

How to Contribute to Financial Inclusion?

Inventory of Products and Services
Available in the Region

2012



ASOCIACIÓN DE SUPERVISORES
BANCARIOS DE LAS AMÉRICAS



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To request a printed copy, contact:
asba@asba-supervisión.org

C. Picacho Ajusco # 238, Oficina 601
Col. Jardines en la Montaña, C.P. 14210,
México, D.F.
Tels. (52-55) 5662-0085, Fax (52-55) 2615-5603

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EXECUTIVE SUMMARY

This paper seeks to identify and characterize financial products and services offered in Latin America and the Caribbean that support the inclusion of segments of the population that are not served by the regulated financial sector.

A central element of the analysis was to define financial inclusion based on a clear difference between access and use of financial services and products. While access refers only to geographic and demographic coverage, use focuses on the possibility of actual use of financial services and products according to the specific needs of the population to be included. Therefore, for financial services and products to be inclusive, they must not only be accessible, but also usable.

For the purpose of this paper, financial inclusion shall be understood as “access and use of quality financial products and/or services by the population not yet served, provided under an appropriate regulatory framework that contributes to improve this population’s living conditions.”

Main Findings

The degrees of financial inclusion differ – considerably – among the Region’s countries, although there is a series of obstacles that appear as common denominators:

- Social, macroeconomic, and infrastructure obstacles.
- Institutional weaknesses that translate into lack of legal certainty and deficiencies in laws that relate to the provision of financial services.
- Obstacles from banking activities, such as high requirements for individuals in need and deficiencies in the tools for assessing risk.
- Regulatory distortions, such as taxes on financial transactions, setting caps on

interest rates, and policies that allocate a percentage of the portfolio, at subsidized prices, to sectors and activities that governments want to encourage.

The analysis also reveals that slow technology development is another key element in some of the Region’s countries.

The Association of Supervisors of Banks of the Americas (ASBA) implemented a survey among its associate members, so that the main regulatory body in each country would provide information about the financial system and regulated institutions in their jurisdiction. Information from this survey reveals that¹ among the main obstacles in increasing the level of financial inclusion is the distance that inhabitants must travel to reach a bank branch or agency, especially in suburban and rural areas.

In this view, models such as non-banking correspondents – that substantially increased the access levels to financial services and products in Brazil – have proven effective in including previously unattended populations. Furthermore, the low level of technological development in some countries has delayed the use of this model, as well as other service delivery channels that are very efficient in low-income areas and areas with low population density, such as electronic banking.

Risk Matrixes, Policies, and Regulation

Having identified the products and services prone to broaden financial inclusion, this paper submits individual risk and impact matrixes for each product and service. The emphasis is on credit, market, operational, and reputational risks. The risk matrixes’ objective is to determine the level of risk that financial institutions could be

¹ Countries that participated in the aforementioned survey were Bolivia, Brazil, Chile, Colombia, Ecuador, El Salvador, Guatemala, Honduras, Panama, Paraguay, Peru, Dominican Republic, and Uruguay.

exposed to when offering services and products to population segments that have not had access to these products before.

In addition, the paper includes a chapter describing policies that foster financial inclusion. While regulatory standards were strengthened in recent years, there are still a series of regulatory distortions that continue to hold back financial inclusion. In view of this, a set of recommendations is proposed that might allow policies that foster financial inclusion to become more effective. This paper also presents a set of successful products, services, and channels, which could be reproduced in the Region.

In summary, while the degrees of inclusion have risen in Latin America in recent years, there is still a long way to go forward in the use of financial services and products. In this regard, the main challenge is identifying the products, services, and channels that make the largest contribution to financial inclusion and the risks institutions face.

Access and Use

There is an extensive debate on the scope of financial inclusion, mainly related to the idea of access and use of financial services. ASBA supports the idea that in order for financial services to be inclusive, they not only have to be accessible but also low-income individuals must be able to use them.

This paper aimed to show the various levels of access and use. Unfortunately, it is difficult, and at times impossible, to find demand-side information - in other words, information on the number of individuals, households, and companies that have savings, loans, make payments, and use other

financial services provided by formal and informal suppliers. Therefore, the analyses about the use of financial services are based on supply-side information. These analyses consist on evaluating the number of deposit accounts and the number of loans, information gathered by financial regulators.

While the ideal way to obtain this information is by means of surveys applied to users of financial services, this process is expensive and requires a long time. Given the lack of this type of information, the analyses used statistics from the following financial service suppliers: branches, agencies, automated teller machines (ATMs), and agents or non-banking correspondents.²

An initial approach to the standing of both variables –access and use– can be found on the tables displayed on these pages.

In order to show the evolution of “access” and “use” penetration in Latin American and the Caribbean, the data compiled by the survey implemented by ASBA was compared with the survey applied by FELABAN, conducted by Liliana Rojas-Suarez and called “Fostering Access to Financial Services”³. The first table shows the growth of branches and smart Automated Teller Machines (ATMs); the second, the relationship between public deposits and credit use.

The distance traveled to reach a branch continues to be an obstacle for financial inclusion in rural and suburban areas. This obstacle decreases in countries where there is an extensive amount of correspondents and ATMs.

The levels of use of financial services and products are still low in a large part of Latin America. As the chart shows a larger percentage of the population uses deposit products more than they use credit products.

2 Given the lack of systematic information throughout the Region, information about the potential coverage of financial services via Internet, telephone and mobile phones, including e-banking, mobile banking, telephone banking, POS or others, is not included.

3 Liliana Rojas-Suárez. Fostering Access to Financial Services. What does information on access to bank services tell us? Analysis based on the FELABAN survey on financial inclusion. Mexico City, 2007.

TABLE 1 | **Indicators of "Access"**
Growth of Branches and ATMs / Data up to 2010

| COUNTRY | BRANCHES* | GROWTH IN %** | ATM* | GROWTH IN %** |
|--------------------|-----------|---------------|------|---------------|
| BOLIVIA | 8.5 | 130% | 11 | 67% |
| BRAZIL | 11.5 | 21% | 18 | -44% |
| CHILE | 14 | 35% | 45 | 44% |
| COLOMBIA | 11.5 | 34% | 21 | 32% |
| ECUADOR | 11.5 | 46% | 23 | 181% |
| EL SALVADOR | 10 | 112% | 20 | 49% |
| GUATEMALA | 17 | 54% | 12 | 32% |
| HONDURAS | 11 | 23% | NA | NA |
| PANAMA | 24 | 49% | 28 | 26% |
| PARAGUAY | 7 | NA | 8 | NA |
| PERU | 10.5 | 118% | 15 | 68% |
| DOMINICAN REPUBLIC | 11 | 44% | 19 | 9% |
| URUGUAY | 25 | 169% | 31 | 166% |

Sources: Data as of 2007 from FELABAN survey on Access to Banking 2007. Data for 2010, ASBA survey for this paper. Rounded figures. *For every 100,000 inhabitants. **Measured in percentage, growth/decrease compares the period 2007-2010.

TABLE 2 | **Indicators of "Use"**

| COUNTRY | LOANS* | DEPOSITS* |
|--------------------|--------|-----------|
| BOLIVIA | 9% | 45% |
| BRAZIL | 22% | 45% |
| CHILE | 28% | 85% |
| COLOMBIA | 35% | 91% |
| ECUADOR | 29% | 72% |
| EL SALVADOR | 27% | 58% |
| GUATEMALA | 18% | 69% |
| HONDURAS | 19% | 47% |
| PANAMA | 40% | 59% |
| PARAGUAY | 12% | 8% |
| PERU | 26% | 46% |
| DOMINICAN REPUBLIC | 22% | 69% |
| URUGUAY | 34% | 42% |

Source: Survey information provided by Regulators, 2010.
*Percentage over total population

Obstacles in Achieving a Higher Financial Inclusion

Many factors hinder the access and use of financial services among the population in need in Latin America and the Caribbean countries. These go from macro elements, such as lack of access to basic social services and weakness in the Judicial Power, to barriers set by financial institutions themselves.

The main obstacles are as follows:

1. Social, macroeconomic, and infrastructure features.
2. Institutional weakness
3. Obstacles arising from banking activities, and
4. Regulatory distortion.

Following is an analysis of each obstacle:

1) Social, Macroeconomic, and Infrastructure Features

There is a direct relationship between quality of life and development of a financial culture in the region's countries. Countries that have fewer social services are the ones that are lagging behind in access and use of financial products and services.

Macroeconomic elements also hinder a better level of financial inclusion. In countries where, for example, volatility in the real interest rate has been historically very high, savers have a low confidence in the banking system. The main reason is that high volatility often has been related to economic policy measures that derived in considerable losses for depositors, such as freezing deposit accounts and converting foreign currency deposits into local currency by using undervalued exchange rates. The acute crisis that Argentina suffered in 2001 and 2002 is a specific ex-

ample of how adopting certain economic measures can damage confidence in the financial system.

