Advancing Savings Services: Resource Guide for Funders

Technical Guide

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A Guide to Unlocking Savings for the Poor

Many microfinance funders have long recognized the importance of savings services for poor people. However, the majority of funders still focus their activities on scaling up access to credit, rather than savings. This is for three main reasons.

First, historically, providing credit has been regarded as having the most direct link to increasing incomes by providing a productive input to help poor people help themselves out of poverty through entrepreneurial activity. Hence, credit-based models may be easier to justify from an economic development and poverty alleviation perspective.

Second, incentives in many funding agencies are skewed toward financing credit. Funders often have disbursement targets, and financing loan capital is an easier way of moving money than investing in the long-term institution-building required to increase savings mobilization.

Third, supporting savings mobilization is a potentially risky business and requires specific expertise, institutional capacity, and long-term commitment. Financial institutions can fail, and high inflation can erode hard-earned savings. Funders are right to think carefully about whether they are best placed to support savings services.

Despite these perceptions, however, there is renewed interest among funders in supporting savings services. Concerns about over-lending and over-indebtedness in high-growth microfinance markets, the impact of the economic recession on the poor, and criticism of microcredit have turned funder interest to savings. These factors have highlighted the importance of savings for poor people's economic well-being and have shown that deposits are a potentially stable source of funds for financial institutions in addition to funding from foreign donors and investors and other sources.

This resource guide looks at how funders can most effectively support the expansion of voluntary[1] savings mobilization. It does the following:

- Describes the importance of advancing savings mobilization from the perspective of both the client and the financial institution.
- Looks at what funders can do to support savings services, including actions directly related to client demand, institutional supply, intermediation, and regulation and supervision.
- Provides guidance on how funders can assess their own organizational capacity to support savings mobilization and discusses the most effective use of different funding instruments.
- Provides a bibliography of resources on savings services for the poor.

[1]This Guide focuses on voluntary savings services and does not analyze compulsory savings. Compulsory or mandatory savings includes savings payments that are required as part of loan terms or as a requirement for membership of, for example, a savings group or cooperative. Compulsory savings are often required in place of collateral. The amount, timing, and level of access to these deposits are determined by the policies of the institution rather than by the client.

1. *The Case for Boosting Savings*

Saving is a crucial component of poor people's economic well-being and can have a direct impact on poverty reduction. Saving can help poor people deal with three fundamental barriers to escaping the poverty trap:

1. Access to a savings mechanism can help poor people smooth their volatile income streams and accumulate sufficient funds to eat regularly, invest in education, and otherwise reduce financial stress.
2. Appropriate savings and insurance products can help provide a cushion against common shocks, such as illness, death in the family, or crop failure.
3. Poor people find it difficult to escape poverty because they are engaged in economic activities with very little or no productivity growth. By saving small amounts over time they can invest in new tools and businesses to improve their productivity, and can afford to search longer for more productive forms of employment. If they are able to self-finance these investments, they can fully capture the productivity gains derived, without having to share them in the form of interest on loans (Christen and Mas 2009).

Poor people know the value of saving, and this is reflected in their behavior. Household studies consistently show that poor people can and do save, and that unbanked households already use a variety of informal savings instruments to manage their small and unpredictable incomes. Such instruments include saving at home in piggy banks or under the mattress, investing in gold or livestock, or being a member in a savings club. However, it is the habit of putting aside cash that is often a challenge, and yet it is savings in cash that are most needed. Here financial institutions have the opportunity to respond to poor people's demand for a place to save. Doing so requires that they provide savings services that are appropriate to poor people's needs. Savings services need to be convenient and safe, and allow clients to put money aside in very small increments.

Increasing savings mobilization also has a positive effect on the financial system as a whole. Savings mobilization can help to build larger, more stable and inclusive financial systems by strengthening local financial intermediation and by increasing the self-sufficiency of local financial institutions. For financial institutions serving poor people, deposits can be the most plentiful, affordable, and stable funding source that also reduces institutions' risk of foreign exchange losses and strengthens their institutional stability, especially in times of economic crisis.

In 2008, deposits represented 75 percent of outstanding portfolios of deposit-taking financial institutions reporting to MIX (MIX Market 2008 Benchmarks). CGAP's research on the stability of small-balance deposits found that deposits are not volatile, but they move gradually and are neither seasonal, nor very sensitive to external shocks (Abakaeva and Glisovic 2009). Furthermore, a recent survey on the impact of the financial crisis conducted of over 400 microfinance institutions (MFIs) found that fewer deposit-taking institutions (44 percent) reported liquidity constraints after the crisis, compared to 52 percent of all respondents (MBB, no. 18, 2009).

Finally, demand for savings services is high when these services are made available to customers in ways that meet their needs. The impressive growth in the number of savers achieved by leading deposit-taking institutions over the last decade demonstrates the presence of substantial untapped client demand for convenient, safe, and affordable savings services. For instance, Equity Bank Kenya served over 3 million savers in 2008, and has added on average 550,000 new deposit clients per year over the past five years (MIX Market). Grameen Bank added over 2 million new savers between 2005 and 2008, and deposits currently amount to 147 percent of the outstanding portfolio (MIX Market). The strong and consistent deposit growth of these and other leading deposit-taking institutions points to the fact that savings services are valued by low-income clients and can make business sense for financial providers.

However, despite significant progress, most of the world's poor, especially across Sub-Saharan Africa, still lack access to formal savings services. There are many factors contributing to this scarcity in supply, but institution-level constraints, inadequate infrastructure, and regulatory barriers stand out as three of the primary deterrents.

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2. *Encouraging Demand for Savings Products and Services*

Key Lessons

- The poor already save in many informal ways.
- Poor people save with formal institutions when their services are close by and appropriate—accepting very small and varied deposit amounts.
- Policy makers and financial institutions may not always understand the importance of savings for poor clients.

Guidance for Funders

- Funders should promote and encourage an understanding of the importance of savings services for poor people among policy makers, financial regulators, and financial institutions.
- Funders should support market studies aimed at quantifying and better understanding client demand.
- Funders should support programs that promote consumer awareness and financial capability of the poor.

Market knowledge and research

Understanding poor people's demand for savings services and the current state of the financial sector in meeting that demand is crucial to designing appropriate savings services. The type of market research that will be most useful to the sector depends on the specific country and any research that already exists. To advance the market for savings services generally, rather than just for one institution, funders can support market research that will capture the overall size and nature of demand. However, financial institutions would still need to conduct their own market research with their intended target segment to further refine their knowledge in order to design appropriate products and services.

To capture the overall size of demand and to better understand the market conditions for savings, sector studies are important. Such studies can either be exclusively focused on savings services using tools, such as CGAP's

Country-Level Savings Assessment methodology (2008), or be integrated into broader studies that look at the full range of financial products and services. Sector-level studies require examining institutional capacity and incentives, as well as industry infrastructure and the policy environment—the micro, meso, and macro levels of the financial system. On the institutional side, country-level assessments should include the full range of institutional types of financial service providers (see next section). For quantifying the size of demand, sector studies should establish the number of poor and low-income individuals who currently use formal-sector savings services; the number who do not currently use them but could or would if appropriate services were available; and the amounts of savings that are or could be mobilized from these groups. This type of market information helps to demonstrate to financial providers the potential market that exists for these services and may incentivize them to consider entering this market.

