FINANCIAL SECTOR ASSESSMENT PROGRAM - DEVELOPMENT MODULE

EL SALVADOR

FINANCIAL INCLUSION

TECHNICAL NOTE

NOVEMBER 2016

This Technical Note was prepared in the context of a World Bank Financial Sector Assessment Program mission in the Republic of El Salvador in March 2016 led by John Pollner and overseen by Finance and Markets Global Practice, World Bank. The document contains technical analysis and detailed information underpinning the FSAP assessment's findings and recommendations. Further information on the FSAP program can be found at www.worldbank.org/fsap.

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ABBREVIATIONS AND ACRONYMS

ABANSA	Salvadoran Banking Association
ACAC	Savings and credit cooperative associations *(associaciones cooperativas de ahorro y crédito)*
ACH	Automatic Clearing House
AFI	Alliance for Financial Inclusion
AFP	Pension Fund Administrator
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
ANM	Agent Network Managers
ATM	Automated Teller Machine
Bandesal	Banco de Desarrollo de El Salvador
BCR	Central Bank of El Salvador *(Banco Central de la Reserva)*
BFA	Banco de Fomento Agropecuario
BMI	Banco Multisectorial de Inversiones
CNR	Central National Registry *(Central Nacional de Registros)*
CPA	Consumer Protection Agency (*Defensoría del Consumidor*)
CPL	Consumer Protection Law
EMP	E-Money Provider
FDE	Economic Development Fund
FEDECACES	Salvadoran Federation of Associations of Cooperatives and Savings and Loans
FEDECREDITO	Federation of Credit Unions and Worker's Banks
FIDEAGRO	Special Trust Fund for the Agricultural Sector
FSAP	Financial Sector Assessment Program
FSV	Fondo Social de la Vivienda
Global Findex	World Bank Global Financial Inclusion Database
GDP	Gross Domestic Product
IGD	Deposit Insurance Fund *(Instituto de Garantía de Depósitos)*
INSAFOCOOP	Salvadoran Institute of Cooperative Development
LAC	Latin America and the Caribbean
LBCSAC	Law of Cooperative Banks and Savings and Credit Institutions (*Ley de Bancos Cooperativos y Sociedades de Ahorro y Credito)*
LFE	Electronic Signatures Law (*Ley de Firmas Electrónicas*)
LFIF	Law to Facilitate Financial Inclusion (*Ley para Facilitar la Inclusión Financiera*)
LSRSF	Law of Financial System Supervision and Regulation (*Ley de Supervisión y Regulación del Sistema Financiero)*
MFI	Microfinance Institution
MINEC	Ministry of Economy
MSME	Micro, Small and Medium-Size Enterprises
MTO	Money Transfer Operator
NBSCI	Non-Bank Savings and Credit Institution
NFIS	National Financial Inclusion Strategy
NPS	National Payments System
OTC	Over-the-Counter
POS	Point-of-sale
PROGARA	Agriculture Guarantee Program
RNPN	National Registry of Natural Persons *(Registro Nacional de Personas Naturales*)
RTGS	Real Time Gross Settlement
SAC	Savings and Credit Institution *(Sociedades de Ahorro y Credito*)
SC	Superintendence of Competition (*Superintendencia de la Competencia*)
SIGET	Electricity and Telecommunication Superintendence *(Superintendencia de Electricidad y Telecomunicaciones)*
SME	Small and Medium-Size Enterprises
SMS	Short Message Service
SSF	Financial System Superintendence *(Superintendencia del Sistema Financiero)*
USSD	Unstructured Supplementary Service Data

PREFACE

The note was prepared in the context of a World Bank Financial Sector Assessment Program mission in El Salvador during March 6-15, 2016. The team comprised John Pollner (Mission Chief), Rekha Reddy (Deputy Mission Chief), Maria Teresa Chimienti, Denise Dias, Tamuna Loladze, Fredesvinda Montes, Mateo Clavijo Munoz (all World Bank staff); Jose Rutman (Former Regulation General Deputy Manager, Central Bank of Argentina), and Monica Caceres (Former Deputy Superintendent, Insurance, Chile). This Financial Inclusion Technical Note was written by Denise Dias, with research assistance by Marianna Camino.

The Note contains technical analysis underpinning the FSAP findings and recommendations. Given the requested focus on digital finance and consumer protection, certain areas relevant to financial inclusion – notably small and medium enterprise finance, financial education, microfinance regulation and supervision– have been addressed in an abbreviated manner in this Technical Note. Although this Note incorporates some insights from the Technical Notes covering Financial Infrastructure, Non-Bank Savings and Credit Institutions (NBSCI) and Public Banks, not all related issues are incorporated in this Note, so the other Technical Notes should be read for a more comprehensive view of Salvadoran financial inclusion.

EXECUTIVE SUMMARY

Despite the challenging economic environment, El Salvador has made significant strides towards a more inclusive financial sector. GDP growth has been sluggish since the global financial crisis and the financial sector overall has been expanding slowly. Also, the implementation of the recommendations of the 2010 FSAP Update in Financial Inclusion has been only partial. Despite this background, certain key areas of retail financial services, particularly mobile money, have developed, allowing expanded access to and use of basic financial services such as bill payments.

However, El Salvador faces a number of challenges, including regulatory weaknesses and uncertainty, anti-competitive practices, and a fragile security situation that impacts investment and innovation. The country still presents low levels of access to and use of a range of financial services. Female, low-income and rural adults have disproportionately low levels of access, and many challenges exist for financial institutions to reach them. Salvadorans are increasingly saving, but many tend to do it informally. Other markets like insurance and factoring are also underdeveloped. The network of access points to the financial sector is relatively good, but needs to be improved and become more interoperable to support greater levels of inclusion. In general, the use of agents and electronic channels in general is still incipient. There is a need to improve data about the access points network in the country. Most importantly, mobile phones present a great opportunity to increase outreach, but mobile network operators may be imposing obstacles.

Authorities have shown commitment to leveraging innovation and the well-established microfinance sector to spur financial inclusion, with the approval of a financial inclusion law in 2015 and the ongoing development of a national financial inclusion strategy, in addition to the slow improvement of the financial inclusion data infrastructure, and several initiatives on financial consumer education. There is no national coordination mechanism for advancing financial inclusion, although the future strategy envisions the creation of such structure by the end of 2016. Authorities are also engaged and several important regulatory and legal reforms. Partly due to the lack of a formal national policy, some weaknesses remain in the inter-agency coordination to advance financial inclusion. Also, there still seems to be the need for greater expertise within financial authorities.

The financial sector is diversified, but some challenges need to be overcome to increase competition and innovation. There seem to be no excessive legal barriers to entry for new banks and the framework allows for a diverse range of large and small deposit-taking entities. The payments market is fast expanding and nonbank e-money issuers have been operating in the country since 2011 and this is a growing market. Although remittances are a major source of funds in El Salvador, the remittances market is facing worrisome impacts of de-risking that is resulting from regulatory tightening in sender countries. The card industry shows high levels of concentration and market power, which could be slowing down competition. Draft e-money provider regulations set reasonable entry requirements but suffer from several weaknesses. Also,

the absence of a payments law continues to be a major gap that results in a fragmented and incomplete framework for financial inclusion.

The microfinance sector is diverse and competitive and reforms are underway to strengthen regulation and supervision, but capacity is an issue. There are two parallel draft laws with proposals to bring the cooperative sector under regulation and supervision, but it is not clear whether there is sufficient expertise and capacity to undertake this challenge, at the Financial System Superintendence (SSF) more specifically. Also, the microfinance prudential regulation should be improved to be in line with international good practices and standards.

Reforms are needed to spur the use of electronic accounts and transactions and to improve the draft rules for simplified accounts. Further progress could be made by allowing bank and nonbank financial institutions access to and use of telecommunications infrastructure on a non-discriminatory basis. Also, the legal and regulatory framework for electronic transactions and contracts is not sufficiently robust to provide certainty to financial service providers and mitigate risks, so priority should be given to building solid legal grounds in this matter. An enabling and non-fragmented regulatory basis for banks and nonbanks operating through agents should be created.

An effective consumer protection legal, regulatory and supervisory framework is needed to ensure healthy financial inclusion. The overlaps of supervisory mandates and the conflicting measures or positioning adopted SSF and the Consumer Protection Agency (CPA) should be minimized through greater coordination to clarify roles. Also, although there are reforms underway to improve the regulatory framework for consumer protection in financial services, additional improvements could be made to ensure that a proportional and effective framework for financial inclusion is in place.

Table 1. Main recommendations of this Technical Note

Financial Inclusion	Priority	Term
Strategy and Coordination		
The Central Bank of El Salvador (BCR) and other key stakeholders should push for the development and approval of a well-designed national financial inclusion strategy (NFIS) based on broad consultation, as well as the creation of a national coordination mechanism for financial inclusion.	High	ST
A robust financial inclusion data infrastructure should be put in place to monitor the effectiveness of the future national coordination mechanism.	High	MT
Digital Finance		
BCR and SSF should improve the draft E-Money Provider (EMP) regulatory framework.	High	ST
SSF should to build capacity, develop expertise and improve data infrastructure to effectively supervise EMPs, MTOs and ACACs and conduct consumer protection supervision.	High	MT
The Competition Superintendence (SC), in coordination with sector regulators such as BCR, SSF and SIGET, should take measures to ensure access to and use of telecommunications infrastructure by financial services.	High	ST

The authorities should build solid a legal framework for electronic contracts and transactions to create legal certainty to providers and consumers.	High	MT
The BCR and SSF should work together to issue a single regulation on security and risk management for electronic channels.	Medium	MT
BCR and SSF should build a single enabling and safe regulatory and supervisory framework for banks and nonbanks operating through agents, including rules for agent network managers and the authorization and inspection processes and consideration of the impact of the financial transaction tax on the use of agents.	High	ST
SSF should review and improve its product authorization procedures.	Medium	MT
Improvements should be made in the draft regulation of simplified accounts and the existing AML/CFT regulation, including to clarify whether electronic documents are acceptable for regulatory compliance.	High	ST
To facilitate simplified account opening, the government should allow access to its national registration database.	High	ST
MINEC, in coordination with BCR, should consider the practical challenges and seek solutions to shift government subsidies to electronic means.	High	MT
SME and Microfinance		
The authorities should introduce a law on factoring that will provide legal certainty to factoring contracts and address short-term financing needs of MSMEs.	Medium	MT
BCR and SSF should improve the prudential rules for microcredit.	Medium	ST
Consumer Protection		
BCR should build a common, harmonized framework for consumer protection in the regulated financial sector and improve the draft reform of NPB4-46.	High	ST
The BCR, SSF and Consumer Protection Authority (CPA) should review their policy on prohibiting service fees.	Medium	ST
With respect to credit information, the authorities should implement improvements to enhance consumer rights.	Medium	MT

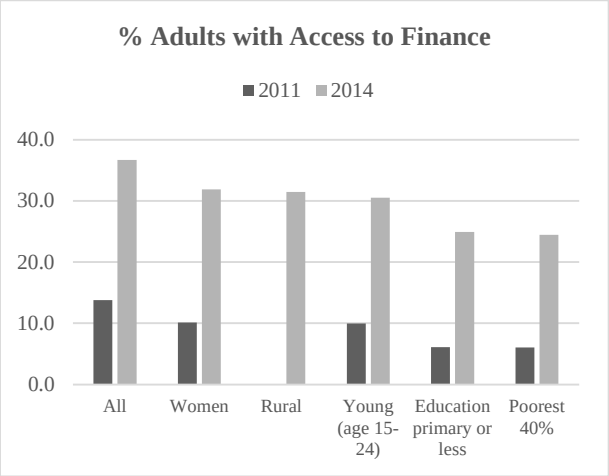
ST=Short term: Less than 18 months; MT=Medium term: 18 months-4 years

I. OVERVIEW OF FINANCIAL INCLUSION IN EL SALVADOR

1.1 Financial inclusion of individuals

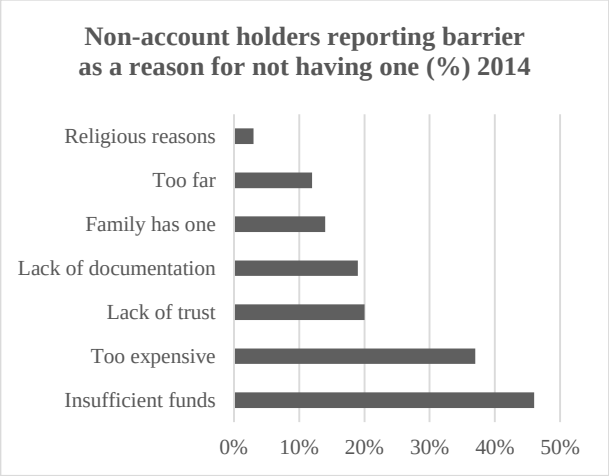
1. **Despite significant recent improvements, El Salvador still presents low levels of access to and use of a range of financial services**. According to the World Bank Global Financial Inclusion ("**Global Findex**") database 2014, 34.6 percent of adults have an account at a financial institution.[1] Despite being severely hit by slow economic growth since the global financial crisis, this financial inclusion indicator has nearly tripled since 2011. The average is still below the average in Latin America and the Caribbean (**LAC**) of 51.4 percent and the average of countries with similar income levels (42.7 percent). Interestingly, the supply-side data from the Central Reserve Bank (**BCR**) shows a decrease of the total number of savings accounts per 1,000 adults since 2011, from 874 to 756[2] (see Figure 4 and Figure 5). Unfortunately, the reasons behind the decrease in the BCR data are not known.

Figure 1: Financial inclusion – demographic features



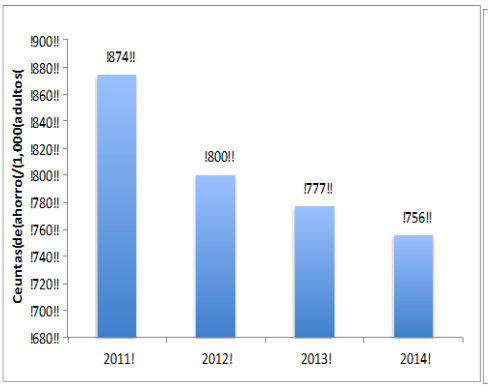
Source: Global Findex, 2014

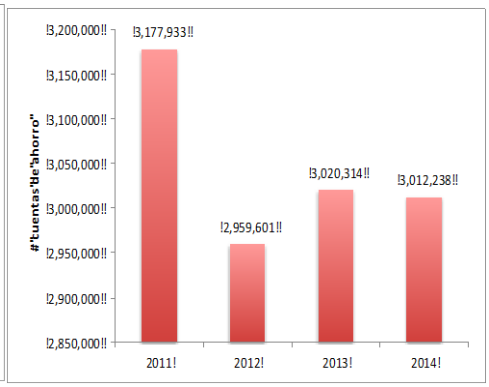
Figure 2. Barriers to account ownership



[1] WB Global Findex Database, 2014. "Account at a financial institution" includes respondents who report having an account at a bank or at another type of financial institution, such as a credit union, microfinance institution, cooperative, or the post office (if applicable), or having a debit card in their own name.
[2] Source: BCR, as of December 2014.

Figure 3: Savings accounts per 1,000 adults (2011-2014) **Figure 4. Number of savings accounts (2011 – 2014)**





Fuente: BCR

2. **Female, low-income and rural adults have disproportionately low levels of access to transaction accounts, and many challenges exist for financial institutions to reach them.** Access to a transaction account is particularly low among the rural and the poorest. Account penetration among the rural population stands at 31.5 percent, and at only 24.4 percent among the poorest 40 percent of households (45.1 percent of the richest 60 percent have access to accounts). The income gap has increased between 2011 and 2014 by 8 percentage points and this is corroborated with supply-side data from the BCR, which shows that the average savings account balance was around US$ 1,750 in December 2014. Women are also more likely to be excluded: only 31.9 percent of women have an account, creating a gender gap of 10 percent in account ownership. Actually, the gender gap increased from 2011 to 2014.[3]

3. **Salvadorans are increasingly saving, but many tend to do it informally.** From 2011 to 2014, there has been an increase of 30 percentage points in the number of adults who reported having saved in the past year, amounting to a total of 57.5 percent of adults saving in 2014.[4] However, only 14 percent saved using an account at a bank or another type of financial institution (the average for LAC is 13.5 percent).[5] This indicates that Salvadorans may lack access to, knowledge of, or interest in formal savings instruments such as savings accounts.

