



**Latin American Shadow Financial Regulatory Committee
Comité Latino Americano de Asuntos Financieros
Comitê Latino Americano de Assuntos Financeiros**

Statement No. 15

Enhancing Access to Financial Services in Latin America

I. The Problem

Widespread concern exists in the region about the lack of access to services provided by the formal financial sector. This is typically the case for low income and rural population groups, small- and medium-sized enterprises (SMEs) and the informal sector.

The limited access to financial services is associated with specific conditions prominent in most Latin American countries: (a) low-density rural population, which makes it costly to provide formal financial services; (b) the history of macroeconomic instability and high volatility, which reduces confidence in the financial sector; and (c) high poverty levels and extremely uneven income distribution, which preclude significant segments of the population from qualifying as clients of the formal financial system.

The issue of access to financial services has come to the forefront recently as a public policy problem because a positive correlation appears to exist between increased access to financial services and social inclusion. The consolidation of democratic regimes throughout the region since the early nineties has implied that sectors traditionally excluded from the benefits of modernization are demanding access to them. They include the provision of financial services, e.g., checking and savings accounts, credit cards, debit cards, ATM services and credit.

The resulting challenge is not a minor one since there is a lack of accumulated knowledge and experience regarding how to increase access in an environment where the private sector largely accounts for the provision of financial services. A positive development helping to meet this challenge is the rapid pace of technological progress (especially cell phones, the internet, satellites, television, ATM machines,

intelligent cards, etc.). The adoption of new technologies reduces the cost of providing access to financial services, especially those related to transactions and payments.

Adding to the challenge, a well behaved and sound financial system requires a delicate balance between fostering competition in a changing environment, on the one hand, and regulation and supervision, on the other. Similarly, special care needs to be taken to avoid undue government pressures on the banking system to engage in unprofitable activities in order to improve access.

In this statement, the Latin American Shadow Financial Regulatory Committee (LASFRC) presents recommendations on initiatives to overcome constraints and expand access to financial services.¹ The guiding principles of our recommendations are to deepen, broaden, improve, and create banking services in an environment of macroeconomic stability, sound regulation and effective competition. Therefore, the following recommendations will be approached in terms of their impact on supply and demand for financial services as well as on the need of improving the institutional environment of the financial system.

II. Recommendations and Current Initiatives

In line with our above discussion, initiatives to improve access to financial services can be classified into three main categories: 1) those that create markets, in the sense that they contribute to coordination and interaction between a large number of agents; 2) those that facilitate the expansion of profitable financial activities, removing potential impediments and barriers; and 3) those that contribute to the expansion of the demand for financial services by broader segments of the population.

Market-creating initiatives

Macroeconomic stability and low inflation are key pre-requisites to enhance access and promote financial deepening. Together with adequate prudential regulation and supervision, they constitute the foundation of a credible and sound banking system. In this respect, while countries in the region have made significant advances in consolidating their macro-policy framework and reducing volatility, these achievements must be consolidated. In Chile, for instance, since 2001 fiscal policy has been designed and implemented in a countercyclical fashion. *The Committee believes that reducing macro volatility is a major element in producing confidence in*

¹ This statement focuses on the banking sector and related financial intermediation activities, such as services provided by mutual and finance companies and savings and loan cooperatives. Such entities are relevant to the persons and firms for which access appears to be most restricted. It is, however, recognized that the problem of limited access applies to a larger universe of financial services, such as those provided by insurance companies and pension funds.

the banking system and reducing interest rates, thereby expanding the market for financial services.