Finally, the lack of physical infrastructure in countries with large geographical extension and low population density is also an obstacle to achieving higher financial inclusion. Providing financial services in areas with a low population is not profitable, deterring financial institutions from expanding their network of agencies or branches, specifically in rural areas.

2) Institutional Weaknesses

In a large part of the region, Judicial Power is weak and suffers from a lack of independence from the political power and pressure from powerful economic groups. These elements lead to an environment that lacks legal security. Subjugation of the rights of owners and creditors damages the growth of business and investment, which in itself affects the development of financial institutions, specifically, growth in the credit market.

Among other inefficiencies, the process of executing collateral is still tedious and extensive, which leads to higher expenses for banks in terms of monitoring and surveillance, maintenance expenses, property taxes, energy and water services, devaluation and deterioration of collateral, and in some cases, the expense for evicting tenants. Expenses are also high for borrowers, since they must pay current and delinquent interests, as well as legal expenses that include attorney fees and the salary of expert appraisers; plus the cost of processing the lawsuit, including any judicial fees and expenses for submitting the case.

3) Obstacles Arising from Banking Activities

There is a set of important elements in banking activities that affect financial inclusion, among them are the following:

High Costs and Requirements

Usually, traditional financial products and services offered by the banking industry do not fulfill the needs of low income populations. In other words, traditional products' interest rates and fees are above the affordable threshold for low income clients. Also, financial exclusion is frequent due to lack of identity documents in areas where there is a large population of immigrants or in rural areas with low levels of education.

Deficiencies in Tools for Assessing Risk

According to the results of FELABAN's survey⁴, the use of specialized risk assessment techniques in assessing risks, in micro, small, and medium size enterprises and clients from medium-low income levels, is still very poor. The direct result of this deficiency during the loan granting process is that a large part of these clients are considered high-risk and low-profitability clients; therefore, non-desirable from a financial point of view.

Poor Customer Care

Commercial banks in the region still have the pending task of training and educating their staff in providing services for low-income populations who usually ignore traditional banking conditions and regulations. The lack of trained personnel many times derives in poor people excluding themselves from financial services offered by formal institutions.

An additional obstacle is the small number of bank branches or other means of access to financial services, especially in rural communities.

Low Income

One of the reasons commercial banks use to justify their reluctance to grant credit cards and financing to low-income

sectors is their low income level. Nevertheless, the expansion of IMF's towards consumer loans and credits for micro, small, and medium-size enterprises shows that these arguments are beginning to lose strength.

Income Volatility

In addition to the ups and downs in economic cycles, a risk factor that hinders access to credit from excluded segments is microeconomic volatility among free-lance workers. Many times, an increase in interest rates responds to the institutions' lack of knowledge about the behavior of customers. The solution could be to develop a loan granting technology that allows institutions to measure the volatility in repayments, according to the income inflows for each type of business.

Lack of Formality

While high levels of informality in the region are considerably responsible for restricting access to credit, it is an element that has not hindered the growth of loans granted to small businesses. On the other hand, it has become a distorting element of competition for those companies that must comply with all the requirements of a formal enterprise (tax payments, submitting audited financial statements, among other requirements.)

4) Regulatory Distortion

There are times when regulators also affect financial inclusion processes. The following are some measures and instances that affect the process:

Taxes on Financial Transactions

Taxes imposed on financial transactions applicable to withdrawing funds from current and savings accounts – whether by check, money transfers, automatic tellers, and debit and credit cards – represent an obstacle for financial inclusion. Applying this type of taxes imply an increase in costs for clients and motivates economic agents to create other ways to make payments and obtain resources, or transfer their deposits abroad.

⁴ Rojas-Suárez, work previously quoted.

Controls on Interest Rates

Setting caps on interest rates limits access to credit among low-income population groups by reducing financial institution's growth prospects. This leads institutions toward shrinking their activities in rural areas and in expensive market segments.

Directed Loans

Implementing policies that make it mandatory for financial institutions to allocate a percentage of the portfolio at subsidized prices to sectors and activities that governments want to encourage, increases the prices of other credit mechanisms to compensate for the granted subsidies.

REGULATORY FRAMEWORK

Policies that Support Financial Inclusion

Governments are not solely responsible for designing an appropriate policy framework that encourages access to financial services, but financial institutions offering these services must also play a decisive role.

Here are some recommendations to make policies that support financial inclusion more effective:

Scalable Regulation According to Complexity and Risk

There is agreement among microfinance sector players in Latin America and the Caribbean that regulation has fulfilled the mission of preventing and mitigating risks, providing stability and soundness in times of crisis.

Thus, new regulation implemented after the recent crisis, should be developed to maintain a balance between promoting financial stability, its main objective, and the need for innovation in financial products and services that support financial inclusion.

In this framework, the development of transparent and efficient markets help in lowering transaction costs and facilitate public access to financial services by offering products with features suitable to the needs of these segments: small loan amounts, minimum financial information, no collateral requirements.

Greater Information Transparency

Financial institutions must provide timely, complete, and relevant information to their clients throughout the financial relationship. Information transparency promotes trust and supports financial inclusion. In this sense, establishing a set of guidelines that describe the features of financial products and services, as well as

the information that potential users must submit in order to obtain access to these services are necessary elements to incorporate low-income segments into the financial system. Disclosure of effective interest rates and the ability to compare costs among different suppliers fosters healthy competition.

Consumer Protection and Financial Education

Improving consumer protection and financial education systems are key elements. Consumer protection regulations must clearly establish the client's rights and duties resulting from a contractual relationship with a financial institution. In addition, customers should obtain information regarding procedures to submit complaints.

Another recommendation is to establish financial education programs that allow clients to gain the necessary knowledge to manage their finances responsibly. An initiative observed in the region is the implementation of financial education projects in schools that teach good practices regarding savings and preparing family budgets.

Greater Efficiency in Credit Information Systems

Having efficient credit information systems allow institutions to better manage their risks, avoid problems regarding adverse selection, and decrease credit risk. In this sense, in order to expand access to financial services at a lower cost, credit bureaus managed by supervisory bodies or private parties may be used as tools to assess a potential client's ability to pay and reward good creditors with more favorable interest rates and terms.

These credit bureaus provide updated and historical information on individuals'

amount of debt; payment status; and behavior in the financial system including operations with non-supervised credit institutions, public utility companies, tax issues, and commercial credit.⁵

Paving the Way Towards Technology Innovation

Technology innovation allows the development of new business models and dis-

tribution channels that will eliminate the main barriers to supplying financial services for people in need. Fostering technology development in countries that are lagging behind in this matter would pave the way for models, such as mobile banking or non-banking correspondents, to spread in the Region. These models show considerable advantages in decreasing transaction costs and bring together suppliers and providers of banking services.

5. ASBA. "Guidelines of Principles for Effective Regulation and Supervision of Microfinance Operations." 2010

SUPPLY IDENTIFICATION

Products, Services, and Channels that Support Financial Inclusion

The economic stability recorded in most Latin American and the Caribbean countries in recent years, coupled with stronger regulation, boosted the emergence of new instruments and practices that – without incurring in excessive risk – allow greater inclusion of segments of the population that do not have access to regulated financial services.

For classification purposes, this analysis covers products and services offered by commercial banks, regulated microfinance institutions (MFIs), credit unions, public banks, and financial NGOs. In addition, the identification of financial products and services is not only limited to services that increase access to credit, but also cover those that allow the use of savings accounts, means of payment, and other services aimed at all socio-economic levels.

The following sections describe:

1 Credit technologies and products

- 2 Savings products and means of payment
- 3 Distribution channels

1) Credit Technologies and Products

According to the survey, there is a diversified range of credit technologies and products in Latin America. The main microcredit technologies contributing to financial inclusion are individual microcredit, loans to solidarity groups, and community banking.

Regarding financial institutions that provide these types of products, commercial banks have a wider range of products. However, non-banking financial institutions, among them MFIs, channel the largest volume of resources that benefit low-income sectors. That is especially noticeable in Bolivia, Peru, and Nicaragua⁶ where these institutions are the main suppliers of microcredits.