There are many dimensions in understanding the nature of demand. Do clients demand deposits or long-term savings accounts? Do clients favor proximity to the financial institution or is trust in the institution the key factor for placing their funds there? Generally, what savers want depends on where their savings come from and why they are saving. Worldwide, low-income savers tend to care most about accessibility and security. Accessibility can be seen as physical accessibility (proximity, convenience of access) and financial accessibility (price, affordability) as well as liquidity preferences and needs. Typically people want products that provide both (*i*) ready access and those that are illiquid and (*ii*) motivation for longer term saving. Security means savers feel their money is safe and not at risk of being lost. Research to capture some of these qualitative dimensions of the nature of demand can also help educate financial institutions before they embark on serving this market segment directly.

There have been major advances in financial sector market research over the past several years specifically focused on poor people's access to, and use of, financial services. Some prominent examples are the World Bank's *Access to Financial Services* studies, national FinScope Household Surveys conducted in certain African countries, and detailed anthropological household studies pioneered by Stuart Rutherford and published in the recent book *Portfolios of the Poor* (Collins, Morduch, Rutherford, and Ruthven 2009). Another example is MicroSave's Market Research for Microfinance toolkit widely used by various service providers.

Developing new products can be a risky and costly endeavor, and market research is a critical step in the entire product development process. However, market research and pilot testing are often overlooked by many institutions. It is an ongoing task to improve and deepen market knowledge, fill in knowledge gaps, and apply that knowledge to improve institutional development. Market research and assistance with product design, piloting, marketing, and operational planning can help financial service providers launch appropriate savings services and design cost-effective delivery mechanisms.

Funders can play an important role in supporting market research studies. Donor-subsidized studies can increase awareness and contribute to attitudinal shifts of both policy makers and managers of financial institutions in support of encouraging savings. Funder support is needed not just for research alone, but also for *information dissemination* and *partnership building* among regulators, financial institutions, and other actors, such as mobile phone operators. Helping local stakeholders collaborate to identify country-specific, locally appropriate ways for increasing access to savings services is ultimately what is going to help advance savings mobilization. Hence, funders should also consider funding workshops and meetings that bring different stakeholders together to examine solutions to scaling-up savings services for the poor.

Consumer Awareness and Financial Capability

Client understanding of product and service features, such as fees, charges, and withdrawal terms and conditions, depends on both the transparency of financial service providers and their clients' financial capability. Programs to promote consumer awareness and strengthen financial capability may not only seek to inform people but they also often endeavor to give them the knowledge and skills that result in behavior change. In the case of savings, this can potentially impact both the take-up and use of savings products. Empirical evidence related to the impact of financial capability interventions is mixed, and relatively few rigorous evaluations exist for programs in developing countries. However, some preliminary insights are possible; financial awareness and financial capability programs appear more likely to be effective when they are directly linked with the provision of financial services, including savings.

Funders can help to develop a knowledge base on what constitutes cost-effective interventions in this area. Two notable examples are DFID's Financial Education Fund (FEF) for Sub-Saharan Africa, which emphasizes monitoring and evaluating results, and the World Bank-administered Russia Trust Fund for Financial Literacy, which funds global work on both impact evaluation and defining and measuring financial capability in a developing country context. There are also examples of funders supporting innovative approaches for delivering financial capability programs and building consumer awareness. For example, USAID launched the nationwide campaign Rural SPEED in Uganda in 2004 to promote the value of savings through road shows, radio, and outdoor advertising. After three years, rural Ugandans opened more than 300,000 new savings accounts due to Rural SPEED's savings activities, exceeding the program's target (USAID 2007). Funders should also look to ensure that organizations involved in designing and delivering financial capability programs have a background of working with poor people, as well as sound financial knowledge.

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3. *Extending the Reach of Sound Retail Providers*

Key Lessons

- Different kinds of institutions are needed to improve access to savings services for the poor. Different providers serve different market segments and client needs.
- Managing deposit services for the poor requires greater institutional capacity than credit-only services.
- The decision on whether to support a particular institution should focus, foremost, on management commitment to savings mobilization and the institution's capacity for safe and sound deposit operations or its ability to build that capacity.

Guidance for Funders

- Support capacity-building and the up-front investment costs of introducing or scaling up savings services and use performance-based funding.
- Explore other, nontraditional service providers (such as telecommunication companies) that may partner with financial institutions to extend their reach and product range.
- Focus support on the types of institutions that match funders' internal capacity and expertise.

Mobilizing savings from poor clients requires greater institutional capacity and more stringent standards than managing only credit services. Unlike credit, where nearly all of the risk is borne by the financial institution, with savings services, the risk is borne by the clients who deposit their money with institutions they trust. While a credit-only provider can manage growth by the number of borrowers approved, voluntary savers cannot be turned away without long-term negative effects on the institution. Institutions need to be prepared for large and often uncontrollable growth.

Mobilizing savings can be done only by institutions that are subject to government prudential regulation, except in the case of informal credit and savings groups and, in some cases, small savings and credit cooperatives. To mobilize savings, institutions must have the capacity to comply with all central bank requirements ranging from staff with specific management profiles to reserves maintained at the central bank. Institutions considering mobilizing savings should do so only if their capacity and governance are strong and management is clearly up to this task. They must have strong internal risk management systems that allow them to manage market dynamics, such as inflation or currency devaluation, which can sharply erode the real value of deposits. Lastly, institutions must consider and be able to absorb the high transaction costs associated with offering small-balance savings services, especially in hard-to-reach, remote markets. A recent CGAP study of the business case for small-balance savings shows that high operating costs linked with small-balance savings mobilization can be more than overcome by the profits generated through cross-sales of loans and other products to small savers and by the fee income derived from their savings accounts (Westley and Palomas 2010). The biggest challenge is often achieving cost-efficiency and finding innovations in service delivery that make it feasible to mobilize very small deposits. Economies of scale and technology-based innovations can play an important role in bringing down costs.

Overview of different institutional types: Challenges to scaling up savings and support needs

There are a number of diverse types of financial service providers that have the potential to scale up savings services. The main operational challenges of these providers to becoming secure and viable financial intermediaries vary significantly across different business models. Hence, each type of provider will require different types and levels of support. The overview below does not include all types of financial services providers. For example, in some countries (e.g., the Philippines) rural banks are important providers of savings services in remote areas.

Informal member-owned savings and credit groups have proven effective in providing the most basic financial services to poor people, especially in areas in Africa and Asia with inadequate infrastructure. For example, rotating savings and credit associations (ROSCAs) are indigenous savings institutions that are found in virtually every country under an indigenous name, such as Tontine in West Africa, Dhikuti in Nepal, and Arisan in

Indonesia. Such groups are usually low-cost operations and simple to manage; they can be seen as a first step to creating a savings culture and discipline. Participation in a savings group can also help empower members and build up social capital within communities, particularly among women who often represent the majority of members. Such community-based groups are growing rapidly. Even in countries with a large number of specialized MFIs, such as Bangladesh, the groups play an important role in the poorest villages lacking formal financial institutions. Another example includes the self-managed village savings and credit banks (CVECAs), a model first developed in the Dogon region of Mali in the late 1980s. CVECAs are member-based organizations widespread in West Africa, and structurally they come between informal actors, like ROSCAs, and formal actors, like banks.

Savings and credit groups provide basic savings services, but their shortcomings can include limited product offerings, members' inability to access savings when they want to, lack of security, and poor management—the risk of theft and fraud can be high.

Nongovernmental organizations (NGOs) often provide support to informal savings groups. The role of an NGO or other support provider typically involves introducing the concept to a community, facilitating group formation, and delivering a carefully structured training program to help members define the group's purpose, elect members to serve as officials, establish terms for savings and loans, and set up systems for record keeping. Funders can usefully finance the costs of such support. For instance, over the course of its 18-year village savings and loan associations (VSLA) program, CARE has established over 54,000 groups in 21 African countries, serving over 1 million members (CARE 2009).