4. **A disproportionate portion of female workforce lacks access to retirement savings instruments.** Formal private sector workers benefit from employer's contribution equivalent to 6.75 percent of their salaries (employees contribute another 6.25 percent, totaling 13 percent of their salaries), which are deposited in accounts managed by private fund administrators (**AFPs**).[6]

[3] Global Findex 2014.
[4] Idem.
[5] Idem.
[6] There is also a legacy pension system for part of the public sector workers.

However, as in many other countries, the pension system does not reach informal workers, who are about half of the workforce[7]. Moreover, around 65 percent of the informal workers in El Salvador are believed to be women, such as around female 115,000 domestic workers.[8] Also considering that women earn 15 percent less in average than men and 37 percent are in vulnerable employment,[9] they are disproportionally unprotected regarding their financial future. A proposed reform of the pension system – submitted to Parliament in March 2016 – may have significant impact on workers currently holding accounts at AFPs, and does not seem to introduce any proposal to extend coverage to workers of the informal sector.[10]

5. **Not having enough funds and high costs are the most common cited reason for not having an account.** Globally, the most frequently cited reason for not having an account is the lack of money to use it. In El Salvador, the perception of limited funds is a key barrier to account ownership according to the Global Findex survey. The survey does not shed light into the underlying reasons for respondents to point limited funds as a barrier. For instance, such perception could be explained by, in addition to actual limited amount of money left to save, transaction and transportation costs, prices and fees of services, opportunity costs (e.g., when there is need to miss a day of work to go to solve a problem in a bank branch), or even the belief that banks are geared towards higher income earners.

6. **In contrast, mobile money[11] has been reaching an increasing number of people with basic payments services, international remittances and potentially a wider range of services**. About 4.6 percent of adults had access to mobile money in 2014, compared to 2.2 in Colombia, 3.4 in Mexico, and 1.7 on average in Latin America. This indicates that the potential exists for a rapid increase in access to and usage of transaction accounts – which can serve as conduit for a range of services, including shifting informal savings to the regulated sector – through the use of innovative business models based on mobile phones. It is relevant to note that international remittances, which are key to support livelihoods of a large portion of Salvadorian families, are also being offered through at least one mobile money provider, although this is an incipient market. It is believed that most of the transactions through mobile money accounts are domestic remittances (7.7 percent of adults sending domestic remittances reported using a mobile phone for that purpose).[12]

[7] International Monetary Fund (IMF), 2015. El Salvador. Selected Issues. IMF Country Report No. 15/11. Washington, DC. January.

[8] Estimates of the Federation of Independent Associations and Unions of El Salvador, available at http://www.ipsnews.net/2016/02/el-salvador-pension-reform-could-take-women-into-account/.

[9] United Nations Development Programme (UNDP) Human Development Report 2015.

[10] The main reform proposal is the creation of a mixed system with public and private sector participation, which would in practice shift most of the workers currently covered by AFP accounts to the mixed system.

[11] Mobile money is a type of e-money account offered, in El Salvador, by nonbanks, and which is usually managed by accountholders exclusively through the mobile phones or through mobile money agents.

[12] Note that there is no data to show that all 7.7 percent of senders reporting use of mobile phones for domestic remittances have a mobile money account.

Table 2: Access to a range of basic financial products by adult Salvadorians

Indicators	El Salvador	Bolivia	Guatemala	Hondura s	Nicaragua	LAC	LMI
% adults with a transaction account	36.7	41.8	41.3	31.5	19.4	51.4	42.7
% adults using an electronic payment instrument	3.0	0.7	2.6	1.4	1.5	10.3	2.2
% adults saving in a regulated institution	14.0	23.5	15.1	14.5	8.1	13.5	14.8
% adults with credit from regulated institution	17.2	19.7	12.3	9.7	14.3	11.3	7.5

**LAC = Latin America and the Caribbean*
***LMI = Low Middle Income countries*
Source: Global Findex, 2014

7. **Access to credit by individuals in El Salvador is slightly higher than in LAC and in lower-middle-income countries**. The total number of borrowers in the system has increased between 2011 and 2013, with particularly strong growth (over 30 percent) for loan sized between US$ 5,000 and US$ 50,000.[13] Smaller loans (below US$ 1,000) observed growth of only 3 percent,[14] showing once more that lower income individuals and microenterprises have lower levels of access to finance. Low usage of formal credit by some segments of the society does not mean low demand: in 2014, 44 percent of Salvadoran adults reported having borrowed money within the previous year, but only 17.2 percent of them used a regulated financial institution.[15] Also, the share of Salvadoran adults with a mortgage is higher than the averages in LAC in lower-middle income countries, as showed by Table 3. Women and the poorest are much less likely to have access to mortgages, but there is no significant divide between rural and urban areas.

Table 3: Adults with an outstanding mortgage

Outstanding Mortgage	Comparison country / group of countries						
	SLV	BOL	GTM	HND	NIC	LAC	LMI
all (% age 15+)	12.1	20.6	7.8	7.1	6.7	9.6	4.7
female (% age 15+)	9.4	19.1	7.7	4.7	6.2	8.1	4.1
poorest 40% (% age 15+)	6.8	11.9	4.8	3.8	5.0	6.1	3.9
rural (%age 15+)	11.5	20.7	6.5	5.8	7.4	10.4	4.7

Source: Global Findex, 2014
**LAC = Average in Latin America and the Caribbean*
***LMI = Average in low middle-income countries*

8. **While increasing in the last years, the usage of insurance is still low.** Total insurance penetration (premiums as a percentage of GDP) has increased to 2.4 percent in 2015from 2.01 percent in 2011. Penetration of life and non-life stand at 1.02 and 0.99, respectively.[16] However,

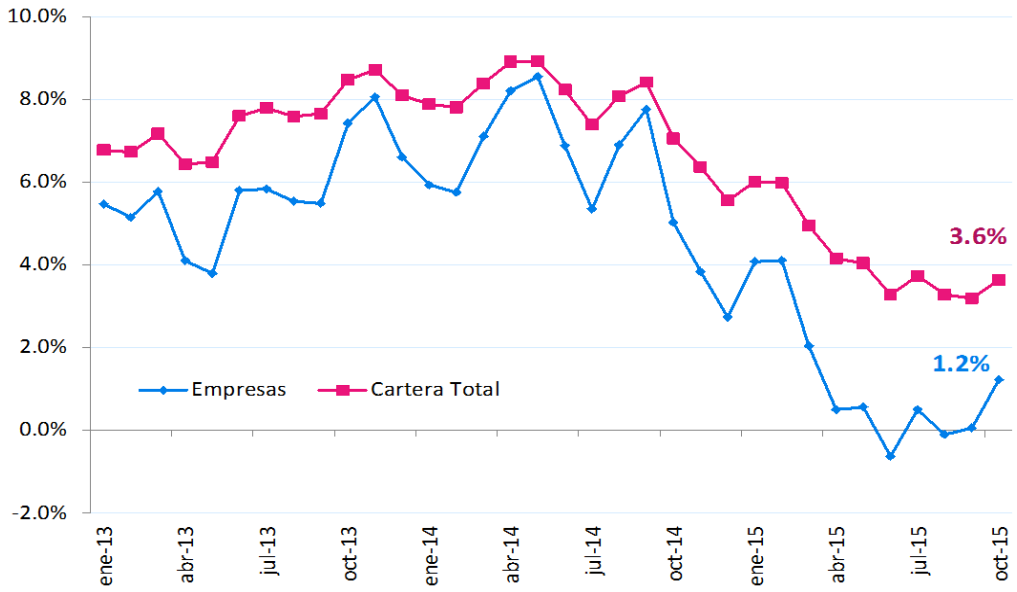
[13] Source: SSF, as of December 2014.
[14] Idem.
[15] Global Findex 2014.
[16] Source: Central de Información Financiera SSF.

while gross premiums for life insurance continued to grow (10.3 percent change in nominal US$, as of 2014), gross premiums for non-life insurance actually decreased by 1.7 percent.

1.2 Financial inclusion of firms

9. **Firms' access to transaction accounts and financing is high in El Salvador, despite the relatively unfavorable macroeconomic and security environment**. According to the Enterprise Survey 2010, over 90 percent of firms report having a bank account. For medium and small firms, account ownership stands at 95.2 percent and 93.1 percent, respectively. Credit to firms in general has seen much slower growth in recent years than credit to households (Figure 3), and consumer credit accounts for 34.4 percent[17] of the total value of credit provided by the regulated financial sector.[18] The bulk of credit growth in the last few years has been on consumer credit. Credit to MSMEs has nonetheless increased, and is provided by a range of institutions, including unregulated microfinance institutions (**MFIs**) and credit cooperatives. The World Economic Forum's Global Competitiveness Index 2015-2016[19] report that access to finance is only the fourth most important constraint for doing business in El Salvador, crime and theft being the biggest obstacles. Similarly, the Doing Business 2016 report places El Salvador in the 15th place on the ease of getting credit, out of 189 economies.

Figure 5: Annual credit growth (banks, cooperative banks and SACs)



Source: BCR, Evolución Sistema Financiero Salvadoreño, Diciembre 2015

[17] BCR, as of December 2015.
[18] Banks, cooperative banks and savings and credit associations (SACs).
[19] The Global Competitiveness Report 2015-2016 assesses the competitiveness landscape of 140 economies, providing insight into the drivers of their productivity and prosperity. Inflation and Foreign Currency regulations were cited as the second and third most problematic factors for doing business in the country.

10. **Still, micro, small and medium enterprises (MSME) would benefit from a wider range of financing instruments, including factoring and leasing.** While El Salvador compares well with peer countries (Table 4) in access to finance by firms – over 53 percent of firms have a bank loan or line of credit, the Enterprise Survey 2010 found that 44.7 percent of small firms and 49.5 percent of medium firms finance their investments from retained earnings (Figure 6). Around 44 percent of small firms and 33.9 percent of medium firms have working capital loans from banks. Data from the International Monetary Fund (**IMF**) shows that 36.5 percent of medium firms and 23.9 percent of small firms identify lack of finance as a major constraint, which is much higher than in, for instance, Colombia, Guatemala or Peru. Collateral requirements are still high on average, at about 166 percent of the value of the loan, but this is lower than the regional average of 209 percent (190 and 151 percent, respectively, for small and medium size firms). Factoring is nearly non-existent in the country, and leasing companies do not usually cater to MSMEs. Hence, 26.6 percent of firms still identify access to finance as major constraint.

Table 4: Access to finance by firms in El Salvador

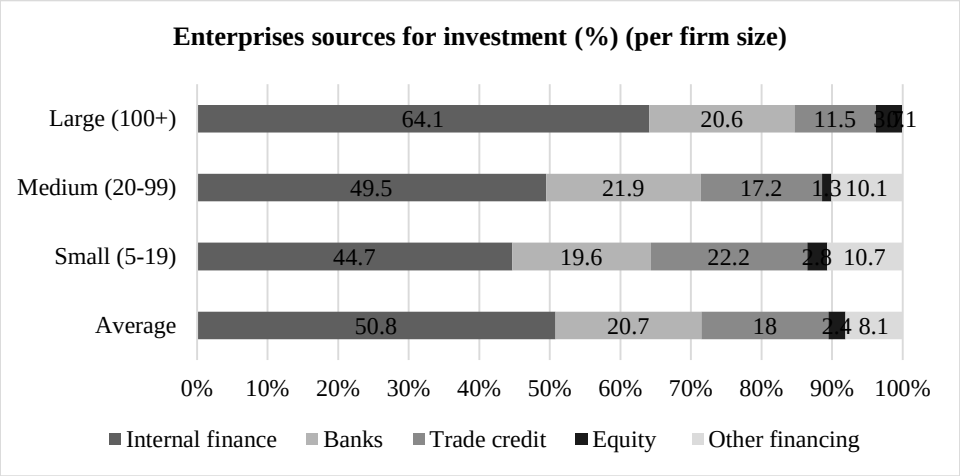
Indicators	El Salvador	Bolivia	Guatemala	Honduras	Nicaragua	LAC
% of firms with a loan or line of credit	53.1	49.1	49.1	31.2	43.4	45.2
% of firms identifying access to finance as major constraint	26.6	28.7	19.6	27	23.3	30.5

Source: Enterprise Survey, 2010

**LAC = Average in Latin America and the Caribbean*

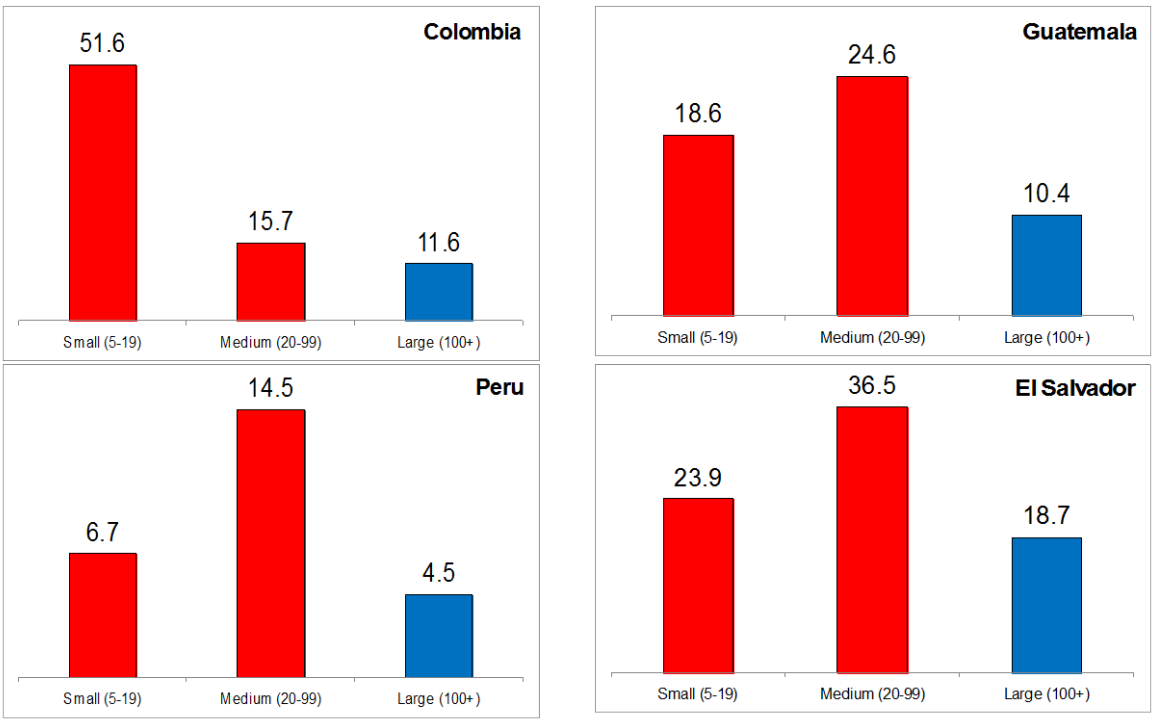
***LMI = Average in low middle-income countries*

Figure 6: Funding sources for investment by firm size



Source: Enterprise Survey, 2010

Figure 7: Percent of firms identifying access to finance as a major constraint



Source: International Monetary Fund, 2015. Financial Inclusion: Zooming in on Latin America, WP/15/206

II. FINANCIAL INCLUSION OF INDIVIDUALS AND FIRMS

2.1 Public and Private Sector Commitment

2.1.1 National Financial Inclusion Strategy and Coordination Mechanism

11. **The authorities have shown deep commitment to financial inclusion.** The Salvadoran authorities, spearheaded by the Salvadoran Central Bank (**BCR**), have elevated financial inclusion as a topic of national interest and priority through a variety of activities and initiatives. Laws or regulations encouraging greater competition and institutional diversity (see 2.2.2), as well as greater physical outreach of regulated financial institutions (see 2.2.1), have been issued or are about to be issued. Draft regulations or legislation aim to lay the ground for the safe expansion of cost-effective electronic services (see 2.3) and strengthen the credit cooperative sector. A range of data collection and research initiatives exists to improve the financial inclusion data infrastructure (see 2.1.4). There are also efforts underway to improve the financial (payments and credit) infrastructure to support financial inclusion, stability and integrity. Another relevant initiative was the endorsement of the Maya Declaration[20] by the Financial System Superintendence (**SSF**) and

[20] The BCR's and SSF's commitment is available online at http://www.afi-global.org/sites/default/files/publications/maya_declaration_el_salvador_bcr_ssf.pdf.

