of Telecommunications, Ministry of Social Affairs and Ministry of Foreign Affairs and Emigrants), the private sector (including fintech companies, information and communication technology firms and mobile network operators), as well as, not-for profit organizations and international and regional financial inclusion players.

c. Beneficiaries

BDL's strategy is expected to target all segments of the Lebanese population. The FIGs will benefit to the following key consumer categories: the poor, people living in rural and remote areas, the youth, the elderly, women, persons with special needs, migrants (source of remittances outflows), the Lebanese diaspora (source of remittances inflows), investors, entrepreneurs and MSMEs in the productive sectors.

VI. Conclusion

Globally, financial inclusion has attained a laudable progress in terms of formal bank account ownership (a global average of 62% according to the last survey of 2014^v). The deployment of technology has succeeded to accelerate the penetration of financial services in many parts of the world, namely in Africa and Asia.

Financial technology (fintech) refers to start-ups, technology companies, or even legacy providers that aim at providing financial services by making use of software and modern technology. These services encompass payments,

transfers, banking, lending, insurance, credit, funding, capital markets, financial data analytics, and personal finance management^{vi}.

Fintech brings about three main opportunities to financial services: (1) consumer experience (customer-centered services, increased access to financial services, clearer disclosure, greater transparency, enhanced understanding, and faster services); (2) efficiency (better products, more choices and lower prices); and (3) opportunity for partnerships with established banks. However, fintech involves various risks ranging from transaction risk, credit risk, liquidity risk, operational risk, compliance risk, data risk, and other unknown risks.

National and regional policy makers should balance the potential of technological innovation and its risks in a sense that it would facilitate innovation provided it has the potential to yield public benefit. In other words, new digital instruments and services should address the needs of consumers and investors, support productivity gains and make our economy more competitive. At the same time, policy makers and regulators should ensure that all inherent risks are thoroughly understood and managed, namely the risk in terms of security, swiftness and financial sustainability. The best way to start, under the umbrella of the regional financial inclusion initiative, is to vigorously engage in an active dialogue about the potential uses of financial technologies and their evolution, and be willing and technically ready to make the necessary regulatory adjustments if the potential benefits of these technologies are found to be impactful on the society and the economy, and their conformity and security attested.

Thank you.

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