Funders' assistance to savings and credit groups should focus on improving risk management and operational capacities, as well as facilitating the creation of new groups in areas with little alternative financial service provision. Studies show that an external injection of capital funding, especially in the early stages of institutional development, has consistently failed, decreasing groups' incentives to build up their own savings pool and undermining sustainability.

Financial cooperatives and credit unions around the world already mobilize large numbers of small voluntary savings. They are inherently savings-led organizations. Typically, they have low operating costs partly because they rely on volunteers and are often located in remote, rural areas where there are no banks or specialized MFIs.

For these member-owned institutions, the challenges to scaling up savings services are typically related to lack of management and staff capacity, poor governance, and lack of oversight and supervision. Some financial cooperatives and credit unions also face an inability to safely lend funds received as deposits due to lack of credit capacity and systems.

Funders can best support member-based financial providers by building institutional capacity to increase and manage deposits (and loans) rather than injecting external funds for lending that can undermine their structure. Often a first step in supporting financial cooperatives is to ensure the safety of deposits by making sure the organization meets accepted financial management standards. The World Council of Credit Unions (WOCCU) uses the PEARLS financial performance monitoring system in its technical support to credit unions. This system is explicitly structured around indicators that ensure the institution is a safe place to save, incorporating measures such as proper loan loss provisioning. It also ensures that assets, financed by savings deposits, generate sufficient income to pay market rates on savings, cover operating costs, and maintain capital adequacy. This is an example of good practice that could be replicated by other associations and credit unions while being adapted to their specificities.

As cooperatives and credit unions grow, they must professionalize their management services, often requiring a growth process that transforms volunteers into professionally qualified staff. The process should be part of the institution's business and financial growth plan and needs to be fully managed at each stage. Funders can support financial cooperatives in developing governance standards, using business planning tools, instituting monitoring systems through formal management information systems (MIS), and developing new savings products and delivery channels to reach poorer customers. Growth also requires investing in information systems and negotiating equal access to payment systems.

Funders should concentrate resources on cooperatives and/or federations that are willing to implement sound policies, standards, and regulations. Such institutions may also need support for federating and linking into larger distribution networks and the commercial banking system to allow greater financial intermediation.

For member-owned savings institutions, funds for lending should be approached with great caution as access to external credit can weaken governance and undermine incentives for savings mobilization without proper oversight and training.

Credit-only MFIs that plan to introduce savings services can have the advantages of already serving a poorer client base and in some cases having a social mission and management commitment to expanding financial access to the poorest. Lack of regulatory authority, institutional capacity, qualified staff, high cost of institutional transformation and preparation for the rigors of prudential regulation and supervision, as well as governance issues are often the main constraints to such organizations introducing savings services.

For credit-only MFIs, developing the capacity to offer deposit services is a major undertaking, representing a process of complete institutional transformation. First, they need to apply for a license to become a regulated and supervised institution, and they must comply with all regulatory standards. Once this is achieved, the biggest challenges are often developing institutional capacity as a financial intermediary, changing the institutional culture from a focus on credit to financial intermediation, and building clients' trust in the institution as a place to deposit their money. Credit-only MFIs select borrowers whom they trust. However, when collecting savings, it is the clients who must trust the MFI. There are three key shifts as an MFI goes from credit to savings. These relate to the importance of marketing and branding, branch distribution (given clients' lower willingness to travel), and treasury management (greater uncertainty over cash flows). Savings mobilization requires moving toward efficient management and accountability systems, expanding both the product range and the client base, building a more qualified and professionally trained staff, and understanding and fulfilling banking regulations. These challenges can be met only if the senior management and board are fully committed and have given serious consideration as to whether transformation is the right move.

There are many cases of transformed microcredit institutions that struggle to mobilize deposits successfully. For example, regulators may put limits on the percentage of the portfolio that can be uncollateralized. This can have major negative implications for MFIs that have been using unsecured lending methodologies to reach low-income clients. However, there are some notable successes; probably the most well-known example of a successfully transformed MFI is the case of Grameen Bank. Grameen II, the bank's fundamental overhaul of its products that began in 2001, has moved the bank from simple microcredit to a more sophisticated system offering a range of financial services, including savings, with remarkable results.[2]

In some cases, credit-only MFIs may decide after initial analysis that they do not have the capacity to carry out full financial intermediation (i.e., raising deposits and on-lending). In such cases, funders might support these MFIs in offering *agency banking* services by mobilizing savings for another regulated institution. In this case, prudential regulation and supervision is required for the principal (e.g., the bank) but not for the agent (e.g., the MFI). The principal is responsible for supervision of the agent. In an agency relationship, the institutional capacity-building requirements for an MFI are far less onerous. However, staff will still need to be trained on savings products, cash management, and overall customer service.

Funders can play an important role in the transformation of credit-only MFIs to deposit-taking organizations. Such support is particularly necessary in the initial two to three years to carry out the detailed business planning and financial modeling for the transformation, technical assistance to help the MFI meet central bank requirements, and the introduction of new internal controls and procedures, such as treasury and asset–liability functions. Investors may also consider helping the MFI meet local capital adequacy requirements to be a regulated institution, such as by making an equity investment. Additionally, support for market research and product design, marketing, upgrading and expanding premises and information systems, and staff training are also needed. For example, the International Finance Corporation (IFC) has supported the transformation and the launch of savings services of several MFIs in Azerbaijan, Tajikistan, and the Kyrgyz Republic.

Specialized microfinance banks include transformed NGOs and non-bank financial institutions, as well as **greenfield banks**, set up as deposit-taking institutions that target poor clients and small and medium enterprises (SMEs). Public subsidies for these institutions should be limited to the initial

[2] For more information see MicroSave's Briefing Notes on Grameen II, www.microsave.org.

years of the operation to help cover the costs of technical assistance and training of local staff. Alternatively, a package of debt and equity can be used to provide the working capital and investment needs of the bank until it breaks even. ProCredit Holdings, which has set up 21 greenfield banks, has been funded in this way by a range of public and private investors, such as Germany's Kreditanstalt für Wiederaufbau (KfW). Several ProCredit banks have been very successful in mobilizing deposits, including from lower income customers.

Savings and postal banks include a broad range of institutions from universal banks, which provide the full range of financial services (money orders, savings, current accounts, credit, etc.), to post offices, which focus mainly on savings services. These organizations, many of which are state-owned, already provide mass-market access to savings accounts and loans for people in many countries, including low-income customers in rural areas. When state-owned, these institutions are too often not a priority for governments or donors. As such, they have suffered from lack of investment and limited customer services.

Savings banks have kept, for the most part, a strong focus on serving low-income segments of the population, and often operate under the same conditions as retail banking institutions. They have the capacity and technical expertise to mobilize savings, but product redesign and marketing, as well as internal procedures and processes, often need improvement. This may require significant investment in information technology (IT) systems and new delivery channels.

Postal savings institutions have traditionally been weak on customer orientation. They also often have poorly qualified staff, limited use of technology and equipment (e.g., connectivity of branches), and procedures that are heavily bureaucratic. These issues are their main challenges to increasing the provision of attractive savings services. Nonetheless, the potential of postal networks for financial service delivery is increasingly recognized by many of the organizations themselves and international development agencies. However, there are few good practice models of how postal organizations can translate this potential. One of the few success stories is Banco Postal in Brazil, which opened almost 10 million savings accounts in eight years, providing access to financial services to 20 percent of the country's 50 million financially excluded people (Universal Postal Union 2010).