BCR in April 2013. The specific commitments – most of which have been are or being implemented – were to (during 2013-2015):

a. Issue regulations on mobile financial services;
b. Develop a financial education strategy;
c. Conduct studies and other actions to develop microinsurance, microsavings, microcredit and micropensions; and
d. Define financial inclusion indicators.

Figure 8: Enabling environment for financial inclusion (Microscope Score, 2014)

Source: EIU (Economist Intelligent Unit), 2014. Global Microscope 2014

12. **However, a National Financial Inclusion Strategy (NFIS) or similar instrument has not yet been articulated or agreed upon by key stakeholders.** A NFIS (or a broader strategy for financial sector development with an inclusion component) helps public and private sector stakeholders to agree upon, strengthen and publicize concrete commitments towards financial inclusion, over a specific timeline and based on clear objectives and measurable targets. The NFIS is also a vehicle for the creation of a coordination mechanism to allow effective implementation and monitoring and evaluation of an action plan towards the achievement of the headline targets (see 2.1.2 below). A large number of countries in all continents have launched NFIS, are about to launch or are already implementing NFIS. In Central America, however, only Honduras has a NFIS. Other LAC countries, such as Paraguay, Peru, and Jamaica have launched their NFIS.

13. **Aware of this gap, the BCR is currently working on a draft NFIS to be approved by the end of 2016**. The draft is being prepared based on broad directions provided through a technical assistance program by the Inter-American Development Bank (**IDB**). According to an IDB report commissioned by the BCR, the NFIS would identify sectors of the financial system, as well as segments of the population, that would be prioritized. This is broadly in line with

international practice.[21] The action plan is divided into measures on the macro level (e.g., regulatory reforms), meso level (e.g., government payments, government financial institutions, awareness and promotion, strengthening the retail payment system, and financial education) and micro level (e.g., incentives for product or channel innovation). Given the current regulatory obstacles – discussed in the next sections – for the development of viable and sustainable business models for the provision of a range of adequate services to the unserved and underserved, it is expected that most of the action plan will focus on the macro level. In this regard, the NFIS is expected to base reforms on the following principles:

a. Regulatory reforms should be proportional to risks and avoid introducing market distortions across different institution types operating in the country; and

b. Regulatory reforms should improve competition, and promote greater physical outreach and interoperability of payment channels and instruments.

2.1.2 Coordination to foster financial inclusion

14. **There is no national coordination mechanism for advancing financial inclusion, although the future NFIS envisions the creation of such structure by the end of 2016.** Several countries, including some that have not launched a NFIS, have instituted a national level coordination mechanism to facilitate the dialogue around broad financial inclusion policy goals and ensure that implementation of priority measures is effective, timely, and properly monitored. The national structure would be created prior to the finalization of the NFIS. It would include a national Commission for financial inclusion comprised of BCR, President's Office, SSF, Ministry of Finance, Ministry of Agriculture and the National Commission for Micro and Small Enterprises (**CONAMYPE**). The Commission would be advised by a consultative Committee. A dedicated unit for financial inclusion would be created, most likely within the structure of the BCR, although it is not clear yet which institutions would be involved in this supporting function. It is not clear yet whether working groups or similar would be created to address different sections of the NFIS action plan.

15. **Partly due to the lack of a formal national policy, some weaknesses remain in the inter-agency coordination to advance financial inclusion.** Currently, the different government agencies, including BCR and SSF have adopted initiatives that are relevant to financial inclusion, with a limited level of coordination and collaboration. For instance, there are instances of inconsistent or contradictory decisions on financial consumer protection issues by also, the somewhat inefficient coordination impacts the public availability of comprehensive financial inclusion indicators (see 2.1.4), for instance, in the current coverage of access points of the financial sector.

[21] For guidance on NFIS, see the World Bank's *Template for the Design of a National Financial Inclusion Strategy* http://pubdocs.worldbank.org/pubdocs/publicdoc/2016/1/379031452203008464/WBG-FMGP-Template-for-Designing-a-NFIS-Jan-2016-FINAL.pdf.

2.1.3 Institutional capacity and commitment

There seems to be no major capacity issues in both the public and private sector to advance financial inclusion, although some improvements are needed. In the public sector, the issues impeding initiatives to improve financial inclusion seem to be rooted on strategic directions (e.g., the role played by government specialized and development banks)[22] or deficient inter-agency coordination, rather than on lack of institutional capacity. There is not an adequate structure at the moment to serve as the central focus point for financial inclusion data collection and dissemination, or to document and coordinate financial inclusion progress. However, these weaknesses are expected to be at least partly addressed in the context of the future NFIS and the upcoming national coordination mechanism.

Although there is minimum capacity to achieve significant progress, there still seems to be the need for greater expertise within financial authorities. This is particularly important for BCR, SSF, but also the Consumer Protection Agency (**CPA**),[23] on effective financial inclusion policymaking, as well as (in the case of BCR and SSF) in regulation and supervision of particular areas of market development that are highly relevant for inclusion, namely the use of agents by banks and nonbanks, credit cooperatives, and retail payment services, systems and providers, including money transfer operators (**MTOs**) and mobile money operators. Greater capacity in consumer protection supervision will also be needed (see section 3). In the private sector, the business models that have shown in some other countries to spur financial inclusion (e.g., the use of agents, mobile money) are still nascent in El Salvador, but the main obstacles do not seem to be a lack of commitment or capacity in the private sector. In fact, there seems to be plenty of expertise in the market for the development products that could adequately cater to the needs of lower income customers in the urban and rural areas (see 2.3), although there is lack of expertise and experience with alternative delivery channels such as agents and with exploring partnerships between banks and nonbanks.

2.1.4 Financial inclusion data

16. **The financial inclusion data infrastructure is limited, but efforts are being done to address this shortcoming**. There are no major country-owned demand or supply side financial inclusion surveys or studies. Also, there is very limited availability of key indicators for financial inclusion, such as information on access points such as point-of-sales (**POS**) devices and the structure of the retail payment systems.[24] Also, the available data (e.g. data on credit) is not periodically compiled in an analytical manner from a financial inclusion perspective as many other countries have done (e.g., financial inclusion reports in Colombia, Mexico, and Peru). The BCR is part of the Financial Inclusion Data Workgroup of the Alliance for Financial Inclusion (**AFI**) and hosted a meeting of this group in April 2016, whose objective is for member countries to

[22] The Technical Notes on Nonbank Financial Institutions and Public Banks provides an assessment of the performance and effectiveness of the policies implemented by public banks.
[23] *Defensoría del Consumidor.*
[24] See FSAP Technical Note on Financial Infrastructure.

improve their data infrastructure in this topic. Accordingly, BCR is currently conducting relevant studies: a demand side survey on access to financial services, whose results will feed into the NFIS.

2.1.5 Financial capability

17. **There are ongoing initiatives to improve financial capability levels to support healthy financial inclusion**. The BCR has already conducted a baseline financial capability survey and it is currently updating it with a second survey. The results should be available in mid-2016. Also, there are several public financial education initiatives. The BCR has a Financial Education Program, launched in 2008, that coordinates other regulatory agencies including the CPA and the IGD. SSF has its own financial education program, separate from BCR's initiative. Well-crafted capability and awareness programs are useful tools overcome lack of trust in the financial sector (if coupled with good business conduct and consumer protection – see section 3).

2.1.6 Recommendations

18. **BCR and other key stakeholders should push for the approval of a well-designed NFIS based on broad consultation.** It is important to approve a NFIS as soon as possible and that the NFIS follows good international practice. Good NFIS form a consistent, strong document built around a clear definition of financial inclusion, well-articulated objectives, and a logical framework to achieve such objectives. The framework needs to be translated into specific measures in a time-bound action plan that identifies the leading implementing party for each action. The NFIS should result from careful and broad consultation with a range of relevant stakeholders, including government agencies and the private sector. The framework for change should be based on the identification of the most important constraints to financial inclusion, which usually leads to the determination of priority sectors or segments of the society. Headline targets to be achieved by the end of the period covered by the NFIS need to be realistic while ambitious to spur immediate and committed action to change the current status quo.

19. **A national coordination structure for financial inclusion should be created prior to the launching of the NFIS**. Effective leadership and coordination mechanisms are absolutely fundamental for the successful transition towards an inclusive financial sector, as the active and coordinated involvement of various stakeholders is necessary. Leadership and, more importantly, a formal coordination mechanism allows for constant assessment of the potential impacts of national policies in the financial inclusion process. A good coordination mechanism should have a high-level policy council or similar, a second-tier level for timely strategic decisions and approvals, and an operational level to implement the action plan. The operational level should include thematic working groups or similar, which are responsible for implementing actions in each area of expertise, according to the action plan, and identifying bottlenecks for implementation. The whole structure should be supported by an active, well-resourced, and knowledgeable secretariat at a leading institution that facilitates discussions and communication, calls for meetings, monitors and documents implementation of actions, and disseminates information.

20. **Even before the formal coordination mechanism is put in place, it is key that inter-agency coordination is improved.** Immediate improvements in coordination are needed to facilitate the dialogue across the key government agencies, such as the BCR, SSF, CPA, and the Superintendence of Competition (**SC)**. This is mainly to identify areas where common understanding and positioning are needed to provide clarity and certainty to the market (e.g., in certain consumer protection issues such as product pricing – see 3.4) and to take necessary measures to unblock market potential (e.g., addressing barriers for the provision of mobile phone-enabled services – see 2.2.2). There is also a need to increase coordination – such as through technical working groups – between the Social Housing Fund (**FSV**) and the public sector banks to increase complementarity and effectiveness of their policies and strategies.[25]

21. **It is key to build and maintain a robust financial inclusion data infrastructure**. Good and accurate information helps shape better policies, regulation and supervision, and steer market investment towards addressing exclusion. Both the supply and the demand side of financial inclusion data, for individuals and MSMEs, should be improved and build on the upcoming demand side surveys prepared by the BCR. Such improvement includes not only conducting and disseminating surveys and compiling data points, but also providing analytical tools for the wider public, such as through annual financial inclusion reports.[26] Moreover, the ultimate objective of data is to use it to assess and improve national policies, as well as market decisions. The recommended coordination structure would facilitate such application, as such infrastructure requires dedicated staff with analytical capacity, and constant coordination across different authorities and with the financial sector.

22. **Efforts by the industry to increase expertise in certain business models and products are needed.** Similar to good and comprehensive financial inclusion data, knowledge sharing by industry associations of success stories (and failures) related to innovative business models and products catering to the underserved and unserved can be a powerful tool to encourage market innovation and development. This could include cases from other countries of alternative delivery channels such as agents and mobile phones. The industry, with support from relevant authorities such as regulators and supervisors should organize knowledge exchange events such as workshops. This could be complemented with challenges and competitions, which could be sponsored by government authorities and international donor agencies.

[25] Details on the recommendation to increase coordination among public banks and FSV are in the Technical Notes on Nonbank Financial Institutions and Public Banks.
[26] Illustrative financial inclusion indicators are listed in Annex 1.

2.2 Provider Reach, Diversity and Sustainability

2.2.1 Provider diversity and sustainability

2.2.1.1 Analysis of the market

23. **There is a wide range of regulated and unregulated financial service providers, but some concentration is seen in several sub-sectors**. The financial sector is diverse. The banking sector is comprised, as of December 2015, of 11 private banks, 2 first-tier specialized government banks, and one development bank (Bandesal). Additionally, there are 26 insurance companies, brokers/dealers, several types of payment service providers, 2 pension fund administrators, a diverse and large microfinance sector, and savings and credit societies (*Sociedades de Ahorro y Crédito* – **SACs**), which are deposit-taking entities similar to commercial banks, with slightly more limited scope and size of operations.

24. **There are no major concerns with regard to concentration in the banking sector, but the insurance sector is highly concentrated**. The banking sector is dominated by foreign groups, with three Colombian financial groups (the largest being Banco Agrícola) accounting for approximately 54 percent of the banking sector assets. Concentration levels have been declining over the years.[27] The insurance sector is more concentrated, although the number of insurers has increased to 26, from 19 in 2010. The 5 largest insurers hold about 74 percent of the total gross premiums of the industry (as of December 2014).[28] A 2012 study by the Competition Superintendence (SC) has noted the concentration in the insurance sector, although the insurance distribution structure – focused on non-exclusive insurance agents and brokers – did not result in entry barriers to new insurers.

25. **Various retail payment service providers - including remittances services service providers – serve both individuals and firms.** Various types of institutions, mostly unregulated (although sometimes the entity – which can be, for instance, a bank, a SAC or a cash transportation company – might be regulated in other parts of its business), provide several types of retail payment services to individuals and firms, such as payments collections (e.g., internet portals where clients can pay bills by providing their bank information or payment points where no bank information is required). The sizable international remittances market is particularly competitive. There are around 30 MTOs operating in El Salvador, with the dominant provider being Western Union. Most remittances are paid through banks (Banco Agrícola is the largest payer).

26. **The remittances market is facing the impacts of de-risking due to regulatory tightening in sender countries.** According to market participants, there has been a significant impact in the volume of international remittances as a consequence of the tightening of AML/CFT controls by regulators in sender countries, in particular the US. This tightening has spurred a de-

[27] More details on the size, composition, performance and concentration in the banking system are found in the Technical Note on Financial Efficiency.
[28] Source: *Central de Información Financiera SSF*.

risking movement where several correspondent banking relationships have been closed and more closures are expected this year. Although there is no hard data on how de-risking has or can affect family remittances, this is a development that needs further investigation, with adequate and proportional measures to ensure that Salvadoran families continue to receive remittances through formal channels.

27. **Nonbank e-money issuers have been operating in the country since 2011 and this is a growing market.** Tigo Money,[29] which is also active in several other Latin American and African countries,[30] has been in operation in El Salvador since 2011. It is the dominant mobile money scheme in the country, and it offers mainly bill payments, but also peer-to-peer transfers (to recipients with and without Tigo Money accounts), and incoming international remittances (in partnership with several MTOs and a MTO aggregator[31]). It has nearly one million accounts, approximately one third[32] of which are active (i.e., at least one transaction in the last 60 days). There are at least two contenders to Tigo Money. One is MoMo,[33] an independent nonbank that just started operations in late 2015 but already aims to have 1 million clients by the end of 2016. The other is Servicios Tecnológicos de El Salvador, S.A (the commercial name of the product seems to be 7/24), although there is not much information about this provider, which seems to be yet to start operations. A future contender is Red Multiservicios Aki, a network of payment collection points owned by the dominant cash handling company (Sersaprosa). Reportedly, Aki would be applying for a license to operate as a mobile money provider (see 2.2.1.2 below).

28. **The card industry shows high levels of concentration and market power.** A study by the SC covering the 2005-2010 period[34] showed high levels of concentration and market power in the credit, debit and acquiring markets. The credit card and acquiring businesses are dominated by 4 banks (Banco Agrícola, BAC, Citibank and HSBC). The result of supposedly excessive powers is, according to the study, entry barriers to the acquiring business, interest rates that are much higher than the costs incurred by issuers, high merchant discount rates that are not differentiated according to the volume of merchant transactions or type of instrument, and no difference between the cost (to the consumer) of using credit or debit card, and between these and other payment instruments. The recommendations of the study, which are not binding, included permitting merchants to be affiliated separately to accept debit and credit cards, and differentiate merchant discount rates for debit and credit.

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[29] In El Salvador, Tigo Money is the commercial name of the company named Mobile Cash, S.A.

[30] Tigo Money is present in El Salvador, Guatemala, Honduras, and Paraguay. In Africa the service is called Tigo Cash and is provided in Chada, Ghana, Rwanda, Senegal, and Tanzania (where it is called Tigo Pesa). See http://www.millicom.com/who-we-are/our-brands/tigo-money/.