TABLE 3 | **Credit Supply**
According to the amount of countries analyzed

| Individual microcredit | Housing microcredit | Solidarity Groups | Associative credit | Community Banking | Agricultural microcredit | Consumer microcredit |
|--|---------------------|-------------------|--------------------|-------------------|--------------------------|----------------------|
| COMMERCIAL BANKS | | | | | | |
| 13 | 9 | 3 | 6 | 2 | 7 | 13 |
| SPECIALIZED BANKS IN MICROFINANCE | | | | | | |
| 8 | 7 | 5 | 5 | 2 | 7 | 7 |
| MICROFINANCE INSTITUTIONS | | | | | | |
| 7 | 3 | 5 | 2 | 3 | 6 | 5 |
| SAVINGS AND CREDIT UNIONS | | | | | | |
| 9 | 5 | 1 | 3 | 1 | 5 | 9 |
| GOVERNMENT FINANCING INSTITUTIONS | | | | | | |
| 12 | 8 | 2 | 4 | 3 | 8 | 12 |
| OTHER | | | | | | |
| 9 | 6 | 3 | 2 | 2 | 6 | 9 |

Source: Survey submitted by regulators, 2010.

⁶ Francesco Biciato; Laura Foschi; Elisabetta Bottaro; Filippo Ivardi Ganapini. Microfinanzas en países pequeños de América Latina: Bolivia, Ecuador y El Salvador. CEPA L. Santiago de Chile, 2002.

In a large part of the Region, MFIs and credit unions focus their activities on supplying individual, housing and agricultural microcredits. Meanwhile, commercial banks offer a wide range of products prone to financial inclusion, but these efforts have not been enough to generate higher levels of inclusion in the Region.

Individual Microcredit

This technology covers small loans granted to individuals who own a low-scale business. These loans are mainly paid back with the business owner's proceeds for the sale of goods and services. These loans are granted by using specialized credit methodologies that require intense personal contact, so that among other things, institutions will be able to assess and determine the potential borrower's willingness and ability to pay back the loan.⁷

A key aspect is the speed and timeliness in processing personal microcredits, and the institution that offers these credits must:

- understand the needs of potential clients to develop credit products that meet those needs;
- offer potential clients effective channels to access the products, allowing them to use financial products;
- gain knowledge on the features of the applicant's business in order to better quantify his/her ability to pay;
- develop efficient data gathering and recording information techniques;
- design methods to evaluate a potential borrower's willingness to pay;
- identify and quickly assess the collateral being offered, if that is the case; and
- make an immediate decision in every case about approval or non-approval of the credit.

Customer references are corroborated by the financial institution with information obtained from credit bureaus, suppliers, creditors, and neighbors, among other sources. In general terms, the background record obtained by a client in a solidarity credit program is a good basis to continue

financial support within a personal microcredit program.

Most individual microcredits are based on personal guarantees and/or collateral. The terms of the contract (deadlines, means of payment, and loan amount) are tailored to the client's needs and ability to pay.

Microcredit to Solidarity Groups

This loan technology is based on trust among members of a group of borrowers (5 to 10 members) who commit themselves to respond jointly in case of any member's eventual delinquency. The commitment among members represents the repayment guarantee for the institution. In other words, this commitment becomes an intangible collateral.

Although the loan is granted to the group, the financial institution evaluates each member's ability to pay. Each solidarity group appoints a coordinator and a secretary to receive the loan. They are also responsible for the collection and repayment of the loan. This type of loans has a short turnover –an average of six months.⁸

If the obligation is fulfilled orderly, the group shall have access to future loans. In fact, access to future loans with higher amount is one of the main incentives of this type of loans. The main objective of this process is provide loan support to low scale businesses (usually with needs below US\$1,000), with a high asset turnover and/or sales. In the rural area, this process has been used mainly to fulfill the demand for liquidity in commercial activities and services for low-income individuals.

Community Banking

The community banking technology consists of groups of 10 to 40 individuals who democratically elect a committee in charge of managing the group's activities. This "bank" acts as an intermediary in granting loans to the target population, has solidarity guarantee (joint collateral) and, among other objectives, encourages savings before credit is granted.

The financial institution provides resources under the "bank's" responsibility.

7 Guidelines of Principles for Effective Regulation and Supervision of Microfinance Operations. ASBA 2010.

8 Tatiana Guzmán, el desarrollo de las Microfinanzas en Bolivia, Serie Crédito No. 2 Funda-Pro.

The board is in charge of disbursing and recovering funds, according to the by-laws, internal regulations, and specific demands by each member. Within the “bank,” each member obtains a loan according to a previously established scale.

Usually, the loan amount and the term increase with each new level, that is, once the previous loan is fully repaid. Currently, maximum amounts do not exceed US\$800 per person and the term is no longer than 12 months. All members of the community bank get their respective loan disbursement and make *interest payments and repayments of principal* every week, fortnight, or month.

One of the key features of this credit product is the joint collateral, since it allows individuals to access financial services without having to submit tangible or real collateral. In this lending methodology, “bank” members guarantee each other. This type of collateral represents a double benefit: on one hand, it increases the possibilities of getting access to credit. On the other hand, it provides financial institutions with more discipline regarding rights and obligations. In fact, assessment mechanisms, self-selection, internal control and peer pressure in community banks have contributed to keeping delinquency levels low.

Credit Products

The following include some of the credit products being offered in the region:

Housing Microcredit

Traditionally, financing for housing for low-income individuals has been part of urban development strategies or initiatives for improving slums. However, established MFIs (regulated or not) frequently offer housing microcredits among their loan products.

This tool mainly consists of lending money to low-income individuals to refurbish or expand an existing housing, as well as the installation of basic infrastructure and connections to urban sanitation networks (electric power, sewerage, water, and gas).

One of the main advantages of these microcredits is that they do not require submitting property deeds as collateral. In addition, the terms of the contract (deadlines, means of payment, and amount of the loan) are tailored to the needs and possibilities of the client. Credit periods that go from 18 to 24 months are slightly longer than those for conventional microcredits.

To this date, most of the demand for this credit product has been loans for home improvement and basic sanitation infrastructure. The purchase of land and construction of new homes are still managed by subsidies usually granted by government-owned banks, while other financial institutions have a small participation in loans used for these purposes.

Consumer Credit

A consumer credit is a product offered in the region that is capable of fostering financial inclusion. There is a growing demand for personal credit to improve children’s education and family members’ health. In general, these loans are granted based on the main borrower’s payment capability.

Associative Credit

This type of loans are addressed to associations and credit unions that are usually made up by about 10 low-income individuals, who live in rural areas with low economic level of development, such as peasants, miners, and craftsmen. The association must be kept current during the life of the loan and the members must have the same economic activity.

Associative credit is also based on joint collateral. Members establish a fund and deposit it at a financial institution. Every organization must have a proper credit background to act as intermediaries among its members and the lending institution. Real collateral, such as deeds of rural lands are only required for high loan amounts.

The destination of this type of credit is usually working capital. If the project being financed is feasible, then there will be permanent access to credit service. If not, financial institutions offer technical assistance until the project becomes feasible. Association representatives are often

trained in credit management, project development, investment processes and trading. That training is financed by the organization's members or by donations from international cooperation. Associative credits allow financial institutions to provide wider set of products and, at the same time, decrease operational expenses. Since the evaluation is made on the basis of a project submitted by an organization, the process becomes less expensive than obtaining personal information from each member.

2) Savings Products

Financial inclusion through savings products is low in the region. On one hand, commercial banks that have the ability to capture major types of savings, have not developed appropriate products for low-income individuals. On the other hand, credit and savings unions and MFIs whose regular clients come from the low-income segment of the population do not have the ability to take deposits from the public; because, in most cases, this activity is limited to regulated financial institutions.

Another reason that explains the limited use of savings products in the region is the high amount of requirements and documents that financial institutions require in order to open a deposit account. Nevertheless, procedures and requirements to open deposit accounts are slowly becoming more flexible. Procredit Bank in Ecuador is an example. This institution allows customers to open a savings accounts with only US\$1 plus a copy of his/her identification card, a copy of the voting registration card, and a document that shows the client's address.

Simplified (Basic) Account

A simplified account, also known as basic account, is a deposit account with fewer opening requirements (which include among others, those related to Know Your Client (KYC) principles, proof of address and/or places where it may be obtained). In order to prevent improper use of this account, this type of account usually has operational limits and, in some cases, a set of approved transactions is specifically established in the regulation.

This type of account allows users to keep their savings in a safe place, which is something that is not often possible for low-income individuals. In most cases, individuals with low income prioritize having their money safely deposited instead of receiving a high level of interest rates, when assessing their savings options.

Another main feature of these products in fostering savings among low-income individuals is flexibility. Aside from increasing people's assets, these savings accounts allow customers to access their funds in various situations, such as cases when income from the family business decreases or in case of illness. In this sense, it is convenient for financial institutions to offer savings products that allow frequent deposits of small and variable amounts, as well as quick access to them.