Funder support to postal banks must respond to demand from these institutions rather than to supply. Given the sheer size, and (typically) state ownership of these institutions, institutional reform and other technical assistance projects are generally complex and large in both volume and scope. Thus, funders should carefully target assistance to institutions that demonstrate a commitment to sound governance and customer service, an interest in targeting low-income savers, and a willingness and flexibility to potentially adopt new operational structures, such as public–private partnerships. For example, the Bill & Melinda Gates Foundation supports the World Savings Banks Institute's (WSBI's) initiative to work with member banks in 10 countries to double the number of accounts held by poor people. Almost all projects will involve postal institutions and will include upgrading IT systems, implementing nonbank agent networks, making existing products more useful for poorer customers, and instituting communications and marketing campaigns.

Mainstream **commercial banks** are relative newcomers in financial services for the poor. For commercial banks the greatest obstacle to servicing small-balance depositors and expanding into rural areas is often management's view that a move down market is not cost-effective, profitable, or a priority. Other important deterrents include a lack of competitive pressure to search for new markets, inappropriate systems to manage low-cost delivery channels, and a corporate culture that is not oriented toward serving poor clients.

Bank down-scaling has historically been focused on encouraging mainstream banks to reach out to low-income clients and SMEs through a support package combining technical assistance and wholesale loans for on-lending. Funders of downscaling initiatives have typically not invested in working with commercial banks to research how they could extend their savings services to low-income customers. However, as traditional commercial banks move into microfinance they are naturally beginning to look at how they can cross-sell products, including savings services. Funders' roles in supporting these banks should focus on knowledge sharing and technical support in product design, customer service, and promotion to low-income customers, as well as in helping commercial banks to adhere to "Know Your Client" norms, which small depositors often find difficult to meet.

The role of technology in scaling up savings

New delivery methods, such as branchless banking and the use of mobile technology,[3] are likely to evolve rapidly and play an important role in achieving financial access for poor people alongside or in partnership with the institutions discussed in the preceding sections. Leveraging existing networks of nonbank retail outlets, such as retail stores or post office outlets, as cash transaction points and agents of licensed financial institutions has already proved a successful business model in countries such as Brazil.

Thus far, branchless banking has mainly facilitated money payments and transfers, and the current linkage to savings mobilization is weak. However, the role of mobile phone technology in savings mobilization is likely to increase rapidly, as more telecommunication companies become savings agents by partnering with financial institutions and collecting savings on their behalf. Poor people are already starting to use mobile banking for something that looks like savings despite what the providers designed the products to be. For instance, M-PESA, operated by Safaricom in Kenya, is not a licensed deposit-taking institution. However, M-PESA clients are storing money in their virtual "wallets." One study found that in Kibera, a poor slum area, a fifth of unbanked interviewees stored money with M-PESA because it is safer than storing it at home (Morawczynski and Pickens 2009). Studies have also shown that saving in a branchless banking account is cheaper than most basic no-frills accounts. Banks, such as Equity Bank, and MFIs are now using the M-PESA infrastructure to offer products, including deposit accounts, which will mean mobile phones can be used to more formally mobilize savings.

[3]For more information see http://www.cgap.org/p/site/c/tech/.

The likely future role of technology is further exemplified by the recent acquisition of Tameer Bank in Pakistan by Telenor, a mobile network operator (MNO). The bank and MNO are now working together to offer multiple financial products, including savings services. Such joint ventures are likely to become more common globally.

When working with mobile phone companies, funders need to take an entrepreneurial and commercial approach. The technology business is not suited to the common donor funding model that comprises a significant amount of money, generalist models of expertise, and very little flexibility about how the money is used. Experience working with telecommunication companies has shown that these private companies already have access to considerable resources and are not seeking external funding from donors with significant strings attached. In fact, the funding needed by funders to work with telecommunication companies is relatively small, but this funding needs significant flexibility to allow those with a strong understanding of the technology to serve the poor. Thus funders need to be strategic, using leverage and influencing markets, rather than using only financial resources, to persuade telecommunication companies to engage.

Several funders (e.g., Bill & Melinda Gates Foundation, DFID, KfW) are already supporting branchless banking and the use of technology to extend the reach of financial services to low-income clients. These experiences have provided many lessons on appropriate business models, cost structures, and partnerships.

Table 1: Summary of the Advantages and Challenges of Different Saving Providers

Financial Service Provider	Advantages	Challenges
Informal Community-Managed Savings Groups (SHGs, ROSCAs, ASCAs, VSLAs)	• serve poor clients, primarily women • operate in remote, rural regions • low-cost operations • easily replicable and/or self-replicating • profits distributed to members • build social capital and self-esteem	• limited product offering • limited managerial capacity • savings methods limit asset building • risk of exclusion of poorer individuals • risk of theft of savings
Financial Service Provider	**Advantages**	**Challenges**
Credit Unions and Other Financial Cooperatives	• inherently savings led • simple, affordable products • often located in remote regions accessible by the poor • low transaction and financial costs	• governance challenges • finding the right balance between borrowers' and savers' interests • risk of capture by net borrowers/elite • lack effective prudential regulation and oversight by financial authorities in some countries
Transforming (formerly Credit-Only) MFIs	• knowledge of poor clients • social mission often oriented to serve poor and marginalized communities • increasingly more interested in using deposits to diversify funding sources	• inadequate institutional capacity for savings, e.g., asset–liability management • high costs of institutional transformation • credit-led culture/ staff resistance to transformation • lack of access to payment systems

(continued)

Table 1: Summary of the Advantages and Challenges of Different Saving Providers *(continued)*

Specialized Microfinance Banks and Greenfields	• adequate skills and expertise • set up as deposit-taking institutions, no transformation required • broad range of products	• require significant subsidies initially • knowledge gained not shared beyond network/holding for proprietary reasons • often not reaching clients in remote areas • limited branch network
Financial Service Provider	**Advantages**	**Challenges**
Savings and Postal Banks	• extensive branch networks that often penetrate rural markets • pre-existing infrastructure can allow for low transaction costs • usually perceived to be safe and secure	• governance and management challenges • bureaucratic culture • often require significant institutional reform • limited product range • poor customer service
Mainstream Commercial Banks	• broad range of products and services; may have recognized brand name • modern branch infrastructure • large network of branches and other outlets • linkages to payment systems • ability to cross-subsidize small-balance accounts with existing high-volume operations • safer than other institutions if properly regulated and supervised	• corporate culture not oriented toward serving low-income markets • limited incentives to target poor and remote clients • existing products often do not meet the needs of the poor • lack of low-cost delivery channels • operate mostly in urban areas

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4. *Strengthening Market Infrastructure for Savings Services*

Key Lessons

- Support to market infrastructure goes beyond microfinance, and it is important to take a broad financial sector perspective when supporting initiatives at this level.
- In-country trainers and technical advisory services for savings mobilization are usually quite limited.
- Access to payment services can affect an institution's ability to attract deposits.

Guidance for Funders

- Support in-country training and technical assistance service providers to increase their experience and expertise to support savings services.
- Support initiatives that increase access of financial providers serving the poor to payment systems. The form of support may begin with facilitating communications among relevant stakeholders (central bank, banks, etc.).
- When supporting deposit insurance, funders should apply good practice design features and have access to adequate expertise.