[31] MTO aggregators are third party service providers that facilitate partnerships between paying entities in the receiving countries and international MTOs, by waiving the need for individual contracts with each MTO. An example is TrasnferTo, which provides aggregation services to mobile money providers such as Tigo Money (see https://www.transfer-to.com/home).

[32] Source: interview with Tigo Money in March 8th, 2016.

[33] See http://www.mobilemoney.com.sv. The parent company is Mobile Americas Corp, based in the US, which is owned by MoMo Software, based in the UK. MoMo is also inaugurating operations in Guatemala and Honduras.

[34] Superintendencia de Competencia, 2011. *Sector Tarjetas de crédito y débito. Estudio sobre condiciones de competencia en el sector de tarjetas de crédito y débito en El Salvador.* Available at http://www.sc.gob.sv/uploads/est_15_inf.pdf.

29. **The diverse and competitive microfinance sector is comprised of some regulated entities and an estimated large number of unregulated providers.** The microfinance sector is well established and very important for the provision of savings, credit and payment services to a wide array of clients, including mid- to low-income customers in rural areas. The sector is broadly divided into the 55 entities affiliated to FEDECREDITO (credit cooperatives – not supervised by SSF – and 7 cooperative workers' banks – of which 5 are supervised by SSF[35]), 32 credit and savings cooperatives (*associaciones cooperativas de ahorro y crédito* – **ACAC**) affiliated to FEDECACES (none is supervised by SSF), 13 entities affiliated to the Association of Microfinance Institutions (**ASOMI**), of which 4 are supervised SACs and 9 are non-governmental organizations (**NGO**) MFIs. The FEDECREDITO system alone serves over 930,000 clients.[36] The remainder of the sector is mostly comprised of ACACs. Cooperatives in general are promoted by and registered with INSAFOCOOP.[37] There are 1,078 registered cooperatives, and 447 of them are financial cooperatives. Only 2 – Comédica and Vicentina – are supervised by SSF. The information available on the non-regulated ACAC sector is very limited.

30. **FEDECREDITO and FEDECACES are industry federations that provide services to their members and act as self-regulatory bodies.** FEDECREDITO, which is also supervised by SSF standardizes deposit and credit products offered by affiliated entities, manages corporate business (e.g., settlement of international remittances and inter-member payments), offers common information systems; and provides training, auditing and advisory services, among others. FEDECREDITO has also developed prudential and operational standards based on BCR´s regulation, and monitors the implementation of such regulations (although it has no enforcement powers). FEDECACES is not supervised by SSF, but provides similar services to its members. These entities are described in more detail in the NBSCI Technical Note.

2.2.1.2 Analysis of the regulatory and supervisory framework

31. **The BCR is the main regulator of the financial sector, while the SSF is the supervisor**. In 2011, a reform of the Law on Supervision and Regulation of the Financial Sector (**LSRSF**) concentrated all regulatory functions in the BCR, while the SSF remained as the sole supervisor of the financial sector, covering banks, cooperative banks,[38] deposit-taking nonbanks, government banks, FEDECREDITO, insurance companies, MTOs (since 2015), e-money issuers (since 2015), administrators of payment systems and securities settlement systems, AFPs, the Social Housing Fund (**FSV**), the Deposit Guarantee Institute (**IGD**), and the National Popular Housing Fund (**FNVP**). SSF is also the supervisor of the capital markets. The BCR is the overseer – and also an operator – of the national payment system.

32. **The legal framework gives powers to the SC to ensure competition in the financial sector and other relevant industries, in coordination with the sector-specific authorities**. The

[35] Source: http://www.ssf.gob.sv/index.php/component/content/article?id=283. FEDECREDITO is also supervised by SSF.
[36] Source: Interview with FEDECREDITO, March 8th, 2016.
[37] INSAFOCOOP stands for Instituto Salvadoreño de Fomento Cooperativo. See http://www.insafocoop.gob.sv.
[38] The cooperative societies that are not under the regulatory and supervisory scope operate in El Salvador under the General Law of Cooperative Associations (*Ley General de Asociaciones Cooperativas*),1994.

Competition Law[39] gives ample authority to the SC to investigate and curb anti-competitive practices in all industries, including the financial and the telecommunications sector. In addition, some sector-specific laws have legacy provisions assigning the sector regulator/supervisor a role in competition, such as the Telecommunications Law,[40] and the Law on Cooperative Banks and Savings and Credit Societies (**LBCSAC**).[41] The laws of the BCR and SSF,[42] though, do not establish a formal mandate for competition, which helps avoid any lack of clarity on who holds ultimate responsibility in acting upon anti-competitive practices. Despite actively conducting studies[43] and deciding on concentration cases, the SC has not taken measures against financial institutions on the basis of anti-competitive behavior observed in its studies. Also, it seems that there is not always a follow up on SC's recommendations spanning from such studies, such as recommendations on legal and regulatory reforms and actions by other authorities.

33. **There seem to be no excessive legal barriers to entry for new banks and the framework allows for a diverse range of large and small deposit-taking entities to enter the market.** Despite a relatively high minimum entry capital requirement – compared to peer countries in the region – of US$ 17.6 million, several regional banking groups, particularly Colombian groups, have entered El Salvador and have grown to hold considerable share of the total assets in the system. There are higher prudential requirements for the first years of operation of a bank, which are relaxed afterwards, but these are in line with international standards.[44]

34. **A recent reform brought MTOs under the regulatory and supervisory remit of BCR and SSF.** The reform of the LSRSF assigned the SSF the responsibility for supervising MTOs and Agents of international MTOs. The BCR issued, in December 2015, a regulation[45] to set entry and operation requirements for MTOs/Agents. A MTO (defined as a locally or internationally incorporated company that offers money transfer in a systematic or substantial manner through any means) and Agents (e.g., banks paying remittances in El Salvador through a contract with an international MTO such as Western Union) cannot operate in El Salvador without registering with SSF. The documentation to be presented is extensive, but does not seem to create excessive burden. Within 60 days, and after conducting an inspection in the MTO/Agent, the SSF may do the registration in a central database. The MTO/Agent is required to inform the BCR of the registration. Other entities already supervised by SSF, such as banks and SACs with an interest in becoming a MTO or an Agent must inform the SSF 30 days prior to starting operations and submit documentation for analysis. They also need to send a copy of the communication to BCR. If already providing money transfer services as Agents, they need request to SSF to be included in its MTO database. For those already operating, the new framework means extra compliance cost,

[39] *Ley de Competencia y Reglamento*, 2004.
[40] *Ley de Telecomunicaciones*, Article 2, Article 8-A and other articles, such as Article 20.
[41] *Ley de Bancos Cooperativos y Sociedades de Ahorro y Crédito*, Articles 147 and 147-A.
[42] *Ley Organica del Banco Central de Reserva and Ley de Supervisión y Regulación del Sistema Financiero*.
[43] For instance, the SC has published a study on competition in the telecommunications sector in 2014 and a study on the cards industry in 2011. SC's studies are available online: http://www.sc.gob.sv/dirs.php?Id=28&Id_menu=306010.
[44] See Technical Note on Efficiency for detailed analysis of entry barriers and efficiency in the financial sector.
[45] NRP-12, *Normas Técnicas para el Registro, Obligaciones y Funcionamiento de Entidades que Realizan Operaicones de Envío o Recepción de Dinero*. This regulation entered into effect in January 4th, 2016.

but there is no indication that the requirements are excessively burdensome. Both Agents and local MTOs need to periodically report transaction statistics to BCR and daily to SSF (starting August 2016).

a. The requirements for MTOs/Agents to inform the BCR of the registration or send copies of communications with SSF, may be seen as a sign of lack of coordination between BCR and SSF, since there could be direct sharing of information between the two authorities.

b. The bulk of the NRP-12 regulation addresses Agents, although it seems that the same requirements (e.g., Art. 22 on the AML/CFT manual) would apply to MTOs incorporated in El Salvador when there is no explicit extension of the requirement to such local MTOs (as there is, for instance, in Art. 18). The exception would then be when another regulation is referred such as the requirement to follow the agent regulations (NASF-03) in substitution of the Chapter 6 in NRP-12, which deals with sub-agents.

35. **The passing of the Law to Facilitate Financial Inclusion (LFIF) shows the commitment of the Salvadoran authorities to increase institutional diversity and competition to spur inclusion**. In line with the G20 Principles for Innovative Financial Inclusion,[46] the SSF has allowed Tigo Money and other two providers to operate prior to the issuance of a specific regulatory framework. The LFIF was issued in September 2015 to fill the legal gap and create a new type of regulated institution: E-Money Providers, which at this moment are providing mainly mobile money[47]. Based on the LFIF the BCR, in coordination with SSF, has submitted for public consultations in early 2016 the draft regulations for the constitution and for the operation of E-Money providers.

36. **The draft E-Money Provider (EMP) regulations based on the LFIF set reasonable entry requirements and a two-phased process for licensing of EMP.** The minimum entry capital is US$ 500,000, which needs to be deposited in the BCR. There is no indication that this value is too high or too low for El Salvador. The licensing of EMP by SSF has two-phases: authorization for constitution and authorization for operation. After the SSF gives the EMP the authorization for constitution, it must adopt all necessary measures to start operations and seek the authorization to operate. The process does not seem to introduce excessive burden and delays (maximum processing times are set) or create an unlevel playing field across different types of applicants. Banks, cooperative banks and SACs do benefit from lower requirements when establishing e-money issuing operations, but this is line with international practice. For instance, they do not need to create a separate entity, and can present a simplified version of the documentation that needs to be presented by new EMP for the authorization to operate. They need to seek a "no-objection" letter from SSF, nevertheless.

[46]http://www.gpfi.org/sites/default/files/documents/G20percent20Principlespercent20forpercent20Innovativepercent20Financialpercent20Inclusionpercent20-percent20AFIpercent20brochure.pdf.
[47] In this Note, "mobile money" means e-money that is used primarily through mobile phones and agent outlets.

37. **However, there are weaknesses in the LFIF (draft) EMP regulation**.

a. **Unclear requirements to operate as a "mobile payments system administrators"**. EMP can apply for an authorization to operate as mobile payments system administrator, which is defined as systems or technological platforms to permit payments or transfers, mainly e-money, across different providers and regardless of the mobile network operator (**MNO**) used by the client.[48] Given the nature of this activity, it is not clear why the EMP would need a separate authorization.

b. **Requirement to create a separate entity to pay international remittances through mobile money accounts**. The definition of operations,[49] which could be considered to be equivalent to the activities permitted to EMP (there is no explicit listing of permitted activities yet), does not include international remittances. Tigo Money currently provides this service through Agent contracts with international MTOs. According to information received it would need to create a separate entity to continue acting as Agent of MTOs, or becoming a locally incorporated MTO, although this is to be confirmed when the regulations on EMP is issued. This interpretation might also be related to the fact that the Art. 32 of the MTO regulation (NRP-12) states that domestic remittances through e-money providers are to be regulated through the upcoming EMP regulation. Creating a separate entity is not only an unnecessary burden given the nature of the operations, but is also not in line with international practice. More importantly, there is no explicit regulatory prohibition for EMP to pay international remittances (in both the EMP draft regulation and in the MTO regulation). In a country where international remittances are so central to financial service providers and the Salvadoran families, this requirement would be a missed opportunity and would disproportionately impact smaller EMP, which in turn could perpetuate the current dominant position of Tigo Money, and distorting the financial inclusion process. For being a business based on narrow margins, e-money issuing is highly impacted by regulatory compliance costs such as this.

c. **Legal requirement to keep the equivalent to 100 percent of projected outstanding e-money in a BCR account and related requirements**. To apply for an authorization for operation by SSF, the EMP needs to open a non-interest bearing account at the BCR and deposit the amount equivalent to the total value of e-money expected to be issued. The EMP needs also to present SSF a certificate by BCR that the interface for the operation of the provider's account at BCR functions correctly, and the description of the mechanisms that will be in place to allow the BCR to control the amount of e-money issued. Banks, cooperative banks and SACs also need to comply with this requirement.

    i. First, experience in many other countries where nonbank EMP exist (including in Asia, Europe and Latin America), the **100 percent deposit**

[48] LFIF, Article 14.
[49] Draft *Normas Técnicas para el Inicio de Operaciones y Funcionamento de los Proveedores de Dinero Electrónico*, Art. 3, (l).

requirement can be met in more practical manner through trust accounts held in commercial banks. This is usually not only more practical due to the infrastructure offered by the commercial banks, but also means that interest could be earned in the accounts, to be either passed on to customers, or be used by the EMP as an internal funding source.

ii. Second, and most importantly, there are **concerns in the market that the account in the BCR will end up causing significant practical challenges for the management of the float** (outstanding e-money issued). The regulation seems to treat the float account as a reserve bank account. That is, the procedures to reduce the float account seem to be excessively burdensome[50] and EMPs might simply decide to keep the balance of the float account always in excess to the outstanding e-money. Or they might decide to have two parallel systems of float management (with a bank and with the BCR). The BCR system might not have the right functionalities to allow timely and correct management of the account, and the BCR might not have the resources and capacity to effectively play the role of a commercial bank to control such accounts and conciliate with the EMP on a daily (or more often) basis, since e-money float levels tend to be volatile. Also, it is not clear what the role of the BCR will be in the control of the individual client account balances, whose sum is to be reflected on a daily basis in the float account. In this respect, the regulatory provision stating that in no case the balance in the float can be lower than the e-money issued might be unrealistic, as the balances may shift during the course of a day and be replenished by the end of the day. In countries where e-money volumes have reached high volumes, many EMP providers conciliate their account systems with the banks (EMP usually manage more than one partner bank) holding their floats more than once daily. Finally, since BCR has no branches like commercial banks, the withdrawals from the account will need to be done through commercial bank accounts anyhow. If the potential operational hurdles become reality, the framework may end up functioning as an additional minimum capital requirement, and will mean additional operational costs for EMPs, particularly small ones.

iii. Third, due to the above, holding the float accounts may generate **hurdles for BCR** and shift human resources from important payments oversight functions (see Technical Note on Financial Infrastructure with respect to BCR's payments oversight activities and capacity).

[50] Draft *Normas Técnicas para el Inicio de Operaciones y Foncionamento de los Proveedores de Dinero Electrónico*, Art. 18 and Art 19.

iv. Fourth, the requirement for applicants to present a BCR certificate to SSF may be seen as a sign of lack of coordination between BCR and SSF, since the SSF could simply seek BCR's opinion on the matter.

Box 1: Safeguarding requirements for e-money accounts

The main reason for requiring EMPs to set aside, by way of a bank deposit,[51] the equivalent to 100 percent of the outstanding e-money is to safeguard client funds collected by less heavily regulated and supervised entities. This requirement may also be seen as a tool to enforce the prohibition for EMPs to intermediate deposits by on lending such funds, which is an activity exclusive of banks and other regulated deposit-taking institutions. It is a key limitation on EMPs so that the regulations to operate as an EMP can be as light as possible to spur market development and innovation and competition. Regulators may also see the safeguarding requirement as a means to limit commercial banks' ability to intermediate the funds held in pooled accounts managed by EMPs. Keeping the funds at the central bank would virtually eliminate the risk of loss of funds from the customers' perspective. However, the objectives should be seen separately. The safeguarding objective should be the central one. It should, whenever possible, be further strengthened with a requirement for a special type of deposit account that shields the amount from EMP's other purposes (such as funding its daily operations) and from the bank's other creditors (e.g., service providers and depositors) and from. A trust account (or similar, depending on the country), determined that the funds are legal property of each individual EMP client, according to the EMP's client account management system.[52] The operation of a trust account at a bank not only protects the property of the funds, but also facilitates the application of any existing deposit insurance limits to the individual account balances, rather than to the total pooled account balance.[53] This is because the trustee has the obligation of keeping track of the individual account balances by mirroring the account controls of the EMP. Coverage by deposit insurance may encourage greater uptake of e-money accounts by customers and may provide incentives for prudent behavior by EMPs, when the insurance scheme imposes obligations on the EMP.