To encourage savings among low-income individuals, proximity – essential in order to reduce high transaction costs for both deposits and withdrawals – convenient office hours, and minimal paperwork are also important. Finally, an ideal feature for this type of accounts is access to payment systems providing consumers the possibility of making payments safely.

In Brazil, for example, an account can be opened by submitting any identification document and the customer's natural persons' registry identification. At the same, regulation establishes a maximum limit on the account balance equal to R\$1.000⁹. Funds kept in this account may only be withdrawn by a magnetic card or other electronic means.

Accredited Accounts

These are bank accounts where deposits are usually made on the basis of legal or regulatory requirements, such as social programs, pensions, and retirement payments.

In Brazil, simplified accounts can be opened by individuals registered in government welfare programs, such as "Zero Hunger." Aside from providing more transparency to the allocation of government resources, beneficiaries of social programs are able to keep their savings in a safe place.

⁹ The Central Bank of Brazil is empowered to change maximum limits on simplified accounts. At the time this report was finished, May 2012, R\$1.000 were equivalent to approximately US\$500.

Regulations also forbids collecting any kind of fees for opening and maintaining these accounts, unless customers withdraw or deposits more than four times per month, if customers request more than four monthly bank statements, or if a check is received to withdraw funds. These simplified accounts allowed an estimated 6.5 million people to access banking services in Brazil.

Savings Groups or ROSCAs

In the region, a group savings scheme has been observed and is known as group savings or ROSCAs (rotating savings and credit association.) This type of scheme requires members to meet regularly during a specific period of time. The number of meetings is usually equivalent to the number of group members. At each meeting, all members must deposit a previously agreed upon amount, while one of the members receives the total amount collected during such meeting¹⁰. At the end of each cycle of savings, each member should have obtained the total amount of contributions according to a previously established installment calendar.

In Jamaica, the Workers Bank offered a product with features similar to ROSCA. The cycles of savings were granted for periods of 16, 24, 36 and 48 weeks, with mini-

mum contributions of approximately US\$5. This initiative demonstrated that savings products may be designed based on methodologies that are more familiar to clients¹¹.

3) Distribution Channels

As mentioned before, one of the aspects that limit financial inclusion is the lack of points of service for customers. This problem is exacerbated in rural areas and the suburbs.

Distribution channels around the world are turning toward becoming electronic processes. The use of technology allows for the expansion of financial services to the most remote places and continue towards providing people access into the formal economy. However, in Latin American and the Caribbean, the growth of financial services via Internet and mobile banking – which were mainly developed by banking institutions and not by MFIs – is far from reaching low-income populations.

Many of legislations in the region's countries still do not include regulations for this type of financial services.

Correspondent banking, services provided through electronic means, and mobile payment methods are widespread only among commercial banks. Government-owned financial institutions play an important role in payments via remittances and debit cards.

10 Focus note: community-managed loan funds: Which ones Work?, CGAP, May, 2006.
11 Prácticas prometedoras en finanzas rurales (experiencias de América Latina y el Caribe). chapter 9: "Microahorro: Lo que podemos aprender de las ROSCAs. Plan de ahorro de socio del Workers Bank (Banco de los trabajadores) Jamaica", Inter-American Development Bank, 2003.

TABLE 4 | **Means of Payment**
By type of institution, according to the number of countries

| Debit cards | Agents or bank correspondents | e-banking | m-banking | Remittances |
|--|-------------------------------|-----------|-----------|-------------|
| COMMERCIAL BANKS | | | | |
| 13 | 10 | 12 | 9 | 13 |
| SPECIALIZED BANKS IN MICROFINANCE | | | | |
| 7 | 3 | 4 | 1 | 7 |
| MICROFINANCE INSTITUTIONS | | | | |
| 2 | 1 | 0 | 0 | 3 |
| SAVINGS AND CREDIT UNIONS | | | | |
| 6 | 2 | 1 | 0 | 3 |
| GOVERNMENT FINANCING INSTITUTIONS | | | | |
| 9 | 3 | 7 | 3 | 9 |
| OTHER | | | | |
| 5 | 1 | 3 | 0 | 7 |

Source: Survey sent by Regulators, 2010.

Smart Automated Teller Machine (ATM)

Automated teller machines, also known as ATMs, can offer a double benefit for financial inclusion. On one hand, they allow banks and financial institutions to operate beyond their network of branches and agencies. On the other hand, they lower the costs of providing services to clients in remote locations, since their use at retail store chains or post offices imply lowering the expenses related to opening a branch.

In addition, ATMs can provide services at different working hours than branches do, which gives clients more flexibility in accessing their accounts or paying their loans at a more convenient time. This is particularly valuable for low-income families with uncertain cash flows.

In recent years, the countries in the region have expanded their geographic penetration levels via ATMs. There are cases of countries and organizations that have taken this service straight to low-income populations. For example, in Bolivia, the microfinance institution Fondo Financiero Privado PRODEM (Private Finance Fund) implemented its “smart automated tellers” in 2002 to provide financial services to populations in rural or semi urban areas.

Incorporating biometric technology into smart cards allows each user to have a unique digital “fingerprint” in and balances on his/her savings accounts in a single card. This process replaces the use of a PIN number – personal code stored on the smart card – which provides higher security. In addition, this type of ATMs work with voice commands that allow the machine to interact with the user in five languages (Aymara, Quechua, Spanish, Guarani and English.) This helped illiterate users or those with limited knowledge of Spanish to access financial services.

Non-Banking Correspondents (NBCs)

This distribution channel for financial products and services operate based on an agreement between financial institutions

and retailers (pharmacies, mini markets, shops, post offices, gas stations, businesses, warehouses, hardware stores) or any other individual or business that serves the public on behalf of the contracting party. Therefore, transactions carried out in establishments under such agreements become the responsibility of the financial institution. The main advantage that NBCs represent for banks is that they expand coverage at a lower cost than establishing a traditional agency.

In terms of financial inclusion, the best results in using this distribution channel arise when NBCs not only allow customer to make deposits and pay utilities (electricity, water, telephone, and gas), but also when customers can withdraw and transfer funds between accounts.

By far, Brazil is the Region’s country that has the most developed non-banking correspondent service. Even though these originated in 1973, it was in 1999 that the Central Bank of Brazil authorized institutions in the financial system to perform transactions through third parties. Institutions such as BRADESCO, CAIXA, and Banco Popular were pioneers in using this channel, by implementing a transactional model based on decreasing customer congestion in banking agencies and branches. Subsequently, NBCs became a model to expand financial access. By June of 2010¹², there were a total of 92,304 non-banking correspondents in Brazil, which represent an increase of 672% in comparison to 2000.

Brazil’s example has been followed in the Region by countries like Peru, Ecuador, Mexico, Colombia, Guatemala, Venezuela, Bolivia, and Chile. These countries now have a solid regulatory framework that allows and regulates this type of financial services.

Mobile Banking (m-banking)

The growing supply of services via mobile phones in the region still tends to answer more to customer loyalty objectives and improvements in efficiency levels than to attract low-income populations without access to financial services. However, the advantages that mobile phones

¹² FELABAN Corresponsales no bancarios, un esquema que ha llegado a América Latina para quedarse. Mexico, 2010. www.felaban.org.

offer given their extraordinary scope and increasing penetration among low-income populations provide a key instrument for financial inclusion¹³, especially among young people.

The use of mobile phone technology dramatically reduces transaction expenses for operations in savings, credit, money transfers, business purchases, and utility payments. In addition, operational expenses of m-banking solutions is considerably lower than operation expenses at offices and ATMs, which allows institutions to offer these services at a more affordable cost for low-income households.

In order to use these services, the client must have an account at the financial institution with a balance that covers the transactions that would be made with the mobile phone.

Acceptance by customers is one of the main challenges that this instrument still faces, given the lack of trust that arises from using new means of communication to conduct financial transactions. An even greater challenge is outlining the regulatory aspects that must cover four environments: banking institutions, telecommunications, payment systems, and money laundering.

An example of a product offered through this channel in the region is the electronic savings account. Banca Caja Social of Colombia¹⁴ offers this service that allows users to conduct the following actions from their mobile phones:

- Basic queries, utility payments, government and personal payments, transfers, and reloads.
- Deposits and withdrawals through the network of non-banking correspondents.

These accounts are opened through a network of non-banking correspondents by submitting basic information on the client. The bank issues a message to the mobile phone with the account number, and the account holder may set a PIN number through a correspondent office to use the account.

Mobile Payments (m-payments)

Mobile payments act as intermediaries between buyers and sellers to facilitate the purchase of goods and services via mobile devices¹⁵. This service does not require the user to have a bank account. The way this service works is similar to purchasing mobile minutes at points of sale accredited for this purpose. Clients pay the cost of the text message, plus a fee for making deposits and withdrawals. A feature that encourages financial inclusion is the low amounts that these transactions allow to be transferred. Some transactions entail only cents of a dollar.