Market infrastructure refers to the full gamut of services and institutions that support retail institutions, including payment systems and money markets, technical assistance, training, and other support services. This section focuses on those services that are most relevant for savings mobilization and not the full spectrum of services that make up market infrastructure.

Training support and capacity building

In-country training and technical support for deposit mobilization are usually quite limited. Until recently this has been because most microfinance markets have been credit-driven, and few local trainers have savings-related expertise. Foreign banks typically send staff to their main institutions for training, reducing their need for in-country technical assistance. The training needed to develop delivery channels, train staff on customer service, or design products for the low-income depositors market is not easily accessible by financial institutions serving poor clients. Most NGO transformations and support for savings mobilization have happened with the backing of international, not local, technical service providers.

Funders can help to strengthen the capacity of local service providers by investing in existing providers, sharing knowledge, and creating linkages between financial institutions and existing local support institutions. For example, KfW has invested in the creation of microfinance training institutes in Nicaragua and Honduras, and has trained over 50 local microfinance consultants to provide technical assistance to regional MFIs, including in deposit mobilization. Another recent example is a regional training center for microfinance created by ACLEDA, Cambodia. Funders can also support training of trainers and individual experts as a way to strengthen the overall supply of trainers and experts for local service providers to draw upon.

Payment systems and money markets

Payment systems allow the transfer of money among participating financial institutions. Access to the payment system can greatly affect an institution's ability to capture deposits. Linkages to payment systems allow financial institutions to make clients' savings available in multiple locations, perform electronic transfers, and issue check books and payment cards. Traditionally, access to payment systems is restricted to large, regulated financial institutions.

Lack of access to money markets can undermine institutions' incentives to mobilize savings. In many markets, regulated financial institutions already have more than sufficient funds relative to lending or investment opportunities, especially in the short term. Demand for short-term client deposits can thus be weak. For instance, in many developing countries liquidity management mechanisms of commercial banks are limited by the lack of treasury notes, interbank market, or repurchase agreements. In developed countries these imbalances are usually corrected by liquidity management mechanisms (i.e., money markets). However, many developing country markets lack such liquidity management mechanisms, and as a result, many commercial banks do not target additional deposits, especially short-term deposits. Improved liquidity management mechanisms that enable institutions to place excess funds into safe, short-term, remunerative investments could potentially increase banks' appetite for deposit mobilization.

Supporting the development and reforms of payment systems is complex and related to the entire financial sector, not just microfinance. Funders should encourage the development of effective communication among relevant stakeholders in the payment system, including the central bank and existing financial institutions using the system. Funders could help organizations serving low-income market segments negotiate terms on which they can afford to link into the payment system.

Deposit insurance

A deposit insurance system is a public or private scheme aimed at protecting depositors from losing their savings when banks fail and stabilizing the banking system by preventing bank runs.

Every country has some type of implicit deposit insurance, even if no explicit deposit insurance system is in place. This means that whenever a large or widespread banking insolvency occurs, even if no explicit deposit insurance system is in place, pressure for governmental relief of at least some depositors and other bank stakeholders can become politically too intense to resist. The International Association of Deposit Insurers (IADI) lists about 120 countries with explicit schemes in operation, planned, or under serious study. As of 2008, 106 countries had explicit deposit insurance systems in place, compared to 85 in 2006 and 47 in 1995; of these more than half are in developing and emerging economies.

Public confidence in providers of deposit services to the poor (whether banks, MFIs, or financial cooperatives) can be reinforced if those providers have deposit insurance. Deposit insurance also protects clients, who may not have the information to assess a financial service provider against failure due to fraud or mismanagement. An explicit scheme typically requires licensed depositories to become members of the scheme and pay regular premiums. Deposit-taking institutions that are not regulated and supervised by the central supervisory body, such as small financial cooperatives, typically are not covered by deposit insurance.

Funders supporting deposit insurance should keep in mind that deposit insurance and government guarantees should never completely replace market discipline. One of the shortcomings of deposit insurance schemes is that they can encourage banks to lend irresponsibly (the issue of moral hazard). Even in strong institutional environments, weaknesses in deposit insurance design (e.g., inappropriate coverage limits, membership criteria) can fuel financial fragility and lessen the discipline that banks receive from private counterparties. Therefore when supporting deposit insurance schemes, funders should have access to adequate expertise, keeping in mind good practice design features (see for example, the IADI Core Principles). Examples of funders' support to deposit insurance include (co)financing of the initial capital allowance of a deposit protection fund or technical assistance in creating the legal and regulatory framework. Funders have already successfully supported deposit insurance in many countries. For example, KfW and USAID supported the set-up of deposit insurance in Bosnia-Herzegovina in 2000 that also helped rebuild citizen's trust in banks after the post-war collapse of banks. KfW and Gesellschaft für Technische Zusammenarbeit (GTZ) are currently supporting the Bank of Uganda as it introduces deposit insurance.

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5. *Supporting Sound Policy Environments*[4]

Key Lessons

- Except in the case of small, community-based intermediaries too tiny or remote to supervise effectively, the assumption should be that prudential regulation and supervision is required for any institution mobilizing savings from "the public."
- Members' savings and capital in a financial cooperative should generally be thought of as funding from "the public," as members may be no better positioned than a typical public depositor to monitor and protect the health of the institution.
- Capacity of regulators and supervisors is often the main bottleneck.
- There is no one-size-fits-all regulatory or supervisory solution. Each country should establish its regulatory and supervisory framework, taking into account its priorities and capacity constraints.

Guidance for Funders

- Funders should support policy and regulatory environments that balance increased access, financial stability, and protection of savings.
- Funders should help build capacity of regulatory and supervisory bodies.
- Funders should not support regulatory reform to promote new types of depository institutions unless they are also prepared to support the supervisory capacity needed to deal with the anticipated new licensees.

Supportive policy environments that balance increased access, financial stability, and protection of savings are crucial for successful deposit mobilization. Generally, if a financial institution takes deposits from the public, prudential regulation is called for, as the return of depositors' money cannot be guaranteed unless the financial institution as a whole is financially

[4] For more information see Microfinance Consensus Guidelines: Regulation and Supervision of Microfinance CGAP, forthcoming.

solvent. Prudential regulation aims to ensure the financial health of the regulated institution to protect depositors from the loss of their savings and the financial system from the so-called contagion effect stemming from the failure of one depository institution. Prudential regulation includes appropriate specifications for capital adequacy and liquidity ratios, minimum capital and reporting requirements, etc. Prudential supervision is an external oversight and engagement aimed at determining and enforcing compliance with prudential regulation. Effective supervision is essential to ensure the security of deposits. It is intensive and expensive, both for the supervisor and the supervised institutions—and sustainable institutions must pass these costs on to customers (in the absence of ongoing subsidy).

Each country has its own regulatory and supervisory framework and there is no "one size fits all" solution on the policy and regulatory side. To manage harmonization challenges, macro-level support by funders must take into account the existing legal and regulatory and supervisory capacity in the country and build on the existing framework rather than importing standard models that are used elsewhere. Funders must also have their own access to adequate technical expertise to work at this level. This does not suggest that all funders should be legal and regulatory experts, but if they are not, they will need to include these types of expertise in their staffing plan, from the beginning of project planning through to the completion of project implementation and monitoring.

Funders should not support the development of deposit services unless prudential regulation and supervision in a country has the potential to be reasonably effective. Funders that focus on the policy level must be careful to balance the need for increased access by the poor with that of the security of deposits and the stability of the financial system as a whole. Some regulatory and supervisory entities may also be reluctant to accept external advice—particularly from parties other than fellow supervisors. To address this problem, peer-to-peer learning and "South–South" dialogue can be very effective. For instance, the Alliance for Financial Inclusion (AFI), a global network of policy makers, currently has such a project in place.