38. **The absence of a payments law creates a gap that impacts the ability of BCR and SSF to adequately cover the growing retail payments system, and it results in a fragmented framework**.[54] BCR's and SSF's powers are less clear with respect to retail payment services and providers other than EMPs, MTOs/Agents. In fact, numerous payment providers operating in El Salvador are not regulated or supervised. Important players such as the switches (e.g., Serfinsa, which processes ATM transactions) are also outside the regulatory remit, which limits the information available about them. A payments law would create a unique and consistent framework for payment systems, system operators and service providers, addressing the current gaps and fragmentation that could lead to an unbalanced playing field, lack of clarity for providers and supervisors, and inconsistencies in legal and regulatory provisions. Setting basic common requirements for all types of entities providing payment services and managing payment systems through an overarching law, as it is done in numerous developed and developing economies could

[51] Some jurisdictions actually allow this to be done in alternative ways, including through an insurance policy, since it is a tool primarily to safeguard client funds, rather than to enforce the prohibition of financial intermediation.

[52] See an analysis of this issue in Tarazi, M. & Breloff, P (2010). *Nonbank E-Money Issuers*, available at http://www.cgap.org/publications/nonbank-e-money-issuers.

[53] Either with the application of pass-through insurance (e.g., Kenya, Nigeria and the US) or the definition in the law that the e-money accounts are considered deposits specifically for the purpose of deposit insurance, and hence be covered as if they were regular bank deposit accounts (e.g., Colombia). See *Deposit Insurance for Digital Financial Products: 3 Approaches:* http://www.cgap.org/blog/deposit-insurance-digital-financial-products-3-approaches.

[54] For a detailed analysis of this and other issues related to the payments infrastructure in El Salvador, see Technical Note on Financial Infrastructure.

have a positive impact on financial inclusion and consumer protection. A less fragmented framework is also necessary for the access points used by payments providers and other regulated institutions (see 2.2.2.2).

39. **Reforms are underway to strengthen the supervision of El Salvador's far-reaching and diversified microfinance sector, but supervisory capacity will need to improve**. The LBCSAC establishes that cooperatives that capture deposits from non-members and/or have member deposits plus contributions over a certain threshold should fall within the perimeter of BCR's regulation and SSF's supervision. The LBCSAC also covers SACs. There are two proposed changes to the LBCSAC to reduce the threshold for cooperative banks and submit ACACs to such threshold. An auxiliary supervisory model would be instituted for ACACs. The reform proposals were submitted by the President's office separately by BCR and SSF, reflecting the lack of common understanding and coordination in the topic.[55]

2.2.1.3 Government policies and programs

40. **The government is an active market participant through specialized and development banks.** Bandesal, the development bank, has since 2011 been engaging in first-tier banking.[56] It also continues to have its original second-tier banking function, having investments and/or loans in select sectors, including infrastructure. The two specialized government banks are Banco Hipotecario (**BH**), which focuses on small loans (up to USD 5,000) to small and medium enterprises, and Banco de Fomento Agropecuario (**BFA**), which lends at subsidized rates to underserved segments such as the rural sector.[57] BFA, BH and Bandesal are very important players but their performance has not been always good, particularly Bandesal's first tier operations.

41. **The government also offers guarantee funds and other funds to incentivize credit to underserved markets, such as SME finance.** The Salvadoran government has created the Agricultural Guarantee Program (**PROGARA**), which is used by BFA to cover and reduce the risk of part of its portfolio. There is also the Economic Development Fund (**FDE**) and the Salvadoran Guarantee Fund (**FSG**), both managed by Bandesal. FDE is used by Bandesal to provide retail or corporate loans up to US$ 3 million. Through the FSG Bandesal provides guarantees to loans originated by other banks (including BFA), specifically for certain priority segments and for amounts up to US$ 350,000.

2.2.1.4 Recommendations

42. **The draft EMP regulatory framework should be improved.** Many of the weaknesses in the draft regulations for the constitution and operation of EMP are based on actual provisions of the LFIF. To the extent possible, BCR and SSF should work together to address such weaknesses by clarifying in the upcoming EMP regulations the interpretation of the legal

[55] The Technical Note on NBSCI provides a detailed comparison of the two proposals.
[56] Law for the Development Financial System (*Ley del Sistema Financiero para Fomento al Desarrollo*), 2011.
[57] A detailed analysis of government banks is done in the Technical Note on Nonbank Savings and Credit Institutions and Public Banks. Some key recommendations of that analysis are incorporated in this Technical Note.

provisions. When not possible through regulation, it is recommended that the LFIF be amended. The specific improvements are:

a. Clarify, in the draft EMP regulations, that EMPs are allowed to pay and receive international remittances to avoid requiring the establishment of a separate legal entity to be licensed as MTO/Agent under the MTO Regulation (NRP-12). This may also be achieved/reinforced by changing Art. 32 of NRP-12, to clarify that EMP can engage in international remittances, in addition to domestic remittances.

b. Clarify the requirements for mobile payment system administrators, including how they differ when the administrator is an existing regulated entity (e.g., bank or EMP), and when it is a federation such as FEDECREDITO. Ideally, this topic would be addressed in a specific regulation dealing with payment service providers and system operators, spanning from a payments law, which is recommended below.

c. Allow the amount equivalent to the outstanding e-money to be deposited in commercial banks. The requirement for EMPs to deposit the funds at the BCR may be mixing two different policy objectives, and might not yield better results in protecting client funds and permitting the efficient management of the float by EMPs as compared to trust accounts at commercial banks, particularly if EMPs start using a common commercial bank account as an intermediary account to be able to continue operating with the minimum disruption possible after the BCR account requirement is put in place. Finally this requirement may, by increasing the operational costs, create hurdles for smaller EMPs to compete in the market. Also consider allowing EMPs to pass on part or the entirety of the interests earned to clients, should the float be allowed to be deposited in commercial banks.

43. **A payments law should be drafted and enacted in line with international standards and good practices**.[58] A strong payments law is fundamental for the safe expansion of access to and use of financial services by Salvadorans. There is no question that full financial inclusion depends, in El Salvador and globally, on digital financial services, as these reduce costs to a level that serving lower-income clients may become an attractive business. Electronic payments are a central piece of this puzzle. There is urgent need for reforms to the legal, regulatory and supervisory framework for payments to allow inclusion to progress while protecting consumers and setting the rules of participation in crucial financial infrastructure.

44. **BCR and SSF should coordinate to present a single draft reform of the LBCSAC that reflects a joint vision for the sector**. A unified legal reform proposal should be achieved and discussed in a coordinated manner with the industry associations and other government authorities, to speed up the reform, address any potential conflict of opinions across the relevant authorities, and align it with international good practices.

[58] See details on this recommendation in the FSAP Technical Note on Financial Infrastructure.

45. **SSF needs to build capacity, develop expertise and improve data infrastructure to effectively supervise EMPs, MTOs and ACACs.** Although bringing MTOs, EMPs and ACACs under SSF's supervision is a positive development to keep high levels of public confidence in these markets – which could help encourage adoption and use of financial services by people who currently use informal services – it signifies a considerable increase of SSF's responsibilities and may stretch its capacity. A carefully crafted program for implementation of these changes is crucial, to allow for effectiveness and efficiency, and also to generate quality data from these sectors, which could the future NFIS coordination structure monitor financial indicators. The roles of BCR and SSF in requesting, sharing and analyzing data should be very clear. Particularly with regard to ACACs, establishing an effective auxiliary supervisory scheme is a complex task in which many countries have failed, and requires time, clarity of objectives and adequate resources. It also requires extensive coaching and capacity building at the institutions that would be acting as auxiliary supervisors.[59] Finally, coordination with INSAFOCCOP is needed to implement a system through which information about the level of operations of unregulated ACACs could be monitored by SSF, so that it can determine whether individual ACACs reach the minimum thresholds that trigger the need to become a supervised entity. This information is also valuable for financial inclusion monitoring.

46. **The government should consider reviewing Bandesal's strategy to enhance its contribution to financial inclusion.**[60] Bandesal should shift its first tier banking to larger loans and focus on second-tier banking, specifically in providing guarantees. In these roles, Bandesal would fill a gap that exists in the market for SME finance. It is also recommended that Bandesal consider providing partial guarantees for bond issuance by MSME lenders, to increase their access to additional sources of funding and ultimately benefit MSMEs.

47. **SC, in coordination with sector regulators such as BCR, SSF and SIGET, should actively take measures to ensure competition in the financial sector**. SC has a clear mandate and has strong and unquestionable powers to act based on its own initiative or when requested by the public or another authority. However, the studies it conducts result in non-binding recommendations, rather than actions (e.g., by SSF or SIGET) or sanctions that would result in improved practices or curbing of anti-competitive practices. The authorities are urged to devise coordination mechanisms and seek government support for a collective stronger mechanism to protect competition, particularly in fast growing markets such as the electronic retail payments sector and related infrastructure, such as telecommunications (see 2.2.2.2).

[59] See also the guidance by the Basel Committee on Banking Supervision for this type of supervisory approach in *Guidance on the Application of the Basel Core Principles for Effective Banking Supervision to the Regulation and Supervision of Institutions Relevant to Financial Inclusion*. Available at http://www.bis.org/bcbs/publ/d351.htm.

[60] Further details on these and other recommendations for Bandesal are found in the Technical Notes on Nonbank Savings and Credit Institutions and Public Banks.

2.2.2 Provider reach

2.2.2.1 Analysis of the market

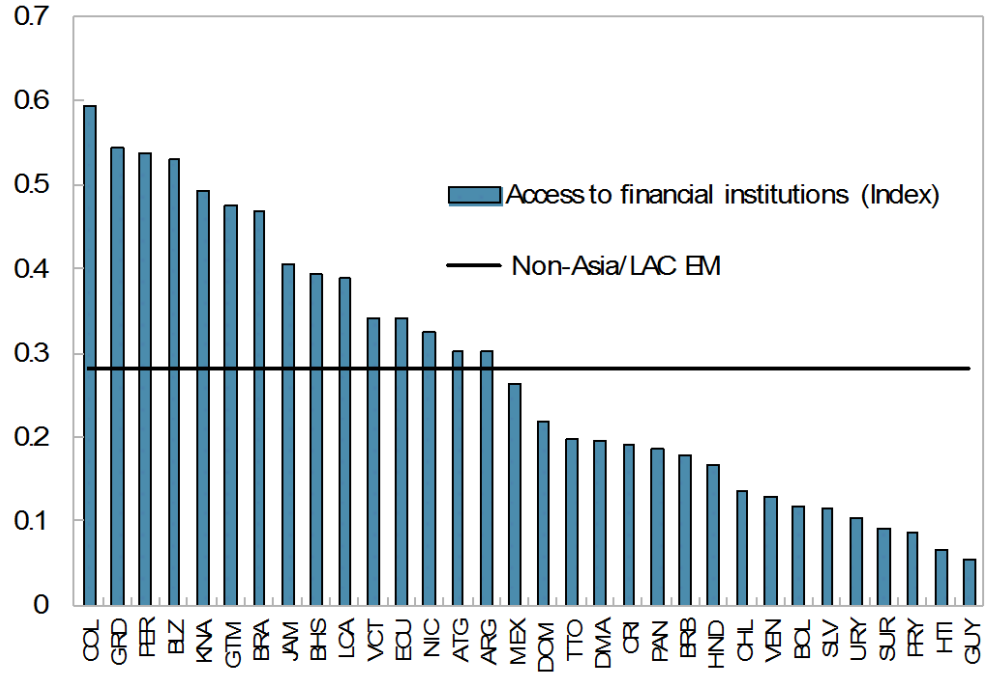
48. **The network of access points to the financial sector is relatively good in El Salvador, but needs to be improved to support greater levels of inclusion**. According to the IMF Financial Access Survey[61] there are 11.6 branches per 100,000 adults, below the LAC regional average of 14.4 branches per 100,000 adults. El Salvador is above the LAC average and much above the low middle-income (LMI) country average with 33.1 ATMs per 100,000 adults, although below Guatemala and Bolivia (Table 6). However, in a composite index prepared by the IMF to reflect the physical access of households to the infrastructure of the financial sector, El Salvador is in the 27th place, among 32 countries in LAC (Figure 9). ATM and POS deployment is below average for LAC, but above the average for (LMI) countries.

Table 5: Access indicators and cross-country comparison

Indicators	Comparison country / group of countries						
	SLV	BOL	GTM	HND	NIC	LAC	LMI
# of financial access points per 100,000 adults	44.7	49.7	72.3	47.8	19.0	44.5	20.4
Of which, commercial bank branches	11.6	15.0	36.5	23.2	7.6	14.4	7.2
Of which ATMs	33.1	34.7	35.8	24.6	11.4	30.1	13.2

Source: IMF Financial Access Survey

Figure 9: Physical access to financial institutions (Index)



Source: International Monetary Fund, 2015. Financial Inclusion: Zooming in on Latin America, WP/15/206

[61] Available at http://data.imf.org/?sk=E5DCAB7E-A5CA-4892-A6EA-598B5463A34C.

49. **Tigo Money has the largest network of access points (comprised of e-money agents), followed by the FEDECREDITO system and banks**. Reportedly, Tigo Money is the largest and more spread out network of access points, comprised of 3,500 agents covering 210 municipalities[62] (2,500 individual agents and another 1,000 points that are part of commercial chains such as Supermercados Selectos). Some financial institutions have become agents for Tigo Money, such as Integral, the largest SAC, and other 2 institutions affiliated to ASOMI, which offer this channel to borrowers to make loan installment payments. As a comparison, banks had 567 branches in the end of 2014 (from full-fledged branches to mini-branches).[63] Banco Agrícola, the largest bank, has the most extensive network, with 68 branches, 60 percent of which are outside the capital city, San Salvador.[64] The FEDECREDITO network has over 500 points of access including branches and agents.[65] ASOMI members have 56 branches only, 26 of which are branches of Integral. The number and location of branches and agents of ACACs is not known. In the insurance sector (which counts with 1,254 insurance intermediaries, 1,163 of which are independent insurance agents), bancassurance has contributed to the sector's growth.

50. **There is a need to improve data about the access points network in the country.** Reportedly, the country is well served geographically by access points to the financial sector, but there is no mapping to confirm the current status and pin point areas that need more attention. For instance, there is no consolidated statistics on POS penetration, although reportedly POS terminals are concentrated in urban areas. A useful tool that is being built or has been built in some countries is an access point mapping covering the regulated and unregulated financial sector. The mapping may even incorporate other data points that may be useful for policymaking or business decisions, e.g., cell phone towers, hospitals/clinics, schools, average income levels, etc.[66]

51. **The use of agents ("*corresponsales financieros*") by financial institutions is still incipient.** Only a couple of banks are using agents to deliver their products and services. Banco Agrícola is the frontrunner, based on the successful experience of its headquarters in Colombia. Agrícola's agent network is branded Amigo and is comprised of commercial establishments selected and managed directly by the bank, with no use of an agent network manager (**ANM**).[67] Agents are mostly used to provide cash-in/out services such as bill payments, but also transfers between accounts of the same institution (inter-bank transfers are not possible yet). FEDECREDITO affiliates are also investing in agents (there are around 216 agents to date), using a common brand ("Punto Vecino") and a few common standards set by FEDECREDITO. The large majority of transactions conducted through agents to date are bill payments, particularly utility bill payments.

52. **However, payment networks are not a new business, and they are expanding their operations to act as ANM.** Like in many other Latin America countries, independent networks

[62] The country has 262 municipalities.
[63] Source: Abansa (http://www.abansa.org.sv/wfManejoPublicaciones.aspx?codigo=63).
[64] Source: interview with Banco Agrícola, March 9th, 2016.
[65] Source: interview with FEDECREDITO, March 8th 2016.
[66] Examples of countries that have done such mappings are Mozambique, Pakistan, Tanzania.
[67] Source: interview with Banco Agrícola in March 9th, 2016.

that facilitate payments, most commonly known as "payment collectors", are very important players in El Salvador. The main ones are Punto Xpress and Red Multiservicios Aki. These two networks are competitors and already broadly used as a complementary channel by many financial institutions for basic payment services (e.g., loan and bill payments), from Tigo Money to banks, to cooperative banks and SACs. In addition to their payments collections business, these networks are setting up ANM contracts with financial institutions to be able to offer a broader range of services on their behalf (e.g., receive applications for bank account openings).