A feature of this service is the ability to pay through a mobile account, providing the user with a way to pay on credit. A mobile operator acts as an intermediary between the user and the supplier of goods and services. At the end of each billing period, the customer receives a bill detailing the telephone services expenses and the purchases made from suppliers of goods and services. Finally, the user must pay the bill in full.

Another service offered by mobile banking is sending remittances, which fosters financial inclusion given its low cost. In the region, some companies have explored these advantages. One of the most relevant is Halcash, a joint project of several Spanish credit institutions (Bankinter, Banesto, and different credit unions) with the Bank of Guayaquil. With this system, it is possible to send money nationally or internationally, as long as the receiver has a mobile phone to receive the transaction code and has access to one of the institution's automated tellers to withdraw the transferred funds.

Other Customer Service Points

In the region, several initiatives have been developed to provide better customer service by expanding and diversifying points of service. A point of service is understood as a facility established or equipped by a supervised institution to perform financial intermediation transactions¹⁶.

13 Emilio Ontiveros Baeza; Álvaro Martín Enríquez; Santiago Fernández de Liz, Ignacio Rodríguez Teubal; Verónica López Sabater. *Telefonía móvil y desarrollo financiero en América Latina*. Published by IDB and Fundación Telefónica. España, 2009.

14 IDB-CA-FOMIN. 19 Ideas oportunas para proyectos innovadores en Latinoamérica y el Caribe. Programa de tecnologías para la inclusión Financiera, www.tec_inc.org, 2010.

15 Rolf H. Weber and Aline Darbellay. "Legal Issues in Mobile Banking." *Journal of Banking regulation*, vol. 11, 129-145, 2010.

16 ASFI "Circular 002/2009: apertura, traslado y cierre de sucursales, agencias y otros puntos de atención." 2009

In Bolivia, there are *mobile agencies* that operate inside vehicles that travel around suburban and rural areas. For example, mobile offices of BancoSol travel around different communities on previously defined routes, having considered a detailed and stringent security plan. When the vehicle arrives at the chosen destination, a satellite dish is installed that establishes a link with the bank's network. A *mobile agency* is equipped to solve the financial needs of

rural area clients (loans, deposits, transfers, and bank drafts, among others), just as if these were carried out in a traditional agency.

Another initiative, also in Bolivia, is a "fair office." This facility works as a point of service located in fairs with the aim of providing temporary or permanent services to clients and users on specified days and schedules, in accordance to the need and demand for financial services.

RISK MATRIXES

What Risks do These Products and Channels Represent?

Any financial activity is inherently exposed to different types of risks that have a different influence on the expected results. The ability to identify these risk situations, their origin, and possible impact is a complex task, but essential in improving levels of profitability.

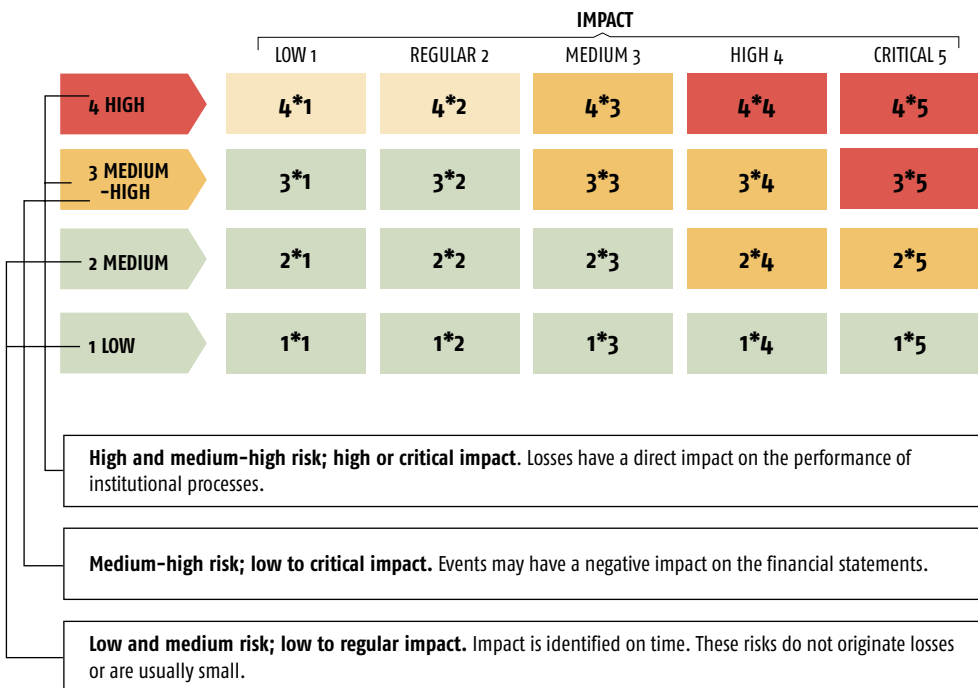
This section seeks to identify the risk exposure of every financial product or distribution channel identified as likely to improve the levels of financial inclusion in the region. The risks considered for this analysis are credit, operational, liquidity, market, and reputational risks.

The results of this analysis are presented through Individual Risk-Impact Matrixes. The probability that the risk will materialize is classified into four levels (low, medium, medium-high, and high) and is weighed from 1 to 4; one representing a low level of probability and 4 a high level of probability. At the same time, the impact, in case a risk materializes, is classified into five levels (low, regular, medium, high, and critical) and is weighed from 1 to 5.

Therefore, the quadrants of the matrix are the result of the combination of risk and impact.

Quadrants For Risk And Impact Levels

Individual risk-impact matrixes



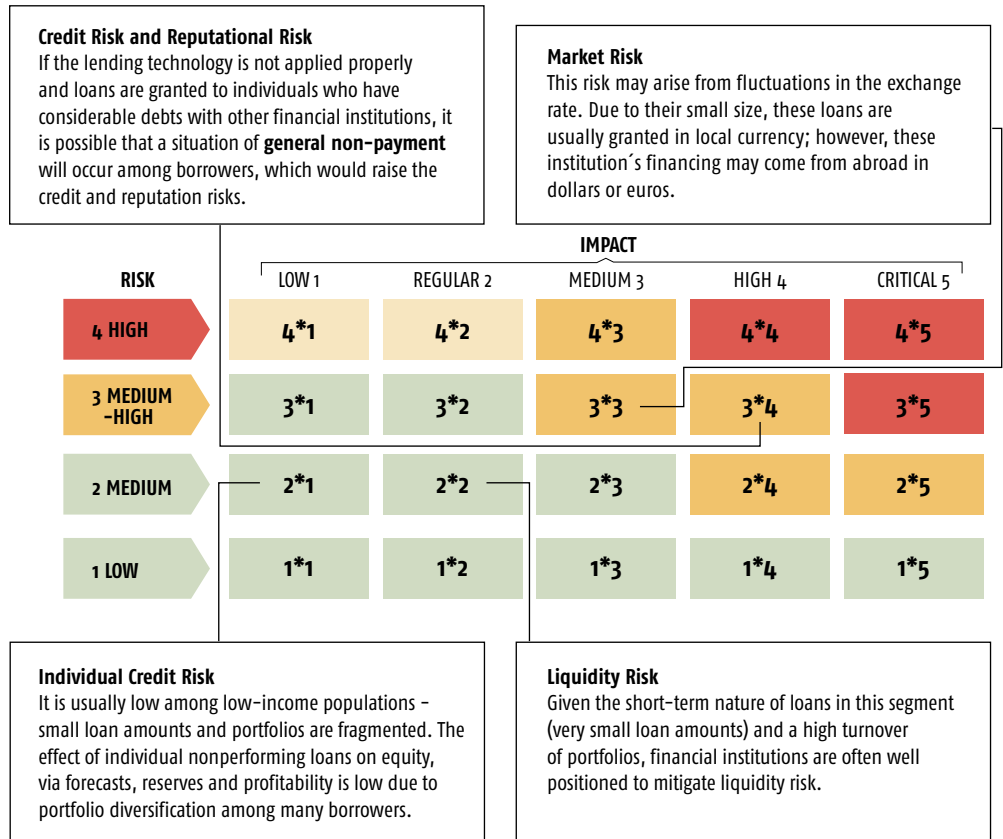
Risk Matrix for Individual Microcredit

The high fragmentation of the portfolio, given the small loan amounts in this type of loans, makes individual credit risk almost non-existent. That is, when a small borrower becomes delinquent on his credit, this represents a low impact on the institution. However, the situation changes when an economic crisis arises, af-

fecting economic activities in general, or when the lending technology is improperly implemented, for example when there is a lack of control over the level of customer indebtedness. In such cases, there is a high risk that the whole portfolio will suffer a strong delinquency increase, which would affect not only the levels of profitability and equity in the financial institution, but also its image translating into reputational risk.