In the past decade there has been a tendency to support regulatory reform aimed at promoting the licensing of new depository institutions targeting the poor, but not the supervisory capacity needed to ensure that the new institutions that are licensed can be effectively supervised. Yet in practice, it is the supervisory body that often lacks the capacity to effectively monitor the performance of regulated microfinance providers and intervene as necessary if their financial health comes into question—or at least not without taking scarce time and human resources away from their duties overseeing the stability of the banking system. Funders should be careful not to contribute inadvertently to this kind of resource allocation challenge, and should instead formulate carefully conceived and realistic plans to build the capacity of regulatory and supervisory bodies to manage supervision of any new deposit-taking entities effectively. Bearing in mind that supervision of microloan portfolios requires expertise that a typical bank examiner does not have (BIS 2010); this is a considerable, long-term commitment. Furthermore, regulators and supervisors need exposure and training on essentials of microfinance to fine tune their systems to the specifics of the sector.

Investors may have an inherent conflict of interest when working on the policy level and must recognize that what may be good for their partner institutions may not necessarily be the most prudent regulatory advice for the microfinance industry or for the stability of the financial system as a whole. In particular, they need to realize that any new regulatory provisions designed to promote licensing of depository MFIs carry the risk of regulatory arbitrage—and that the applicants for the new license may include a substantial number who choose this option because it appears an easier license to obtain than a banking license, rather than out of a genuine interest in serving the poor.

Box 1: Regulation and supervision of financial cooperatives

While cooperatives in many developing countries provide savings services (and other financial services) to large numbers of low- and middle-income clients who often cannot access banks, they typically have not been subject to the same kind of regulatory scrutiny and oversight as banks—or at least not until they grow to a significant size. Cooperatives tend to hold a far smaller fraction of systemwide assets, and they are often considered more "cooperative" (i.e., nonfinancial member-based) than financial institutions and, hence, are not considered a risk

(continued)

to the financial system as a whole. However, given their importance in providing savings services to large numbers of low-income clients, improving their regulation and supervision—and governance—is a topic of intense concern.

Although in some countries larger cooperatives may be regulated and supervised as banks, in practice the vast majority of financial cooperatives are not effectively regulated, and many are entirely unsupervised. The arguments for regulation and supervision of cooperatives are related to those for the regulation and supervision of the banking sector as a whole. Even when cooperatives account for a fraction of total deposit amounts in a given country, depositors are still worthy of protection, and in many cases large cooperatives function more like banks than member-based organizations. As such, they have the potential to impact the stability of the financial system. Moreover, an argument can be made for protecting their (typically poorer and more vulnerable) depositors and suppliers of redeemable share capital even where they are unlikely to have a systemic influence. The challenge therefore is how to set up a supervisory system that minimizes those costs while still providing credible protection.

The arguments against regulation and supervision of cooperatives are typically associated with the costs of supervising large numbers of relatively small institutions. For small cooperatives, at least where the concept of membership and mutuality is strong, costly external regulation and supervision may not be justified. Instead, good governance and well-functioning internal control mechanisms may be sufficient to ensure protection of the deposits of members and to prevent management and boards of directors from exposing depositors' funds to unwarranted risks.

Funders who wish to work on policy issues related to cooperatives need to have a deep understanding of the performance of the sector in the country and its particular features (in many countries, financial cooperatives do not present a homogeneous picture). Also, more research aimed at understanding and identifying the conditions under which alternative regulation and supervision models may be more effective than others (including cost effectiveness) is needed—and might be a worthwhile investment for interested funders.

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6. *Choosing the Right Role in Promoting Savings*[5]

Key Lessons

- Only funders with the relevant internal capacity should support savings mobilization.
- Savings mobilization is an integral component of overarching goals, such as poverty alleviation, access to finance, and building an inclusive financial system.

Guidance for Funders

- Funders should have a clear strategy that articulates the funder's goal in supporting savings mobilization.
- Funders should support savings mobilization only if they have the adequate expertise, systems, and instruments.
- Promoting savings is best suited to funders with the resources (typically grants) to support capacity building and technical assistance over the medium to long term.

Funders need to reflect internally to determine if they have the capacity to support savings mobilization or to develop their work in this area.

First, funders should have a **clear strategy** that articulates their goal in supporting savings and how their support for savings mobilization builds on its existing support for microfinance. Funders typically set three main overall goals when supporting microfinance:

1. Expanding access to finance
2. Building inclusive financial systems
3. Reducing poverty

[5] This analysis is based on CGAP's SmartAid methodology. For more information see http://www.cgap.org/p/site/c/template.rc/1.11.7956/

Supporting savings mobilization is a crucial building block to achieving these goals (see Box 4). Some funders (notably the Bill & Melinda Gates Foundation) focus primarily on savings and support research into the most effective methods, policies, and regulatory changes needed to help deliver safe, quality, financial services outside traditional bank buildings. Funders also need a long time horizon and a tolerance for high-risk but potentially high-return (in terms of impact) projects. Savings projects may require many years of ongoing technical support without the guarantee of success.

Second, funders should support savings mobilization only if they have **adequate staff capacity** and market knowledge. This includes either in-house staff or consultant time to identify and assess appropriate interventions and partner institutions. If supporting a licensed deposit-taking institution, staff or consultant skills will need to include understanding of the basic issues

Box 2: Example of how savings work fits into funders' strategies and helps achieve development goals

Expanding access to finance (e.g., World Bank, IFC)

- Savings promote greater outreach to poor clients: Outreach to savers is larger than outreach to borrowers.
- Successful savings-based MFIs reach 5–10 times more savers than borrowers.

Building inclusive financial systems (e.g., GTZ, Swiss Agency for Development and Cooperation [SDC])

- Savings contribute to strengthening local financial *intermediation* (as opposed to *channelling* of cross-border funds).
- Savings increase self-sufficiency of local financial systems in terms of funding.

Poverty reduction (e.g., Ford Foundation, Swedish International Development Cooperation Agency [Sida])

- Savings reduce the vulnerability of poor households to economic shocks of different kinds.
- Savings provide a tool for risk management by the poor.
- Savings can have a direct impact on poverty reduction.

of prudential regulation and supervision, business planning for a savings-based institution, asset–liability management, and savings product design.

Also, when supporting savings mobilization, funders should have **accountability systems** that measure the performance of the individual projects or investments. They should focus on the right mix of indicators for project-level monitoring, which is more comprehensive than for financial institutions that do only credit. Such indicators include, for example, the number of depositors, total number and value of deposits mobilized, and additional financial performance and risk measures, such as, capital adequacy, savings liquidity, and the effective financial expense of savings.[6]

Finally, funders need to have an **appropriate mix** of funding instruments. Promoting savings is fundamentally about capacity building at the micro, meso, and macro levels of the financial system. Hence, it is best suited to funders with the resources to support capacity building and technical assistance.

Grant support is perhaps the most useful financial instrument for supporting savings mobilization. Grants can be effectively used to support a broad range of institutional needs and models. In the case of supporting the scale-up of retail provision, grants can be used to support investments in technical assistance and training, and physical infrastructure (e.g., upgrading premises, MIS, study visits, etc.). Grants can also be used to support technical assistance and capacity building to develop market infrastructure and a sound policy environment for savings mobilization. Grant support should be time-limited, performance-based,[7] and disbursed against the grantee institution's attainment of clearly established performance targets.