53. **Electronic channels (internet and mobile banking, ATMs, POS) are mostly used by banks and EMPs, while other institutions rely more on staffed channels.** Banks are increasingly using electronic channels, although the most used channel – and the one that offers more types of services – continues to be the branches. Salvadorans still rely mostly on tellers as the main channel for deposits, and ATMs are used almost exclusively for withdrawals. Banks are though, pushing for greater use of electronic channels as a cost-reduction strategy. The use of electronic channels, including withdrawals at AMTs in the microfinance sector and partnerships with banks to use their infrastructure (e.g., ATMs and POS) are almost non-existent, and only a couple of SACs offer debit and credit cards to their clients.

54. **Mobile phones present a great opportunity to increase outreach, but mobile network operators may be imposing obstacles.** MNOs are key players in facilitating financial inclusion globally, given the high levels of penetration of mobile phones among people who are underserved or unserved by the financial sector. In El Salvador, the number of mobile phone subscriptions is equivalent to 146 percent of the population and wireless geographic coverage is near 100 percent.[68] However there are several reports that MNOs[69] – which are regulated by SIGET – have been imposing hurdles for financial services providers through discriminatory access conditions or requirements (e.g., large share of revenues from mobile money operations), pricing and quality of the services rendered (e.g., delays in completion of financial transactions) to financial institutions using MNO channels, such as **USSD** and **SMS**. Preferential conditions are offered to certain institutions, while other institutions lacking special relationships with the MNO would not have access at all to the USSD channel. This is particularly the case of MoMo, since it could potentially offer competition to Tigo Money, or to other e-money schemes in which the other MNOs could invest. When a player competing in a market is also the owner of an essential infrastructure, a clear case for regulatory action could be made to curb anti-competitive or restrictive practices.

55. **Limited interoperability is a central obstacle for greater use of electronic channels and full financial inclusion.** There is little interoperability between different networks of access points within each of the sectors (banks, EMPs, SACs, cooperatives) and across different sectors. The FEDECREDITO branch network is largely interoperable (i.e., reportedly, clients of one cooperative bank can use the branch of another cooperative bank to make a deposit), thanks to a

[68] Source: BuddeComm http://www.budde.com.au/Research/El-Salvador-Telecoms-Mobile-Broadband-and-Digital-Media-Statistics-and-Analyses.html

[69] There are 5 MNOs in El Salvador: Millicom International (Tigo), América Móvil (Claro), Telefónica (Movistar), Digicel and RED (Intelfon).

common core system managed by FEDECREDITO. The agents used by FEDECREDITO members are not interoperable, though. Interoperability is limited across banks (ATMs and POS), largely because of the slow process to join the switch and clearinghouse. The private sector automated clearing house (**ACH**) started operations in 2011, and not all banks are members yet. The ACH's viability will depend in the growth of transaction volumes, which in turn depends on greater push for the use of electronic channels and greater interoperability across the different financial sectors. There is also no interoperability across EMPs and between these and the other sectors (e.g., for transfers across different platforms). It is not clear whether the EMPs will join the ACH.

56. **Limited familiarity with new business models and cost-effective channels, as well as lack of partnerships across different sectors are challenges for the network of access points in the country**. With a few exceptions, the representatives of different sectors seem suspicious of each other. This is due to healthy competitive forces, but it has delayed the establishment of partnerships to maximize the use of the existing infrastructure to bring services closer to potential clients. For instance, there are opportunities for banks to create partnerships with institutions operating outside the larger cities as a means to increase awareness of potential clients about bank accounts and other services. There is need for an industry-wide dialogue towards the sharing and expansion of the access points network as a means for achieving full financial inclusion.

57. **High levels of criminality and violence form an important obstacle that brings uncertainty and reduces appetite for investments by financial institutions in El Salvador.** Differently from many other countries with high levels of financial exclusion, coverage and reliability of public infrastructure such as telecommunications, roads and electricity services do not seem to form important obstacles for providers to expand geographically to rural or remote areas. Neither are educational levels and availability of workforce, according to reports from the financial industry. However, high levels of criminality and violence are a major concern at present and reduce significantly the attractiveness and viability of doing business in certain localities, including some urban areas in and around San Salvador. As a result, potential clients or current clients need to travel and spend time to access the formal financial sector, which increases their costs and risks (e.g., by carrying cash for a deposit).

2.2.2.2 Analysis of the regulatory and supervisory framework

58. **The legal framework for electronic transactions and contracts is not sufficiently robust to provide certainty to financial service providers**. The Electronic Signatures Law (*Ley de Firmas Electrónicas* – **LFE**) was recently passed and the governing regulations are currently being drafted by the Ministry of Economy (**MINEC**).[70] Although one of the stated objectives of the LFE is to provide legal security and validity to "transactions authorized through technological applications or their electronic subscription"[71], and although it equals electronic signatures to physical signatures, it focuses on certified signatures (rather than simple electronic signatures),

[70] The draft regulations have not been analyzed by the FSAP team.
[71] Preamble to the *Ley de Firmas Electrónicas* (Decreto No. 133).

which are not expected to contribute financial inclusion due to the burdensome procedures involved. There are no provisions in the Civil Code[72] or Code of Commerce about electronic documents and transactions. Other instruments have tried to fill this legal gap, for instance, the BCR Law[73] recognizes electronic transactions and signatures within the payments system, and another law provides for the electronic negotiations of securities.[74] However, banks and other players are wary of using electronic contracts, arguing that judges do not usually accept them in court as valid proof. Their understanding is that transactions can be electronic only if they are based on a contract that is physically signed by a client.

59. **The large-scale use of electronic contracts and transactions is further hindered by interpretation and potential enforcement of AML/CFT requirements**. Reportedly, the lack of certainty spanning from the legal framework for electronic documents and transactions, is coupled with the question of whether client information can be electronically gathered and electronically stored for the purposes of complying with the AML/CFT law and regulations. The AML Law[75] expressly provides for electronic record keeping and transmission of any record or report required by the law, but is silent with regard to the collection of client information. This is reinforced by the AML regulation (NRP-08, Art. 7, i), which makes reference to electronic or physical files of clients reported as irregular or suspicious. Moreover, providers seem to be unsure of whether electronic data collect and storage would be accepted in practice by SSF supervisors.

60. **The framework for security and risk management of electronic channels and transactions more generally is also fragmented.** For instance, while the draft EMP regulations have extensive provisions to ensure data security and privacy and operational reliability with regard to services based on e-money accounts and also over-the-counter (**OTC**) transactions, similar requirements should exist to any other electronic channel, including Internet, ATMs, POS and any other new channel. This would be better accomplished through a standalone regulation on electronic channels, similar to the approach taken in many other countries, including Colombia and Mexico. In fact, BCR has a draft e-banking regulation to fill this gap, but it would not apply to EMPs or MTOs (it covers banks, cooperative banks, SACs, and credit card issuers).[76] It is not clear why such fundamental regulation would not apply to regulated entities providing e-money and remittances.

61. **The regulatory framework for the use of agents by regulated institutions is unduly fragmented and sometimes unclear**. Although the regulation is relatively open (e.g., types of entities and individuals that can act as agents and places where they can operate; prohibition of exclusivity and sub-contracting, types of services permitted, no limitations on the fees, etc.), and

[72] The Civil Code, Art. 1314, defines "contract", but it does not expressly determines that it needs to be a physical contract. Articles on the principle of proof (1579 and 1580) may are key for future legal clarification in the upcoming regulation of electronic signatures, specifically with regard to the concept of "written".
[73] *Ley Orgánica del Banco Central de Reserva*, Art. 67.
[74] *Ley de Anotaciones Electrónicas de Valores en Cuenta*, which is supplemented by the Securities Law (*Ley del Mercado de Valores*).
[75] *Ley Contra el Lavado de Dinero y de Activos (*Decreto Legislativo 498/98), Art. 14.
[76] *Normas Técnicas para Realización de Operaciones y Prestación de Servicios Financieros por Medio de Banca Electrónica*.

it has the basic risk mitigating provisions found in agent regulations elsewhere, it is unduly fragmented, which results in an unclear overall framework. This is particularly important if one considers the increasing blurring of the lines separating different types of channels, the expected (and needed) increase in the level of interoperability across different channels and the fact that institutions provide a range of services through the same channels, regardless of which regulation cover the particular services being offered. The fragmentation is due to the fact that the channel may be governed by a regulation that was designed to deal with a type of institution. It makes changes – should they be necessary – to the overall framework for the use of agents rather complex. Currently, there are at least 6 different types of rules (or the absence of) for the use of third party establishments as a channel:

a. **Agents (*corresponsales financieros*) under the NASF-03.**[77] This is a key regulation and the only one that is purely a channel regulation. It was issued in 2013 and modified in early 2015. It allows the following principals to have agents: banks, SACs and cooperative banks to use agents and it also governs the hiring of ANM. A No-Objection by SSF is required for the principal to start using agents (no authorization is required for each new agent). The principal is required to month report on agent hiring and closings, and their location.

b. **Agent network managers (ANM) under the NASF-03.** ANM needs to have an agent contract with the principal. A No-Objection by SSF is required for each ANM hired by the principal. The rules are generally the same to those applicable to an institution that selects and manages agents directly without an ANM.

c. **MTO sub-agents under the NRP-12.** The rules pertaining to sub-agents seem to be equivalent to a framework for agents; hence a locally incorporated MTO would not have agents, but sub-agents (although the definition of sub-agents only refers to a contractual relationship with an Agent, not with an MTO). The exception would be the case of a licensed financial institution operating as a MTO or MTO Agent, in which case NASF-03 would apply instead. There is no need to seek No-Objection to operate through sub-agents, although the information on sub-agents needs to be included in the application for registration of MTO or MTO Agent. The SSF is required to publish the list and location of sub-agents in its website, but this has not been done to date. The MTO or MTO Agent needs to report monthly on their sub-agents.

d. **EMP agents ("points of attention") and distributors**. The rules for EMP agents are in draft form. The requirements are generally similar to those applicable to agents in (a), although simpler and there is no need to seek a No-Objection from SSF. Also, there are no specific requirements for distributors beyond the general requirements applicable to agents. The definition of "distributors" in the draft

[77] *Normas Técnicas para Realizar Operaciones y Prestar Servicios por Medio de Corresponsales Financieros y de Aministradores de Corresponsales Financieros.*

regulation seems to equate them to the ANM of the NASF-03. In practice, Tigo Money, in line with international practices, relies on distributors to perform ANM functions.

e. **Agents of a mobile payment system administrator (MPSA).** The LFIF allows EMPs and FEDECREDITO to act as MPSA, which is defined in the law. There is no reference to MPSA in the draft EMP regulations and it is not clear whether a MPSA could also be an ANM for a regulated financial institution and what the requirements would be.

f. **No regulation**. The existing payment networks such as Red Multiservicios Aki and Punto Xpress, as well as the unregulated members of FEDECREDITO, and unregulated ACACs suing agents are not subject to any regulation setting standards for services outsourced to third parties.

The main questions arising from the regulatory fragmentation described above include:

a) What set of rules applies for the agents when a bank, a cooperative bank or a SAC is also an EMP? Are they disadvantaged compared with nonbank EMPs in this respect?

b) Are financial institutions operating as MTO or MTO Agents in disadvantage compared with other MTO Agents, since they are obliged to follow NASF-03,[78] while MTO Agents (and other types of MTOs locally incorporated) follow NRP-1?

c) If the same agent provides services to an EMP, to a MTO, to a bank and is also a payment point for Punto Xpress, would a different regulation apply for each type of transaction and how would that work in practice?

62. **Additionally, there are a few other weaknesses in specific rules for the use of agents**. These include:

a) **Sharing of devices at EMP agents**. While the draft regulation for the operation of EMPs prohibits agent exclusivity, its Art. 20 is unclear with regard to the sharing of devices through which the transactions are conduct.

b) **Lengthy authorization process for the use of agents**. The authorization process is described in NASF-03 as a simple No-Objection request, which is slightly stricter for sharing an existing agent or ANM. SSF needs to decide within 30 business days, but reportedly the process has been lengthy, taking several months. This is not aligned with international practices and with the need to allow regulated institutions to timely hire and dismiss agents.

[78] *Normas Técnicas para el Registro Obligaciones y Funcioanmiento de Entidades que REalizan Operaciones de Envío o Recepción de Dinero,* Art. 33.

c) **Burdensome agent monitoring requirement**. Providers are required to conduct annual onsite inspections on agents to ensure regulatory compliance (NASF-03, Art. 28). During the first year of operation, the inspections need to occur every month. Such requirements are unnecessary based on the experience in Africa, Asia and other Latin American countries, where visits to agents can be both random, or due to a risk assessment of agents, and such functions may be performed by ANM. The current requirement could increase the costs of operating agents to the point where only large institutions could have agents. Furthermore, it is not in line with the approach that is taken in El Salvador and other countries with respect to other types of outsourcing in the financial sector.

63. **The impact of the financial transaction tax on agent transactions with their banks should be further analyzed**. El Salvador has a financial transaction tax that impacts every deposit account in the country. As agents have accounts with banks, through which they operationalize their agent role with a financial service provider, the tax is also applicable. Given the incipient use of agents to date, the impacts of the tax are not very clear yet. However, there are signs that it may become a significant problem for the agent model: reportedly, a few institutions have entered into individual agreements with their banks with the Ministry of Finance in order to avoid the tax with regard to agent transactions. The issue has appeared, for instance, in Colombia, where in 2013 an exemption to the tax was introduced by creating in the regulation of a new type of exempted account, to be used exclusively for agent transactions.

64. **The legal framework gives ample room for measures to be taken by the relevant authorities to address the restrictive and anti-competitive practices adopted by MNOs.** In addition to the SC's broad legal powers and mandate on competition in all economic sectors, the Telecommunications Law, Article 8-A, states that, with the objective of preventing an important provider from adopting anti-competitive practices, SIGET will collaborate with the SC to take necessary measures. Article 2 (a) and (c) state that the provisions of the Telecommunications Law will be applied with the intent of fomenting access to telecommunications by all sectors of the population, and developing a competitive telecommunications market at all levels. Moreover, Article 22 of the LFIF specifically states that the telecommunication services used for the delivery of financial services must be offered in equal technical, economic, administrative or legal conditions to every financial institution. The practices that do not comply with this provision "will be considered a restrictive commercial practice and will be sanctioned by the SC". While the SC has pointed out that it cannot summarily sanction a MNO without going to the formal procedures described in the Competition Law,[79] it could pro-actively investigate the issue and take actions based on the results of the investigation.

[79] Title IV of the Competition Law.

2.2.3 Recommendations

65. **The authorities should take immediate measures to ensure non-discriminatory access to and use of telecommunications infrastructure by financial services providers.** Innovative financial services delivered through mobile phones are transforming the financial inclusion landscape across the globe. To avoid MNOs adopting discriminatory and anti-competitive practices as observed in El Salvador, SIGET should immediately coordinate with SC to implement measures (directives, or even regulation, if needed) to clearly prohibit and impose sanctions on such practices, as provided for in the Telecommunications Law and in the LFIF. In parallel, SC should also take steps to further investigate this issue and take any necessary measure according to the procedures laid out in the Competition Law.

66. **The authorities should build solid a legal framework for electronic contracts and transactions to create legal certainty to providers and consumers**. Serving lower-income segments on a cost-effective basis depends on the use of electronic means for information capture, checking documentation and identity, transaction processing and recordkeeping, with respect to operations on both sides of the balance sheet of financial institutions. MINEC should clarify, in the upcoming regulation of electronic signatures, the concept and application of "simple electronic signatures". It should also, in coordination with BCR, SSF and other relevant authorities, determine whether other legal or institutional measures (e.g., changes to the Civil Code, the Civil Procedural Code, the Code of Commerce or even the Penal Code, as well as initiatives within the justice system to ensure electronic documents are a valid form of proof) are necessary to provide a solid legal basis for the country's shift to electronic contracts and transactions.

67. **BCR and SSF should clarify the acceptability of electronic documents for AML/CFT purposes**. BCR and SSF should issue position papers (or similar) clarifying that electronic documents are acceptable for AML/CFT controls, according to the existing regulation, and that they may be considered by SSF supervisors as effective means for regulatory compliance, equally to paper-based documentation.

68. **The BCR and SSF should work together to issue a single regulation on security and risk management for electronic channels**. The regulation should cover all types of regulated institutions operating through such channels. The regulation should be flexible enough to allow a variety of channel types, transaction average values and consumer types to be offered or served.