Once macroeconomic stability is achieved, governments can successfully engage in market-creating activities when market failures or distortions hinder private sector progress in such a role. However, identifying true externalities and other forms of market failures is not an easy task. Often lack of financial development is caused by structural factors or distortionary regulation. Notwithstanding these caveats, the Committee acknowledges a number of successful efforts in market creation initiatives aimed at enhancing credit availability for SMEs, such as, for example, those provided by Nacional Financiera (NAFIN) and Fideicomisos Instituidos en Relación con la Agricultura (FIRA) in Mexico. *The Committee believes that such initiatives may be successfully replicated in other countries in the region.*²

Market creation and development require improving the legal infrastructure to support credit contracts and their enforcement. *The Committee believes that initiatives such as the modernization of registries and strengthening of property rights facilitate, inter alia, the use of collateral, which is important for improving access to credit. Moreover, modernization of judicial procedures, such as improving expediency, transparency and accountability, are essential to ensure proper contract enforcement.*

In addition, enhancing the quality, coverage and dissemination of information by credit bureaus improves risk evaluation by banks and allows better access to credit. However, small borrowers may be reluctant to disclose information for tax compliance reasons. In this context, *the Committee believes that it may be useful to adopt simplified tax regimes for small productive units to encourage them to participate in credit bureaus.*

One of the areas where there has been a fair amount of discussion in the region has been that of supervision and regulation of public banks. *The Committee believes that there should be equal regulatory and supervisory treatment of private and public banks. If public banks perform a social function to broaden access to financial services and subsidies are required, they should be accounted for in the public budget and not through preferential regulatory/supervisory treatment.*

However, in the case of microfinance institutions there is a rationale for special regulation. Experience with microfinance institutions shows that default rates are extremely low while costs of generating and monitoring loans are extremely high. In this regard, *the Committee endorses the recommendations of the Consultative Group to Assist the Poor (CGAP) on regulation and supervision on loan loss provisions, minimum capital requirements and interest rate ceilings.*

Initiatives to expand supply and demand of financial activities

² NAFIN has created an on-line market for factoring services. FIRA promotes structured finance transactions.

A number of initiatives in several Latin American countries focus on facilitating the expansion of the supply of new profitable financial activities. This largely reflects the beneficial effects of technical progress which is constantly reducing costs of providing financial services. For instance, the development of networks of non-bank correspondents in regions without access to banking services in Brazil constitutes an example that is currently being replicated in other countries in the region. In Chile and Mexico initiatives focus on increasing Points of Sale (POS) terminals with low or zero cost for SMEs.

The Committee believes in adapting regulations to facilitate the use of new technologies and techniques to allow for the expansion of financial services and to reach the un-served population. In particular, the Committee encourages the adoption of a proper regulatory framework to allow a safe expansion of internet banking.

In several countries in Latin America interest rate ceilings discriminate against small borrowers who usually have a higher risk profile and/or higher loan costs than others. *The Committee believes that if interest rate ceilings cannot be eliminated they should differentiate among products, so as to recognize the different risks involved.*

The demand for financial services responds to structural characteristics which are not easy to modify in the short run. Therefore this is an area where focused public-policy actions are likely to have a limited impact.

However, the Committee believes that selective actions should be taken to improve demand for financial services by un-served agents.

For example, Chile has made significant progress at enhancing transparency and promoting the adoption of standardized presentation of accounting information by SMEs that reduce banks' operating costs and facilitate credit risk evaluation. In some countries, financial intermediaries are required to disseminate information to allow clients to understand fully the components of costs. In Peru, the first steps have been taken to introduce financial education in the school curricula.

Although the Committee acknowledges that financial transactions taxes are a significant source of revenues, there is growing evidence that these taxes are regressive and hamper financial intermediation. *The Committee recommends the gradual elimination of financial transaction taxes, to be replaced with other, less distortionary sources of revenue.* If removing financial transactions taxes is not a feasible option for policy-makers, other options could be considered including: (a) counting financial transactions tax payments as credit towards income tax; and (b) eliminating the tax on renegotiations of existing credit contracts to avoid double taxation.

III. Concluding Remark

In this statement we have discussed a number of initiatives and recommendations to broaden access to financial services. However, it should not be overlooked that these initiatives are no substitute to dealing with deep structural impediments to financial access, such as high income-inequality and poverty rates and social exclusion. Without dealing directly with these deeply rooted problems, the Committee remains skeptical that the recommendations included in our statement can go a long way in expanding significantly financial access.

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