Debt financing is one of the most prevalent ways that funders support microfinance, representing 63 percent of all cross-border funding in 2008 (2009 CGAP Funder Survey). Debt financing can support, but it can also hinder, savings mobilization. Debt financing should be incentive-compatible (i.e., nondistortive) and complementary to savings mobilization.

To advance savings mobilization, debt financing should be structured in such a way that it does not negatively affect financial institutions' incentives. For example, funders should price loans to financial institutions at least as high as the total cost of mobilizing deposits. Pricing external credit lower

[6] See New Financial Ratios for Microfinance Reporting, Excerpt from *MicroBanking Bulletin*, Issue 19, December 2009.

[7] For more information on performance-based agreements see El-Zoghbi, Glisovic-Mezieres, and Latortue (2010).

than this rate undermines the incentive for an institution to finance its loan portfolios with deposits. Debt providers can also use their influence to promote savings mobilization with retail service providers even if their funding is primarily being used to expand credit provision. For example, increasing savings could be a condition or performance target for a loan and could function as a positive incentive.

Equity is less prevalent in microfinance, with only 11 percent of all committed funds channeled this way as of December 2008. However, equity can be an important instrument in supporting savings mobilization. Development finance institutions (DFIs) have used equity investment to help meet the start-up capital needs of greenfield microfinance banks or to help credit-only institutions meet the capital adequacy standards of banking regulators when transforming to a regulated deposit-taking institution.

Equity can potentially provide a more patient source of growth capital than debt and is thus better suited to institutions looking to start-up or scale-up savings services. Furthermore, it involves risk-sharing by the investor, which can make it a more attractive source of funding. However, to appropriately use equity as a tool for advancing savings mobilization, equity investors must have at least a medium-term investment time frame and set realistic financial return expectations. With equity investment, an investor typically gets a seat on the board and a stake in the governance of an institution. Investors can use this position to maintain oversight of the governance and management of the institution to ensure that it has the necessary capability to mobilize savings and that sound financial management standards are being met.

Overall, different types of funders are best suited to add value at different stages in the development of financial intermediaries, depending both on their own goals as funders and the type of finance they can offer.

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Annex 1: Savings Glossary

1. Types of Savings Services

Compulsory/Mandatory Savings

Savings payments that are required as part of loan terms or as a requirement for membership, usually in a credit union, cooperative, MFI, village bank, or savings group. Compulsory savings are often required in place of collateral. The amount, timing, and level of access to these deposits are determined by the policies of the institution rather than by the client. Compulsory savings policies vary: deposits may be required weekly or monthly, before the loan is disbursed, when the loan is disbursed, and/or each time a loan installment is paid. Clients may be allowed to withdraw at the end of the loan term; after a set number of weeks, months, or years; or when they terminate their memberships.

Contractual/Programmed Savings

Savings in which the client commits to regularly depositing a fixed amount for a specified period to reach a predetermined goal. After the maturity date, the client can withdraw the entire amount plus the interest earned. Early withdrawal is prohibited or penalized. Contractual products help depositors accumulate funds to meet specific expected needs, such as expenses associated with school, a festival, a new business, an equipment purchase, or a new house. They also help financial institutions better predict the volume and timing of deposits and withdrawals.

Current Accounts

Demand deposit accounts that allow the account holder to transact using checks. Account holders can also transact face-to-face at the branch and may be able to use ATMs or point-of-service devices.

Demand/Sight Deposit

Fully liquid accounts in which the saver may deposit and withdraw any amount at any time with no advance commitment. The saver must maintain a minimum required balance. Demand deposit transactions (deposits, withdrawals, transfers/payments) may be made using passbooks, checks, debit cards, and ATMs and/or point-of-service devices. If clients overdraw their demand deposit accounts, financial institutions generally charge penalties and/or high levels of interest or the payment may be rejected outright.

Informal Savings

Savings held outside of a formal financial institution. Informal savings mechanisms include saving at home (in cash or kind), savings groups, rotating savings and credit associations (ROSCAs), accumulating credit and savings associations (ASCAs), reciprocal savings and lending with neighbors or relatives, money guards (friends or relatives willing to hold a saver's money for a period), and informal sector deposit collectors (people who charge a fee to hold a saver's money for a determined period). Informal savings devices are often highly convenient but may be unreliable, insecure, and/or illiquid. A financial institution should have a solid understanding of the local informal savings market before it attempts to develop savings services for poor people.

Passbook Accounts

Demand deposit accounts that use passbooks rather than checks, ATMs, or point-of-service devices for transactions.

Savings/Regular Savings Accounts

Demand deposit accounts that use passbooks, magnetic stripe or smart cards, ATMs, point-of-service devices, or some combination of these for transactions. They do not allow account holders to use checks.

Time/Certificate/Fixed Deposit

A savings product in which a client makes a single deposit that cannot be withdrawn for a specified period. At the appointed time, the client withdraws the entire amount with interest. The financial institution offers a range of possible terms and usually pays a higher interest rate than on its demand deposit or contractual products. Because they tend to be larger than other types of deposits, have contracted withdrawal times, and involve fewer transactions, time deposits can provide a significant source of relatively low-cost funds that facilitate asset–liability management. This is particularly true if an MFI can attract large institutional depositors.

2. Financial and Risk Management

Asset–Liability Management (ALM)

The process of planning, monitoring, and controlling asset and liability volumes, maturities, rates, and yields. A primary goal of ALM is to minimize interest rate risk while still earning sufficient profits. ALM is more important and complex for institutions engaged in financial intermediation because interest rate risk tends to be higher for these institutions than for institutions engaged solely in credit or savings. Financial institutions manage interest rate risk by carefully maintaining a balance between different types and volumes of assets (in particular, loans) and liabilities (in particular, savings).

Financial Intermediation

The process of mobilizing deposits and disbursing them as loans to clients or investing them in other types of financial instruments. Managing financial intermediation is significantly more demanding than managing credit alone. In particular, maintaining the quality of assets in order to protect the value of deposits and managing liquidity, internal controls, and assets vis-à-vis liabilities are more challenging.

Interest Rate Risk

The risk associated with changes in market interest rates that can harm a financial institution's profitability. A financial institution exposes itself to interest rate risk when it mobilizes deposits at one interest rate and lends them out at another.

Interest Rate Spread

The difference between the rate the financial institution pays for deposits and the rate it charges for loans. In a financially sustainable institution, this spread is large enough to cover operating costs, the opportunity cost of holding liquid reserves that earn no or low interest, losses in the value of the institution's assets due to inflation, the cost of provisions for loan and investment losses, and capitalization.

Internal Controls

Policies and procedures designed to minimize and monitor operational risks, in particular the risks of fraud and mismanagement. Because the unpredictable size and timing of cash deposits make financial institutions particularly vulnerable to fraud and errors, institutions that mobilize deposits must implement rigorous internal control policies and procedures. Essential controls include board approval and monitoring of information; rotation and segregation of duties; dual control of safes and vaults; established limits on cash holdings and expenditures; signature requirements; cash management procedures; daily balancing of cash drawers with the general ledger; receipts for all transactions; restricted access to offices and assets; periodic physical inventory of assets and cash counts; internal operational reports that are timely, easy to understand, and concise; accounting that complies with local accounting law and is consistent from one period to the next; sequential numbering of documents; an adequate audit trail; a secure management information system; and periodic reconciliation of the general ledger totals with bank statements or other subsidiary ledgers.