69. **BCR and SSF should work together to build a single enabling and safe regulatory framework for banks and nonbanks operating through agents**. The fragmentation of the current framework may have negative impacts in the speed of development of the market, and may result in unforeseen problems as agent networks expand and are increasingly shared by diverse types of institutions offering a varied range of services. The authorities should consider adopting the approach taken in Brazil, Chile, Colombia, Peru, Mexico and other countries, where the same set of rules govern the use of agents by different regulated institutions, and provide flexibility for institutions to raise or reduce requirements according to the services provided by different agent

types. Also, insurance companies should also benefit from using agents, and the rules should be similar.

70. **BCR and SSF should also consider creating a specific set of rules for ANM.** Third party service providers such as ANM, a role that in El Salvador is increasingly being played by well-established payments networks such as Punto Xpress and Red Multiservicios Aki, are key for the safe use of agents for furthering financial inclusion, including agents of MTOs and other regulated payment service providers. It is recommended that these players be a type of regulated institution, under the broader payments legal and regulatory framework recommended in the previous section (e.g., for similar reasons, Nigeria has issued a regulation for ANMs), given that they provide basic and fundamental infrastructure for financial service providers. The framework should not be burdensome, but should allow SSF to directly supervise ANM.

71. **BCR and SSF should clarify the effect of the provision on "exclusive information technology" in the draft EMP regulation with respect to shared agents**. The objective is to provide for the same device to be used by multiple institutions. The requirement should focus on the logic segregation of platforms, which is done through adequate software programming.

72. **SSF should ensure that the authorization process for institutions to operate through agents is timely and it does not impact the needed expansion of the access point network**. For such, SSF should ensure that its staff is adequate qualified to have a full understanding of how agents and ANM operate in El Salvador and other countries.

73. **BCR and SSF should eliminate the burdensome requirement on monthly and annual onsite inspection for every agent**. This requirement of NASF-03 should be broader, a general requirement for the regulated institution to put in place effective mechanisms to monitor and evaluate their agent network, individual agents and ANMs, without specifying how they should do it in practice. If needed, the regulation should clearly allow the ANM to conduct onsite inspections and assess agents on behalf of the principal. Finally, the rule should – explicitly or implicitly – allow the use of a risk-based framework that does not specify visiting every agent periodically.

74. **The impact of the financial transaction tax on the use of agent should be further investigated and measures considered**. The BCR should coordinate with the tax authority, *Dirección General de Impuestos Internos* to further investigate the current and potential impact of the financial transaction tax on agent operations and consider adopting a measure similar to that taken in Colombia.

2.3 Product and Service Diversity and Appropriateness for Individuals and Firms

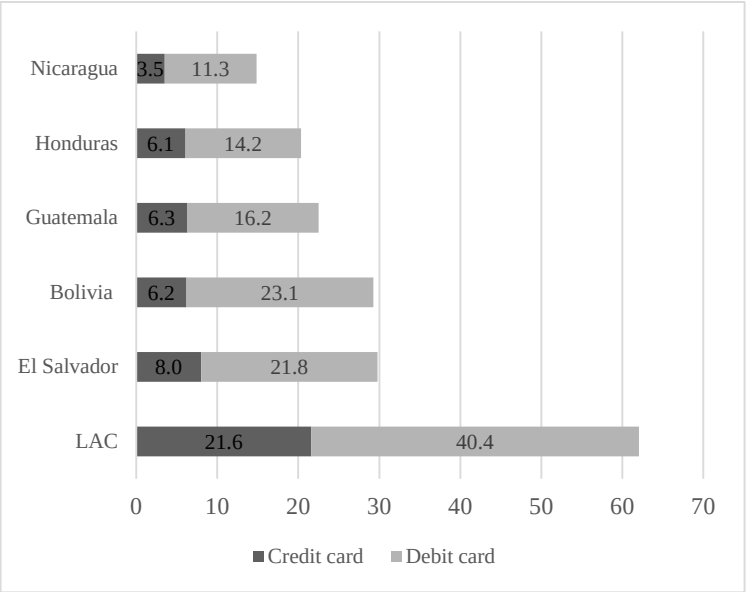
2.3.1 Analysis of the market

75. **While El Salvador has seen a remarkable increase in the number of accounts since 2011, this has not yet translated into a fully diversified set of adequate deposit and transaction products for lower-income customers and MSMEs**. Full financial inclusion is more than physical access to the financial sector and it is more than having an account with a regulated financial service provider. Although these two elements are critical steps, financial inclusion implies effective use of a range of appropriate products and services, delivered in a responsible and sustainable manner and at a reasonable cost. The diversity and quality of products and services have been improving but there is a long way to go until the large majority of the population effective uses adequate services and products.

76. **Despite the emergence of e-money, payments, transfers and remittances are still mostly done in cash, which result in higher costs and risks for users, as compared to electronic instruments.** While 44.3 percent of government social transfer recipients receive the funds in a transaction account, the majority of workers in El Salvador still receive their wages in cash (58.7 percent).[80] This is despite the growing adoption of e-money accounts (Tigo Money has 350,000 active accounts). Also, 64.9 percent of adults received domestic remittances in cash in 2014.[81] Overall, ownership and usage of electronic payment instruments remains low compared to the regional average. Around 22 percent and 8 of adults reported having a debit and a credit card, respectively, and only a small portion of them actually use such cards.[82] It is also important to note that the lion share of e-money transactions to date is bill payments only. Additionally, a great part of the transactions in the Tigo Money platform are OTC transactions, i.e., payments and transfers that do not use the client's accounts. OTC transactions, while helping people get acquainted with e-money agents and electronic means of transaction, do not encourage the use of e-money accounts to store value and make purchases and transfers with it. Also, this reality makes it harder for e-money accounts to become gateways to other products, such as microinsurance, or be linked to bank accounts, where customers could earn interests and have access to a wider range of services.

[80] Global Findex 2014.
[81] Idem.
[82] Idem.

Figure 10: Payment card ownership (% age 15+)



Source: Global Findex, 2014

77. **The banking and insurance sectors are still focused on corporate or high net worth individuals, providing limited options for low-value accounts.** While FEDECREDITO and FEDCACES members are more geared towards middle to lower income clients, the banking sector, with very few exceptions, is focused on profitable high net worth clients. This means there is a lack of adequate and tailored products to a wider range of clients, particularly rural dwellers and women, who usually require lower value transactions and investments, quicker turnaround of applications and lower document requirements. Group life insurance and health insurance are the most important insurance products in the market, with market shares of 31.4 percent and 30.2 percent, respectively, but penetration continues very low. There are very few examples of good microinsurance products (most is credit life insurance), savings and investment products (including savings for retirement).

78. **International remittances are a major business for financial institutions, but have not yet been fully explored to encourage the use of savings and other products**. According to the BCR, nearly 1.4 million people and 358,245 households received approximately US$ 3.9 billion in international remittances in 2013. Given the importance of remittances to the Salvadorian economy and households, their linking with accounts could potentially help increase access to and use of a wider range of services, including savings, pensions and insurance. Also, it is widely known that the vast majority of the international remittances received by Salvadoran families are cashed out and used for immediate consumption. This reflects not only potential lack of financial capability necessary to plan for the future, but also the lack of appropriate products that could steer behaviors, by both senders and receivers. For instance, the Mexican Pensions Regulator, CONSAR, has been promoting a remittance service whereby the sender can use electronic means such as mobile phones, and divide the total remittance into chunks to be used for different purposes, including to be directly deposited into a pensions account of the receiver in Mexico.

79. **The credit market, particularly the microcredit industry, is more advanced in terms of product variety and customization, but credit infrastructure can still improve**. Consumer credit has increased from 8.4 percent in 2005 to 14.1 percent of GDP in 2015 while enterprise credit declined from 23.8 percent to 18.1 percent of GDP during the same period. The microfinance sector, including FEDECREDITO and FEDECACES members, as well as ASOMI affiliates, offers a wide range of loan products an approximate 100 thousand borrowers, with differing terms and conditions, including through group lending methodology. The average loan value across ASOMI members is USD 2,000, although some members – particularly those operating in rural areas, such as Finca and MiCredito – have much lower averages. It is interesting to note that around 36 percent of the clients served by the ASOMI network are below the poverty line.[83]

80. **Innovative products designed to fill gaps in the market are finding obstacles in SFF's authorization process.** There are a few new proposed customized products to fill market gaps, such as a couple of products linking remittances to savings or loans, and others. Reportedly, financial institutions find an obstacle in the lengthy authorization process for new products by SSF, and some products have been waiting for authorization for over a year. This might be related to the newness of the product and the limited familiarity of SSF staff with innovations that blur the traditional boundaries of payments, credit, and savings products.

81. **The financial (payments and credit) infrastructure can still be improved.** The credit infrastructure is relatively well-developed, but still has shortcomings.[84] For instance, the legal procedures to collect collateral in the event of default are still burdensome. Also the credit information system is very fragmented and contains incomplete data (there are 4 credit bureaus licensed by SSF and 2 additional operated by FEDECREDITO and FEDECACES), and the coverage of the bureaus is lower than the average in Latin America and most countries in Central America (Table 7). The payments infrastructure has also consolidated and expanded, but challenges remain to manage risks and improve efficiency. These conditions are needed for the safe expansion of financial inclusion that could be achieved through the use of electronic channels and transactions. Beyond the need to improve the legal framework, major steps are to define and communicate policies for the national payment system and strengthen cooperation between BCR and SSF.[85]

Table 6: Coverage by credit registry and bureau

Indicators	SLV	Comparison country / group of countries					
		BOL	GTM	HND	NIC	LAC	LMI
% individuals covered by credit registry	27.6	15	19	22.2	16.3	12.3	n/a
% individuals covered by credit bureau	34.4	43.2	8.8	36.2	48.7	40.5	n/a

Source: Global Findex 2014.

[83] Interview with ASOMI, March 8th, 2016.
[84] International Monetary Fund (IMF), 2015. El Salvador. Selected Issues. IMF Country Report No. 15/11. Washington, DC. January. For a detailed analysis of the credit infrastructure in El Salvador, see FSAP Technical Note on Financial Infrastructure.
[85] See the FSAP Technical Note on Financial Infrastructure for a full analysis and recommendations.

82. **The market for factoring is underdeveloped and does not benefit most MSMEs**. Currently a few large banks and unregulated factoring firms perform factoring operations, but the risks involved, including cases of fraud with same invoices being factored multiple times by different factoring agents, have led to a decline in the total volume, especially among banks. the legal framework is not appropriate (see 2.3.2 below) and induces further exclusion of MSMEs to this instrument. Factoring of government receipts for goods or services bought could be a promising area but the government does not recognize the transfer of its bills to another creditor.

2.3.2 Analysis of the regulatory and supervisory framework

83. **Improvements are needed in the draft regulations for simplified deposit accounts.** The LFIF created a new type of savings accounts with simplified opening requirements. BCR has prepared draft regulations with the specific rules governing this new instrument. However, there seems to be wide agreement within the banking sector that the draft regulations are not adequate for this account to serve as an important financial inclusion tool. There are also a few other shortcomings in the LFIF and in the draft regulation, described below.

a. In practice, the only document requirement that is lifted compared with traditional savings account is the tax number. The need for the client to fill out an extensive sworn form (which includes information about the account holder and beneficiary) remains (such form is not required to open an e-money account), and according to reports of the industry, this is where potential clients see the biggest obstacle, as long forms asking for personal and financial information can intimidate low-income customers and can also increase costs for clients, given the time that is needed to open an account.

b. Remote opening through electronic channels is not possible for new clients (only current account holders could do that). The LFIF allows these accounts to be opened at agents, but the draft regulations (as well as the agent regulation, NASF-03) only allow agents to receive and forward account applications. This is inconsistent with the procedures permitted to e-money accounts, whose balance and transaction limits are the same as the ones imposed on simplified accounts.

c. The LFIF and the draft regulation only allow the accounts to be operated exclusively through electronic means. While this requirement could be understood as an attempt to reduce costs for providers, it could become an instrument of exclusion. This is because potential clients, particularly those whose do not have experience with the financial sector and with electronic channels, would most likely be wary of keeping values in an instrument that can only be operated through unfamiliar electronic channels and not permit, for instance, the use of face-to-face services at branches. Also, this provision makes it unclear whether transactions at agents are allowed.

d. While there is a clear desire to limit the money laundering and terrorism financing risk by imposing balance and transaction limits to these accounts, the LFIF and the

draft regulation allow clients to have one simplified account in each of the various financial institutions that could potentially offer this instrument.

84. **In general, the AML/CFT regulation could be improved to establish a risk-based framework for low-value accounts, regardless of which types of regulated institutions offer them**. The AML/CFT regulation (NRP-08) attempts to create a risk-based framework for account opening and monitoring requirements, but there are some inconsistencies which could impact the growth in the offering and adoption of low-value deposit and payment accounts. Specifically, Art. 18 requires client documentation according to the risk level. However, monitoring should be stricter according to risk factors, and Art. 16 seems to indicate that certain products (i.e., electronic transfers, international and domestic remittances) and channels (i.e., intermediaries or agents and sub-agents, ATMs, e-banking, mobile banking) have an inherent higher level of risk. This interpretation was confirmed with a few market participants. There is also concern that SSF supervisors have a conservative interpretation. Also, Art. 18 does not give flexibility for monitoring according to different levels of risk of low-value accounts.

85. **The regulatory and supervisory framework for microfinance is not aligned with international good practices.** A specialized framework for microcredit is needed for the prudent operations of microfinance providers. Existing regulation does not provide a differential prudential treatment of low-value loans for productive purposes and, reportedly, SSF's supervisory practice requires microfinance institutions to follow standards similar to those of commercial banks (e.g., organizational structure, loan guarantees, loan documentation). The lack of a differentiated regulatory and supervisory approach, coupled with the uncertainties about the potential for lower interest rate caps as part of the ongoing reform of the usury law (*Ley Contra la Usura*), could negatively impact some microfinance providers, in particular those facing higher operational costs and those providing housing loans.

86. **There is no adequate legal framework for factoring as an instrument for MSME financing**. The lack of a factoring law prevents accounts receivables to be transferred in a legally binding process. As a result, factoring agents take risks when they fund clients against invoices and need to rely on client integrity. This limits access to such financing instruments by new clients, particularly MSMEs. There is no legal requirement for the buyer to accept the transfer of the invoice to the factor. An informal and legally nonbinding document known as *Quedan*, is used instead. A legally binding instrument called *factura cambiaria* was created in 1999 through a special law, but due to its requirements and legal nature, it has not been used in practice.

2.3.3 Government policies and programs

87. **MINEC is currently implementing its plan to migrate all government subsidies to electronic means**. MINEC is shifting government subsidies to prepaid cards to incentivize the use of electronic transactions and payment instruments, while reducing the use of cash, which may pose security risks for people living in more vulnerable and violent areas. However, the current POS network in the country may not be adequate to provide beneficiaries with a sufficiently

convenient network where they could use the cards, such as to make purchases or withdraw cash from the accounts linked to the cards.

2.3.4 Recommendations

88. **SSF should review and improve its product authorization procedures**. SSF act as an effective gatekeeper of the financial sector, including by assessing the potential risks of new products and services, which is usually done through an authorization process. However, such review should be expedient and objective, to avoid stifling innovations that could facilitate healthy financial inclusion. To be able to do so, it should review the current procedures and requirements, and make efforts to increase expertise and knowledge, as well as capacity (if needed) so that its staff is able to make clear and correct risk assessments without hindering or delaying market development.

89. **Within the upcoming NFIS coordination structure, working groups for the different sectors should be formed to spur dialogue, knowledge exchange and growing expertise**. This would help build specialized expertise at financial institutions, as well as at regulatory and supervisory agencies, that could result in faster progress towards a wider range of adequate products for priority segments of the population. Working groups should specifically address the potential of exploring opportunities created by the large international remittances flows. It is also particularly important to pay specific attention to the challenges faced by and needs of women who are excluded form the financial sector, given their disproportionally greater levels of exclusion. The upcoming demand side surveys being conducted by BCR should help shed some light on this issue.