Individual Microcredits

Individual Risk-Impact Matrix



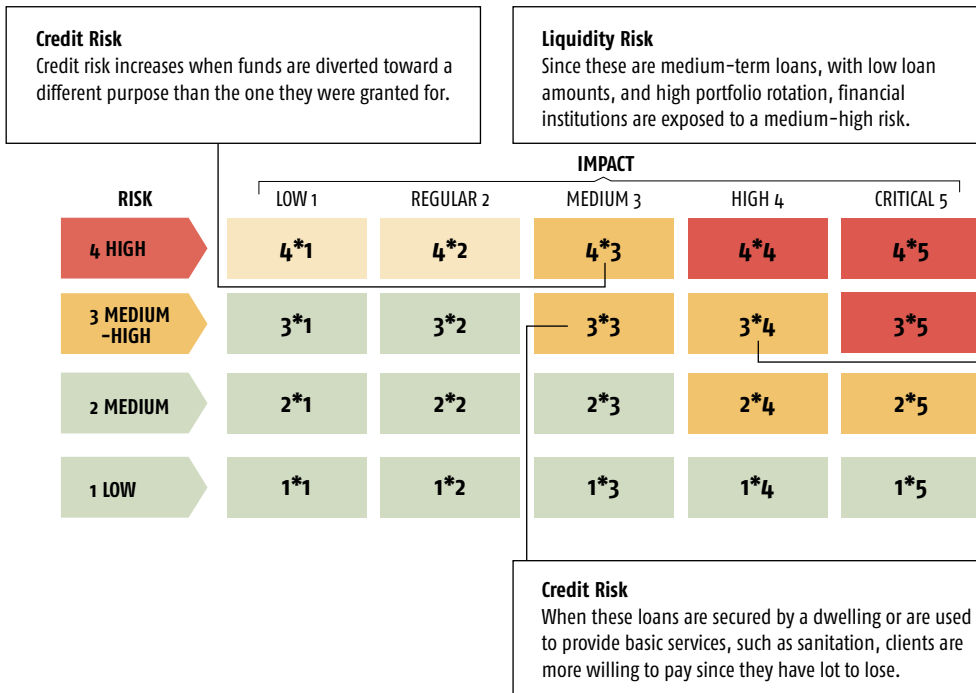
Risk Matrix for Housing Microcredit

The repayment of housing microloans among low-income segments is generally very high (above 90%). However, since these are medium-term loans (up to 5

years maximum) financial institutions are exposed to liquidity risk. Regarding credit risk, this product is exposed to a level of risk similar to that of a loan without real collateral and offered to informal sectors of the population that do not have deeds on the property.

Housing Microcredits

Individual Risk-Impact Matrix



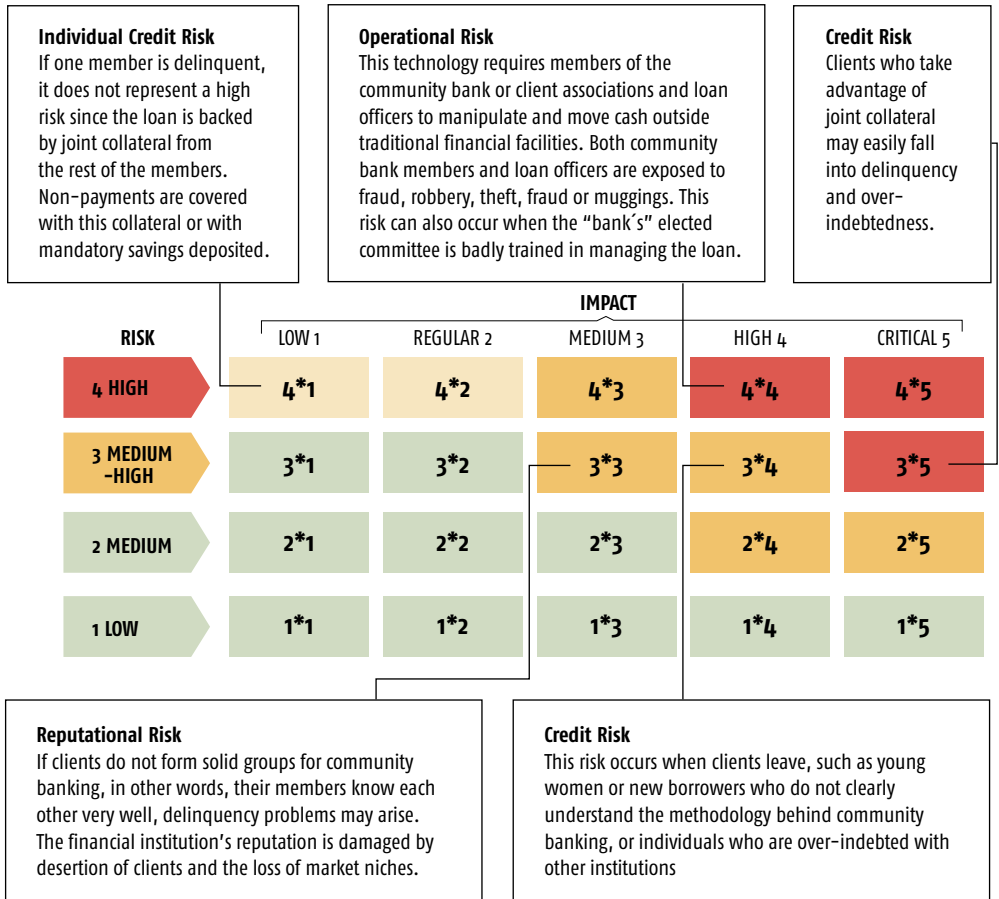
Risk Matrix for Community Banking

The greatest risks for community banking are operational, since this technology requires cash handling outside the financial institution's offices, increasing the exposure to robbery, theft, fraud or muggings. Hence, the insurance expenses or cost to cover this type of events are high. As administrative expenses increase for the institutions, interest rates for these loans end up being high.

There is also risk exposure originating from non-payment. When delinquency arises from a single member of the community bank, the impact is low since this technology is based on joint collateral in solidarity. But if several members of the group do not meet their loan commitments, a high risk could be faced as a result of badly implementing the credit technology or economic cycles that affect the whole economic activity of a country.

Community Banking

Individual Risk-Impact Matrix



Risk Matrix for Solidarity Groups

Loans under this technology are basically exposed to credit risk. That is, to the probability of non-payment by the solidarity group. This risk generally increases when solidarity groups change

their focus, damaging the group's financial cohesion and affecting their ability to pay. In order to mitigate credit risk, it is essential to support solidarity groups by providing technical assistance to improve quality, production, and distribution channels.

Solidarity Groups

Individual Risk-Impact Matrix

| RISK | IMPACT | | | | |
|---------------|--------|-----------|----------|--------|------------|
| | LOW 1 | REGULAR 2 | MEDIUM 3 | HIGH 4 | CRITICAL 5 |
| 4 HIGH | 4*1 | 4*2 | 4*3 | 4*4 | 4*5 |
| 3 MEDIUM-HIGH | 3*1 | 3*2 | 3*3 | 3*4 | 3*5 |
| 2 MEDIUM | 2*1 | 2*2 | 2*3 | 2*4 | 2*5 |
| 1 LOW | 1*1 | 1*2 | 1*3 | 1*4 | 1*5 |

Credit Risk
In case of delinquency, if group negotiations are held there is a possibility of a general default of all group members.

Credit Risk
It occurs when there is no clear understanding of this credit methodology or when the group's cohesion is damaged.

Credit Risk
The repayment capacity of the solidarity group may be affected if market search for the group's products and adequate distribution channels are not treated as a priority. This may damage the project and reduce the group's capacity to repay the loan.