Liquidity Management

The process of effectively balancing between two requirements: (1) satisfying all cash outflow requests and reserve requirements without having to sell assets at a loss or borrow at a high cost and (2) holding enough assets in forms that earn sufficient interest to ensure operations are viable.

Financial institutions use tools, such as cash flow forecasting and ratio analysis, to project future liquidity needs and monitor current liquidity levels. They also arrange reliable options for obtaining liquid funds quickly when needed (a line of credit for example) and for safely investing excess liquid funds at reasonable rates of return.

Liquidity Reserve Requirements

Government regulations mandating the percentage of deposits that a financial institution must set aside as liquid reserves to be able to meet withdrawal demands. The reserve rate affects the viability of the institution in two ways. First, by improving the likelihood that depositors will be able to withdraw their funds when they want to, reserves protect the institution from the risk of a liquidity crisis and insolvency. Second, reserves often earn no or little interest, so if the reserve rate is high, the financial institution must compensate by obtaining a higher return when it invests the rest of its deposits. In some countries, nonbank deposit taking institutions are required to deposit their liquidity reserves in local banks or in a central finance facility. In these cases, the returns are determined by the reinvestment market and are still likely to be lower than the returns on lending or long-term investments.

Liquidity Risk

The risk that a financial institution will not have enough liquid assets to meet the demand for cash outflows, including savings withdrawals, loan disbursements, and payment of operating expenses. A lack of liquidity can put a quick and final end to a financial institution's efforts to mobilize deposits—and, in the worst case, can cause it to collapse or close. Deposit mobilization requires clients to trust that they will always be able to access their savings when they want or need them. A financial institution invests significant time and resources instilling this trust in clients, but a liquidity crisis can destroy it instantly.

Risk Management

A systematic approach to identifying, measuring, monitoring, and managing business risks in an institution. Effective risk management includes the following steps: (1) identify, assess, and prioritize risks; (2) develop strategies to measure risk; (3) design policies and procedures to mitigate risks based on cost–benefit analyses of different measures; (4) implement and assign responsibility for policies and procedures; (5) test their effectiveness and evaluate the results; and (6) revise policies and procedures as needed. The operational risks that financial institutions must manage include credit risk, liquidity risk, interest rate risk, reputation risk, transaction risk (the risk of financial loss due to negligence, mismanagement, or errors), and fraud risk.

(Anita Campion, "Improving Internal Control: A Practical Guide for Microfinance Institutions," MicroFinance Network with GTZ, 2000, pp. 2, 5, 8–10.)

Note: Except where noted, these definitions are from Savings Operations for the Poor: An Operational Guide, edited by Madeline Hirschland, Kumarian Press, 2005.

Annex 2: Tapping into Opportunities: Linking Remittances and Government-to-Person Transfers to Savings Accounts

According to the World Bank (2010), officially recorded remittance flows to developing countries reached US$316 billion in 2009. Unfortunately, a relatively small portion of these funds remains in the formal financial system. A number of recent studies have found a positive correlation between remittances and savings mobilization. For instance, a 2009 World Bank study of the Mexican remittance market found that clients who receive remittances through a formal financial institution are more likely to open a bank account (Demirgüç-Kunt, Cordova, Peria, and Woodruff 2009). Offering affordable remittance services can thus introduce the unbanked population to savings accounts. Financial institutions can also benefit from mobilizing longer term savings from migrants, tapping into a new market segment, cross-selling products, and earning extra revenue on wire fees. For instance, a 2009 analysis of MIX data found that financial institutions that offered remittance services were able to mobilize a higher level of voluntary savings than MFIs that did not (Sukadi Mata 2009).

Linking government-to-person (G2P) transfers to savings accounts has also successfully brought poor people into the formal financial system. CGAP estimates that close to 170 million people are recipients of transfers from their government, and less than 25 percent receive these payments into a bank account. Institutions that participate in electronic G2P programs can thus benefit from guaranteed deposits as well as a new client base. Mexico's Oportunidades program introduced optional savings accounts with the Mexican Bank of National Savings and Financial Services (BANSEFI). By 2004, over 1 million of 5 million beneficiaries of G2P programs had savings accounts linked to the program. Preliminary evidence from pilot programs also implies a positive link between G2P programs and willingness to save. A study of Paraguay's Tekoporã program found that beneficiary households saved 20 percent more on average than they had prior to the introduction of the program, with the highest savings rate changes occurring among the extreme poor (Zimmerman and Maury 2009).

Some funders already support efforts to link remittances and G2P transfers with savings accounts. For instance the Ford Foundation is funding Proyecto Capital, a project that seeks to support governments in Latin America and the Caribbean in the design, implementation, and evaluation of savings-linked conditional cash transfer policies. The United Nations Development Programme (UNDP) conducted a study on Paraguay's Tekoporã conditional cash transfer program, demonstrating the positive effect of the program on savings levels among poor participants. Funders can also be involved in designing financial capability campaigns for G2P recipients, since most of them are new to the formal financial system. In addition, funders can support evaluation mechanisms of existing programs to strengthen the evidence base. Evidence would be useful on how recipients use the financial services when offered to them. The business opportunity for banks also needs to be better understood. (Pickens, Porteous, and Rotman 2009).

Annex 3: How to Select a Partner: Summary Checklist of Due Diligence/Assessment Considerations

A funder looking to partner with a formal financial institution in scaling up savings should make a number of assessments. These preconditions help to guard against the most important risk—loss of client savings.

Legality: Is it legal to accept deposits? If this is unclear, are the authorities willing to waive or adjust legal or regulatory requirements? If the institution is not supervised, as is often the case with member-owned institutions, is it prepared to implement high financial monitoring standards and full disclosure on an ongoing basis?

Current profitability: Has the institution reached sustainability? An institution should offer voluntary saving services only if it is at or very close to profitability. Otherwise, the risks to the depositors are unjustifiable.

Credit management: Does the institution have a history of stringent credit management and results to match, including sustained high levels of portfolio quality?

Liquidity and asset–liability management: Does the institution have the skills, policies, and systems needed for proper liquidity and asset–liability management?

Internal controls: Are internal controls sufficient or adequate? Are they reinforced by the institution's culture, policies, procedures, information systems, and training and supervision of staff? Is cash and data security prioritized as an integral part of operations?

Human resources: Does the institution have (or can it add) adequate management and staff to design and successfully launch a savings operation? Does management have the skills to reorient existing staff or recruit and train new staff to interact with clients in a way that inspires trust and confidence to make deposits?

Distribution channels: If relying on branch offices, will the physical facilities afford adequate protection, accommodate clients, and inspire their trust? If a branchless banking model is being used, has a full operational and financial analysis been done of the business model and due diligence carried out on proposed partners?

Information systems and financial reporting: Can the information system handle the expected number and type of transactions associated with the new service? Does the information system provide information that is sufficient, accurate, timely, and transparent? Is the institution capable of providing the reports required by the banking supervision body, if required?

Governance: Does the institution have an effective board or other governance body that exercises reasonable oversight, ensures sufficient discipline, and serves as a check on management?

Demand: Is there effective demand for the proposed product? Will the proposed product strike the right balance of product features, convenience, security, and price?

Future profitability: Is there a business plan that demonstrates ongoing profitability across the business? Does it include sufficient reserves, capital, and operating funds to cover initial operating losses and losses due to major portfolio shocks without relying on client deposits? Does it have a profitable place to invest excess savings?

Note: These due diligence criteria are adapted from a list of prerequisites for intermediating deposits developed by Katharine McKee in "Savings Services for the Poor: An Operational Guide," edited by Madeleine Hirschland (2005).

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