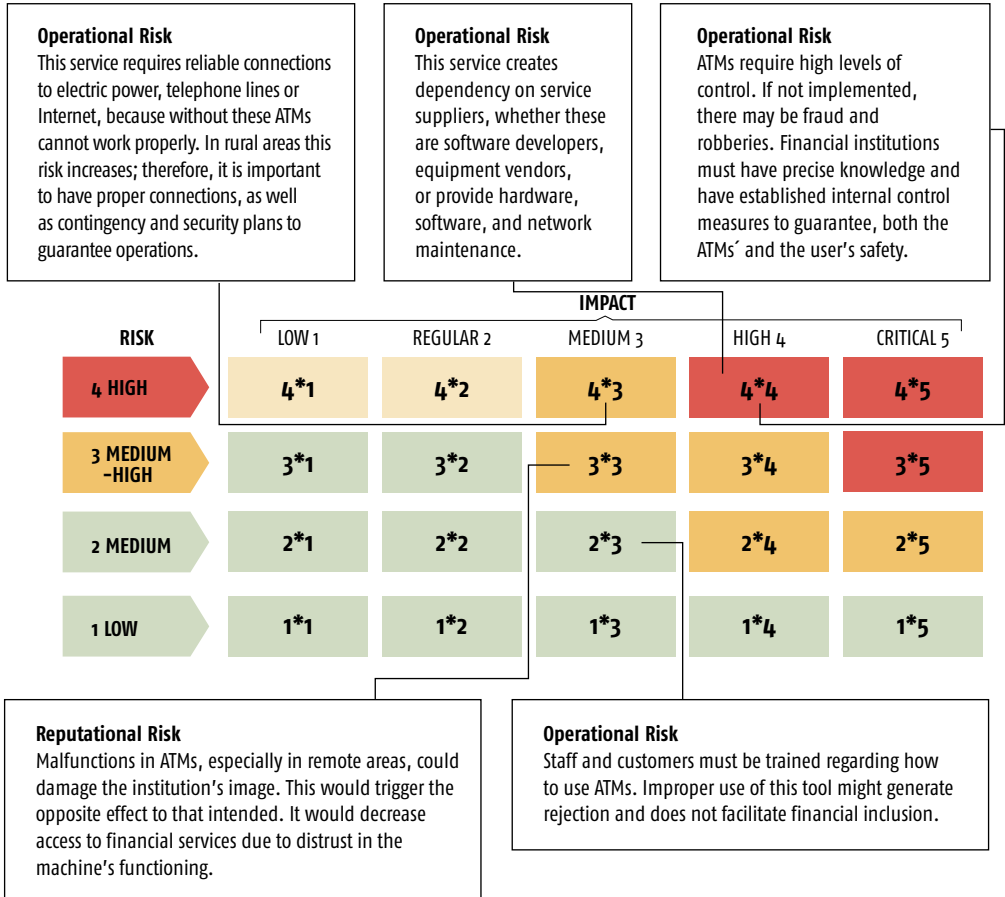
Risk Matrix for Using Smart Automated Tellers Machines

Operational risk and reputational risk are the main risks in this service. The re-

lationship between these two risks arises from the fact that good service at ATMs depends on suitable technology and communications being used (Internet, telephone, connections to electric power.)

Using Smart ATMs

Individual Risk-Impact Matrix



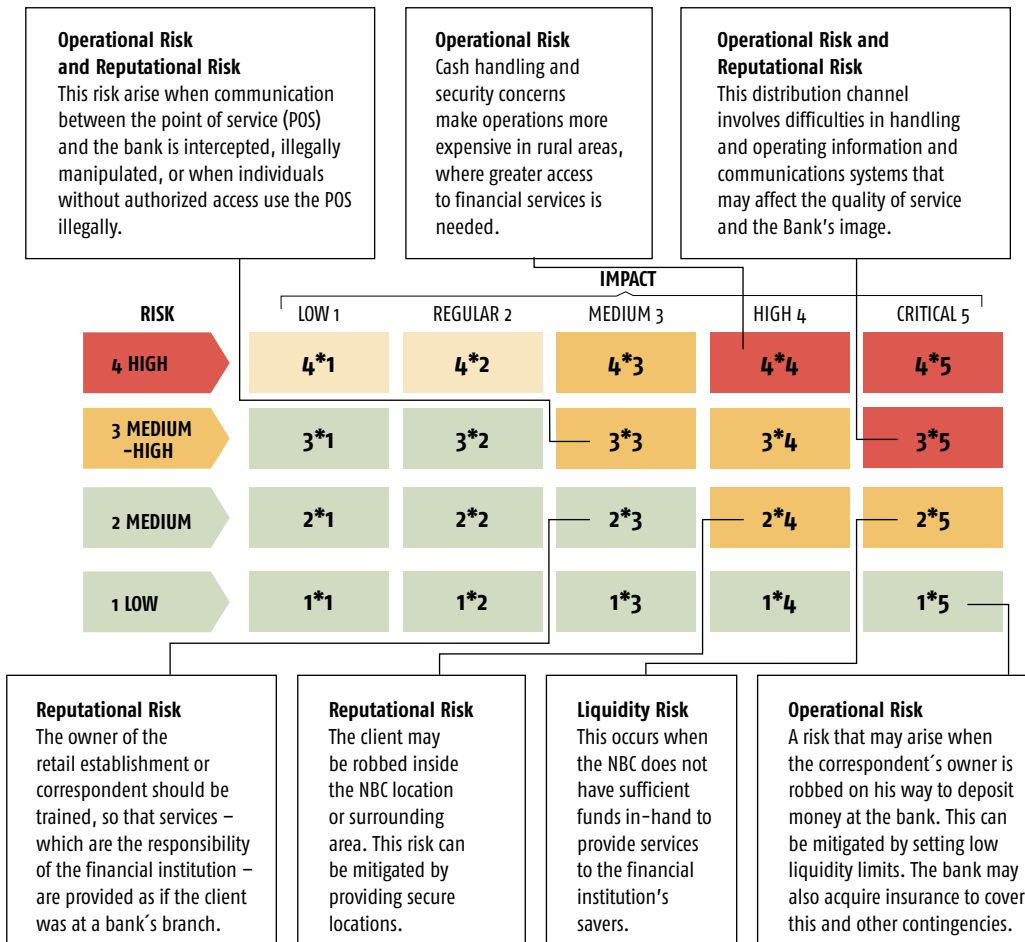
Risk Matrix for Non-Banking Correspondents (NBCs)

The main risk posed by this distribution channel is operational risk, since in many instances, staff at retail establishments or correspondents is not properly trained to manage, collect, receive, and pay money. This risk also increases when institutions do not adequately investment in information and communication technologies.

On the other hand, there is a reputational risk, because the NBC acts as a representative of the financial institution that could potentially provide poor customer service, perform forbidden transactions, disclose confidential financial information, and improperly use information technologies. Finally, there is a legal risk exposure when clients are robbed while inside the retailer’s location.

Non-Banking Correspondents (NBC)

Individual Risk-Impact Matrix



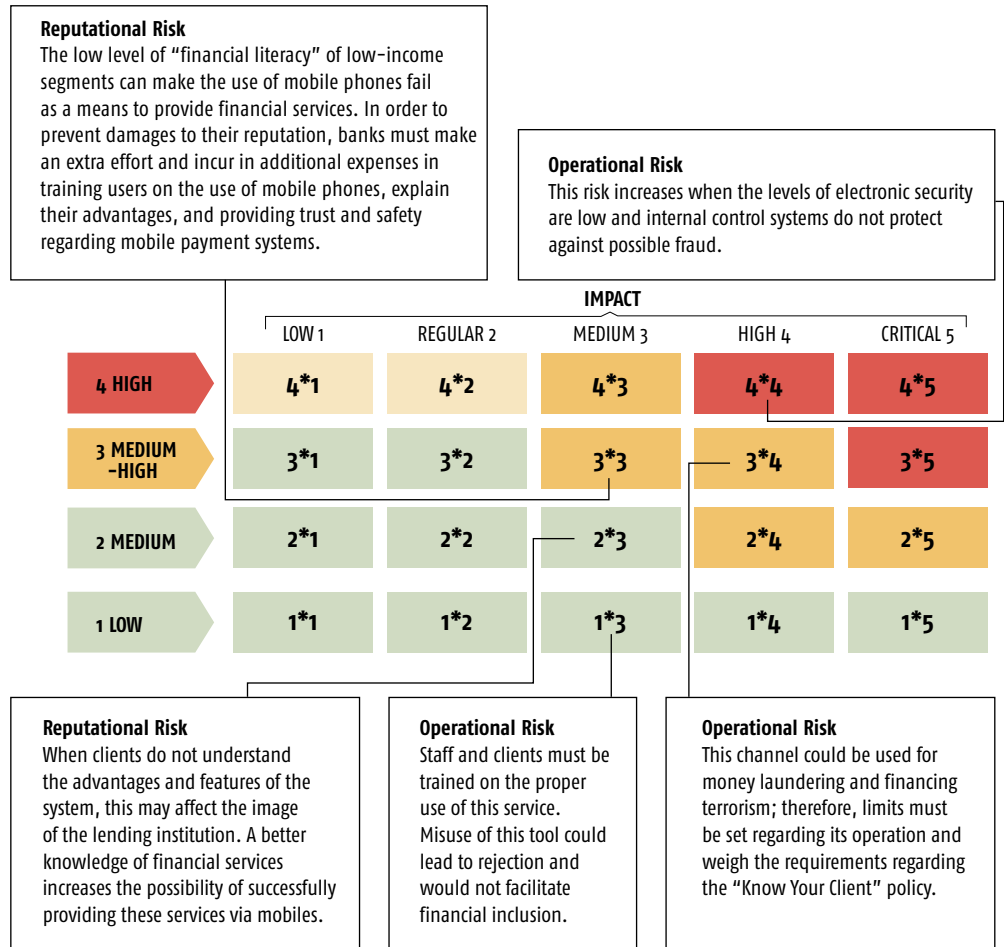
Risk Matrix for Mobile Phone Services

This technology's main risk is operational since it requires integrating financial transactions with a proper safety level.

There are also risks relating to money laundering and fraud, which have led to limit the type of transactions allowed through this technology. Finally, low levels of financial literacy in the region also increase reputational risk.

Mobile Phone Services

Individual Risk-Impact Matrix



Microfinance and Financial Inclusion

Microfinance has the main objective of providing low-amount financial products and services to low-income segments of the population. In countries like Peru, Bolivia and Ecuador, where the levels of poverty and informal employment are high, microfinance has proven to be an efficient tool for financial inclusion and the development of low income individuals.

Microfinance providers in Latin America and the Caribbean include:

- Non-government organizations (NGO's) that have become regulated institutions (upscaling) (17);
- Banks that have joined the microfinance market (downscaling);
- Traditional finance institutions created with the objective of serving the micro entrepreneurial market.

Among the financial products and services provided by these institutions and which favor inclusion are:

Microcredit

It is the most widespread product. According to the survey implemented for this analysis, in December 2009 MFIs granted microcredits to 18, 8 million clients in Latin America and the Caribbean. The average balance of these loans represented 24% of the respective GDP per country, according to the latest *Micro Banking Bulletin* (MBB).

Microsavings

One of the main advantages of MFIs compared to other suppliers that focus exclusively on credit, such as financial NGO's, is that they mobilize savings from the public. The survey revealed that the number of savings accounts reached 14.4 million in

December, 2009. In Peru, for example, municipal savings and credit unions are leaders in mobilizing savings above the rest of financial institutions, according to the Superintendency of Banks, Insurance and AFP (SBS) of Peru.

Deposits in savings and credit unions are the most popular microfinance products with a total value exceeding US\$1,469 million, followed by deposits on demand.

Remittances

Even though the level of remittances to Latin America and the Caribbean decreased when the global economic crisis began at the end of 2008, this flow continues to be very important in several countries in the region.

Guatemala is one of them. There, BANRURAL, a universal bank specializing in microfinance, channels 50% of the remittances that enter the country with an average individual value of US\$391. The bank offers its clients accounts where they can deposit remittances, as well as Internet access to Guatemalans who live in other countries, so that they can pay utilities and buy goods for their relatives living in Guatemala.

Microinsurance

This type of insurance is distributed to clients with microloans and usually covers life, disability, and accidents linked to microenterprises. An example is Banco Estado, a leader in the insurance market in Chile, with over 1.3 million clients. This institution has created low-cost products, such as "the incredible insurance" that covers death by accident at a price of only US\$7.8 per year.

[Annexes]

17 For more information regarding the terms upscaling and downscaling, refer to the Glossary at the end of this paper.

METHODOLOGY

In order to conduct the regional assessment, covering countries that belong to the Association of Supervisors of Banks of the Americas (ASBA) in relation to the levels of financial inclusion in these countries, ASBA sent out a survey to the main supervisory body or financial supervisory agency in each country. The questionnaire was designed to gather information about financial products and services that the region's financial institutions offer.

For the purpose of this paper, financial inclusion is understood on the basis of a clear difference between access and use of financial services and products. Access only refers to geographic and demographic coverage; while use refers to financial services and products being actually used since they respond to the specific needs of the population segments that will be included.

The analysis in the various countries was limited to the following "access" indicators to financial services and products:

- Amount of branches for every 100.000 inhabitants.
- Amount of ATMs for every 100.000 inhabitants.
- Amount of correspondents for every 100.000 inhabitants.

The following parameters were used to study the indicators for "use" of financial services and products:

- Deposit accounts / total population of the country

- Amount of loans / total population of the country

Since there are many types of financial institutions in the surveyed countries, regulators were requested to group the information in six categories of regulated institutions in order to make it easier to perform an international comparison. These categories include:

- Commercial banks;
- Specialized banks in microfinances;
- Microfinance institutions;
- Savings and credit unions;
- Government-owned financial institutions, and
- Other financial institutions

In order to prevent limitations to the scope of the analysis, information about financial services and products offered by non-regulated institutions, basically financial NGOs, were also included.

The identification of financial products and services was not limited to institutions that grant access to credit, but also those that allow the use of savings accounts and means of payment.

Once financial products and services were identified, individual risk-impact matrixes were defined in order to establish the degree of risk that these products and services face. For this purpose, definitions of credit risk, operational, liquidity, market, and reputational risk were used as established by the Basel Committee on Banking Supervision.

GLOSSARY

- **Community Banking:** A group of 10 to 40 individuals, usually women, without any real and/or personal collateral that gather to guarantee each other, and encourage savings before access to credit.
- **Credit Risk:** the possibility that a borrower or counterpart is not able to fulfill his/her obligations within previously agreed upon terms.
- **Downscaling:** A process where formal financial institutions expand financing to low scale microenterprises, having previously provided traditional banking transactions with large companies.
- **Liquidity Risk:** Possibility that a financial institution incurs in losses because it does not have enough resources at hand to fulfill its obligations.
- **Market Risk:** this risk arises from losses in transactions within the balance sheet and off-balance sheet resulting from market prices' fluctuation.
- **Microcredit:** Small amount loans granted to individuals who run their own low-scale business, and which will mainly be repaid with the proceeds from the sale of goods or services.
- **Microfinance:** Low amount financial products and services provided to low income segments of the population without access to formal financial systems.
- **Microinsurance:** Insurance products tailored to low income populations.
- **Mobile Banking (M-banking):** Describes electronic banking transactions carried out through mobile phones, PDAs or tablets. In order to use this service, the client must have an account in the financial institution with a balance that backs up the transactions carried out via mobile phone. Among these transactions are deposits, payments, credit applications, or transfers between accounts.
- **Mobile Payments (m-payments):** Technology that offers intermediation between buyers and sellers to facilitate the purchase of goods and services via mobile devices. A basic feature is that the use of this service does not require a bank account.
- **Non-banking Correspondents (NBC):** Distribution channels that allow financial institutions to expand geographic coverage of their services by outsourcing; these are usually retail companies.
- **Operational Risk:** Risk of loss resulting from inadequate or failed processes, staff, and internal systems or from external events. This definition includes legal risk.
- **Remittance:** Sending and receiving money locally and internationally.
- **Reputational Risk:** Risk associated to the possibility that negative publicity regarding business practices and relationships of a financial institution, whether true or false, may cause loss of confidence in the institution's integrity.
- **Risk-impact Matrix:** Control and management tool used to identify processes, type, and level of risk of a financial product or service.

- **Savings and Credit Unions:** Association of individuals who share a common characteristic and whose objective is to offer financial intermediation services to its members.
- **Simplified Accounts:** A financial product that can be opened as a deposit account with fewer requirements, and usually, has established limits on their operations.
- **Joint Collateral (collateral in solidarity):** Commitment by a group of individuals to honor the obligations of any of its members in case any of them falls into default.
- **Solidarity Groups:** Financing methodology addressed to groups of five to ten people – usually small growers, rural workers and craftsmen – who commit themselves to pay in case any of its members defaults on his/her financial obligation.
- **Upscaling:** This is a process whereby non-regulated microfinance institutions turn into regulated institutions and expand their activities to small enterprises.

ASBA'S MISSION

To develop, disseminate, and promote banking supervisory practices throughout the Americas in line with international standards. To support the development of banking supervision expertise and resources in the Americas, through the effective provision of training and technical cooperation services.

ASBA'S OBJECTIVES

- To promote the implementation of regulatory and legal frameworks in member countries in line with international standards.
- To support Associate Members' efforts to develop sufficient skilled and capable supervisory resources to enable them to fully carry out their bank supervisory responsibilities in a dynamic environment.
- To develop a network of internal and external working relationships that supports the development of the organization, contributes to its growing international recognition by acknowledging its representative capabilities in the topic of banking regulation and supervision.
- To develop an internal and external working framework that will benefit the organizations' advancement, strengthen its support activities, international recognition, and representative capabilities.