90. **Improvements should be made in the draft regulation of simplified accounts and the existing AML/CFT regulation.**

a. In the upcoming simplified accounts regulation, BCR should not restrict the operation of simplified accounts to electronic channels, as a means to encourage adoption of such accounts by people with little experience with financial services and with electronic means of transacting and managing their savings.

b. BCR should consider reforming the AML/CFT regulation to create a risk-based (e.g., tiered account system with more than one low-risk level, such as that of Mexico) that would apply to all types of low-value accounts, including the simplified account created by the LFIF. Low-value (hence low-risk) accounts would not require the same extensive client profile form that is required for full-fledged accounts that have no balance and transaction restrictions; would (depending on the value limitations) be allowed to be opened in agents and through electronic channels; would permit verification of client documents at a later stage (as it is permitted for e-money accounts); and would have less strict monitoring requirements. Specifically, the regulation should be changed to eliminate the assumption (Art. 16 of NRP-08) that electronic channels and products are inherently risker than traditional products and channels, with no regard to the balance and transaction limitations.

a. BCR to ensure that the simplified account regulation permits the use of electronic means to capture and store client information and the use of electronic contracts;

b. BCR to streamline AML/CFT requirements for low-value accounts and services, including microinsurance, in particular revisit the need for a long, paper-based client declaration based on the assumption that electronic channels are riskier than in-branch services; and

91. **To facilitate simplified account opening, access to the government's national registration database should be permitted**. Access to a central and reliable database where financial institutions could verify the documentation presented by new clients opening accounts or transacting at financial institutions and their access points network is a powerful tool to facilitate financial inclusion. It reduces costs and time for both providers and clients, and it could address AML/CFT concerns, and hence support moves to lower AML/CFT requirements. The BCR should coordinate with the National Register of Natural Persons (**RNPN**) to allow provide financial institutions online access to RNPN's database (which could be done in exchange for a fee, as it is done, for instance, in Pakistan, where an efficient national database is managed by NADRA[86]). This would facilitate compliance with NRP-08's requirement to verify the veracity of client documentation.

92. **The authorities should introduce a law on factoring that will provide legal certainty to factoring contracts and address short-term financing needs of MSMEs.** Such a law should recognize invoices as legal claims, streamline the invoice transfer process and make the acceptance of the invoice transfer mandatory for buyers (including government purchases). These elements represent the minimum preconditions before a full-fledged electronic platform for factoring, similar to the ones that have been operating in Mexico and Chile, could be introduced. A type of central recording system for invoices could be a useful intermediary step to prevent multiple uses of an invoice. These are necessary steps before more sophisticated capital market instruments backed by receivables flows could be developed.

93. **The prudential rules for microcredit should be improved**. The BCR should ensure that the reform on asset classification/provisioning (NCB-022) aligns with the Basel Committee's guidance on prudential regulation of microfinance portfolios, specifically a differential classification and a stricter provisioning schedule.[87] SSF should ensure its supervision recognizes practices of microfinance institutions that are safe but different from commercial bank lending, particularly on loan documentation. This may require additional training to build specialized expertise.

94. **MINEC, in coordination with BCR, should consider the practical challenges and seek solutions to its plan to shift all government subsidies to electronic means**. It is key to find

[86] https://www.nadra.gov.pk.

[87] "Guidance on the application of the Core principles for effective banking supervision to the regulation and supervision of institutions relevant to financial inclusion". https://www.bis.org/bcbs/publ/d351.htm

alternatives to improve the POS network if MINEC has chosen this payment instrument over other options, particularly in the places where the beneficiaries are located. A mapping of the current POS network, as proposed in 2.2.1.4, should be done, including mapping other networks where the cards could be used (for instance, points without a POS device, but with other devices, such as mobile phones, that could be furnished with card reading capabilities). If POS or other card reading devices cannot be available for beneficiaries to transact, MINEC should consider also using other types of electronic payment instruments such as e-money accounts operated through mobile phones.

III. RESPONSIBLE FINANCE: CONSUMER PROTECTION

3.1 Legal, regulatory and supervisory framework

95. **Substantial progress has been made, but the institutional overlap in the financial consumer protection regulatory and supervisory framework remains.** International good practices require a specialized financial consumer protection legal, regulatory and supervisory framework.[88] El Salvador has a general Consumer Protection Law (**CPL**) and related regulation that specifically cover financial services (Art. 19), mostly with regard to disclosure, contracts and marketing and promotional materials. According to the CPL, the financial authorities would be part of the National Consumer Protection System, but it seems that this concept has not been fully implemented in practice and the CPA remains the main implementing agency of the CPL. The CPL is based on sound principles; however, the overlapping mandates of CPA and the SSF result in actual conflicting directions to regulated financial institutions (e.g., mostly with regard to contractual provisions, specifically pricing); incomplete regulation that can be directly enforced by SSF; limited attention to unregulated providers, and area that could be overseen more closely by CPA; and underdeveloped, non-specialized supervision by SSF.

96. **The regulatory framework for the institutions regulated by BCR and supervised by SSF is based on solid principles and good international practices, but is fragmented and incomplete.** In terms of regulatory requirements for financial consumer protection, the most comprehensive regulation is NPB4-46 (Transparency Regulations),[89] which is currently being reformed based on recommendations provided in a diagnostic report conducted by the IMF in 2015,[90] which mirrored the World Bank's Good Practices for Financial Consumer Protection. Importantly, this regulation requires financial institutions to appoint an executive who is responsible for ensuring compliance with all applicable consumer protection laws and regulations, including the CPL, and report annual to the SSF. However, several instruments, including the draft

[88] A specialized legal framework not necessarily entails a separate financial consumer protection law, but requires legal provisions clearly placing financial consumer protection exclusively under the responsibility of a financial supervisory authority (World Bank Good Practices for Financial Consumer Protection available online at http://responsiblefinance.worldbank.org/publications/financial-consumer-protection).

[89] *Normas para la Transparencia de la Información de los Servicios Financieros.*

[90] Jose Rutman, 2015. *Asistencia Técnica: Regulación de la Protección al Consumidor de Servicios Financieros – El Salvador*.

EMP regulations, the agent regulation (NASF-03), the MTO regulation (NRP-12) and insurance sector regulations, have provisions pertaining to financial consumer protection, such as on internal dispute resolution mechanisms and disclosure. The EMP regulation, for instance, has a broad provision (Art. 12 (e)) requiring EMPs to comply the CPL, while such provision is not included in other instruments governing the creation and operation of other types of regulated financial institutions. While the current reform to the NPB4-46 creates a more complete single framework, the fragmentation, inconsistencies and overlaps remain and it is not clear how these weaknesses could be easily resolved, rather than reforming each regulation that mentions the topic and applying NPB4-46 instead.

97. **The supervision of consumer protection issues by SSF is still incipient due to emerging capacity and expertise, and evolving organizational structure**. SSF is responsible for supervising the implementation of the existing consumer protection regulatory provisions issued by BCR. The CPL (Art. 58) states that the CPA has the power to conduct inspections and audits at financial services providers and request reports. Although this does not seem to be done in practice, it creates a clear overlap with SSF's powers and legal supervisory mandate instituted in the LSRSF. SSF's current work in this area focuses on the reception and facilitation of consumer complaints, through a dedicated unit. Although this unit may conduct inspection in the institutions with relation to specific complaint cases, it is not a supervisory team dedicated to enforcing consumer protection provisions on an ongoing basis. It does not have a supervisory program with specialized risk-based methodology. It periodically sends complaint statistics to the prudential supervision teams. The prudential supervision team includes the consumer protection provisions in their supervisory program.

98. **The SSF and the CPA have clear and sufficient enforcement powers.** Such powers are based on the CPL, in the case of CPA, and in the LSRSF. For instance, the LSRSF (Chapter VI) gives broader enforcement powers to SSF, including warning, fines, suspension, and withdrawal of license. The CPA has broad powers as well, set in Title II of the CPL.

3.2 Disclosure

99. **BCR is modifying the current transparency regulation to incorporate recommendations from the previous diagnostic**. Although not very extensive, regulation NPB4-46 is the main instrument for information disclosure to consumers in the regulated financial sector, in addition to the CPL, which sets some general requirements. The NPB4-46 requires (Art. 9) financial institutions to document the way they calculate interest rates, and keep such information available for the scrutiny of SSF supervisors. Art. 9 also requires the clear differentiation, in the disclosure of interest rates, of variable and fixed rates in the marketing materials and contracts. In addition, the regulation requires institutions to publish in their website the formula to calculate effective interest rates and how loans can be amortized, in addition to examples of the use of such formulas. The effectiveness of this type of web-based disclosure is likely to be limited, given that the regulation does not impose standardized formats for it, so consumers and the general public will not be able to compare the information across different institutions. Art. 10 requires fees and

charges to be disclosed in a manner easy to be understood by clients and all should be foreseen in the consumer contracts. The regulation also creates a key facts statement (*hoje resumen* or *carta de comunicación*). It is not clear from the draft reform if such documents can be in electronic form. There are many other important provisions on disclosures, including a standardized link in the institutions' webpage for clients to find information about current interest rates, and fees and charges, which need to be updated monthly.

3.3 Sales practices, fair treatment and business conduct

100. **All consumer contracts need to be "deposited" with the SSF, but also reviewed by CPA**. This double checking system in practice results, sometimes, in divergent views and situations where a consumer contract is accepted by SSF but considered not acceptable by CPA (particularly with regard to fees and changes). CPA may even impose sanctions due to a contract that allowed to be commercialized by force of SSF decision.

101. **The CPL and the NPB4-46 prohibit some types of fees and charges, but CPA's interpretation on this issue may become problematic for financial inclusion.** The NPB4-46 prohibits financial institutions from charging for amenities and conveniences such as special attention to VIP customers, air conditioning, water, coffee, parking and other services. It also prohibits the charging of more than one of the same type of fee for the same exact service. The CPA has coordinated with the SSF to come up with a list of 7 allowed fees to give effect to Art. 12-A of the CPL, which prohibits fees and commissions for items/services that are inherent to the particular product/service. In practice, this legal provision seems to generate undue limitation in the market. CPA seems to have a position that financial institutions should focus their revenue on interest revenues. Some staff at SSF may be in agreement. However, fee income is absolutely key in modern financial sectors across developed and developing countries, in particular for low-value transactional services that are so important for low-income clients. There is a wealth of evidence that low-income customers are willing and able to pay for fair fees, and prefer doing so, rather than using informal financial services providers.

102. **The regulatory framework has extensive provisions for the qualification of staff and third parties, including agents.** The NPB4-46, the agent regulation and other instruments all have provisions requiring financial institutions to qualify their staff, particularly those dealing with consumers. Requirements are also explicit for staff who are supposed to assess the payment capacity of potential borrowers and the suitability of products being offered to potential clients more generally.

103. **There are reports of abusive loan collections in El Salvador, but the regulatory framework is not sufficiently strong in this regard.** There are no specific provisions in the CPL or in the NPB4-46 about prohibition of abusive loan collection ("*gestión de cobro*") practices, although instances of abuse have been reported in the market, particularly by banks and SACs. The draft reform of NPB4-46 does have new provisions that would theoretically cover this issue (Art. 37 and 37-A), and keep financial institutions responsible for ensuring that consumer

protection legal and regulatory provisions are observed when third parties are used for loan collection. However, it does not explicitly prohibit or give examples of abusive practices.

104. **With regard to insurance, a legal reform will govern insurance contracts.** The current provisions governing insurance contracts are defined in Title X of the Commercial Code. To avoid stifling the development of this market, the government has proposed to – instead of reforming the Commercial Code – create a separate Insurance Contracts Act, which is being drafted.

3.4 Data security and privacy

105. **There are many provisions for data security and the framework is being improved.** Data security provisions are scattered in various regulatory instruments. The BCR is preparing clearer and specific regulations to better address this issue, through the draft rules on e-banking,

106. **With regard to credit information, many improvements could be made.**[91] The Law on Credit Histories is a key instrument to protect credit information but has weaknesses. These weaknesses are mainly the lack of provisions on as client consent for the collection of personal and financial information, rules for data retention periods and rules for data format. These would be subject to further regulation by BCR. Also, the rights of consumers with respect to the reporting of their credit information to credit information systems rights, access to and right to correct information are not clearly dealt with in the current framework. The issue of credit information is discussed in greater detail in the Financial Infrastructure Technical Note.

3.5 Dispute resolution mechanisms

107. **In practice, the internal complaints handling systems by financial institutions vary widely, although most seem to have some basic infrastructure in place**. All institutions have some structure in place to deal in a systematic manner with consumer complaints, which is in line with NPB4-46. It is common for institutions to have targets for reducing the amount of days to resolve complaints, despite the lack of a regulatory maximum number days for resolution. Some institutions seem to have more sophisticated systems and governance structure that allows for the more effective and timely course correction by the affected areas of the institution, and the global analysis of statistics and the root cause of complaints, with the purpose of proposing improvements in the procedures or products of the institution. All regulated financial institutions are required to periodically report complaints statistics to SSF. However, the systematic assessment of the internal dispute resolution mechanisms by SSF could be improved if there was a special team for consumer protection supervision.

108. **Although improvements are being made, there is fragmentation of requirements on internal dispute resolution mechanisms**. The main reform of NPB4-46 is to provide more detailed requirements on this topic. The draft details what the consumer service unit must do,

[91] A detailed analysis is found in the FSAP Technical Note on Financial Infrastructure.

requires the channels for complaints handling to be simple and at least similar to those channels through which the products and services are commercialized, sets reporting requirements on complaints statistics, and establishes disclosure requirement about the complaints handling unit in a range of consumer communication tools such as account statements. It does not set a common maximum resolution time for disputes to be solved by financial institutions, though. The draft EMP regulation sets requirements for the operation of internal dispute resolution mechanisms, which are not exactly the same as those in NPB4-46 (which does not apply to EMP). The requirement for channels for complaints to mirror commercial channels is an important one for EMP, for instance. As in other regulatory areas analyzed in this Note, the fact that cross-cutting issues (such as consumer protection, or the use of agents – see 2.3.2) are treated in separate institution-focused regulations results in fragmentation and some inconsistencies. The best approach would be to have a single regulation on internal complaints handling by all types of regulated institutions.

109. **With regard to the external dispute resolution mechanisms for financial consumers, the CPA and the SSF are the most relevant players.** There seems to be a good level of coordination with respect to facilitating the resolution of consumer complaints in the financial sector. The CPA coordinates with SSF by, for instance, seeking SSF's opinion on particular cases of misconduct by financial services providers. The system seems to work properly, although the number of total complaints in the system seem to be low, which could related to the limited awareness of financial consumer about it, or lack of trust in the resolution of complaints. Also, the system is not a hierarchical one, i.e., financial institutions are not considered the necessary first instance of resolution, and SSF or CPA playing the ombudsman role. Consumers may register the same complaint in all three channels at the same time, causing inefficiencies and draining resources of government institutions, while not encouraging institutions to improve their own internal complaints handling systems.

3.6 Recommendations

110. **Ensure, through better coordination between CPA and SSF, that there are no overlapping or conflicting measures and positioning.** This is particularly important for avoiding differing views on contracts, and overlapping and excessive supervisory work (e.g., onsite inspections) on financial institutions, since both authorities seem to have powers to conduct inspections.

111. **The SSF should gradually build its expertise on more effective and specialized consumer protection supervision.** SSF should move beyond the work on addressing consumer complaints. Consumer protection supervision should be based on specialized risk-based methodology and specialized staff. SSF should, in the future, create a dedicated and separate department, in the same hierarchical level of the prudential supervision department. The focus of the supervision should shift from the current focus on fees and charges and abusive clauses to overall conduct of financial service providers, actual disclosure and sales practices, their consumer

risk mitigation measures, including data security and protection, compensation policies, avoidance of frauds and other operational risks that can impact the consumer.

112. **BCR should build a common, harmonized framework for consumer protection in the regulated financial sector and improve the draft reform of NPB4-46**. BCR and SSF should consider transforming NPB4-46 into the overarching regulation to cover all consumer protection issues in the regulated financial sector, across all types of regulated entities. That would require the consumer protection provisions in other specific regulations, to be overruled by the NPB4-46.

113. In addition, a few improvements should be done in the current rules:[92]

a. Make it explicit in NPB4-46 that electronic documents are acceptable for complying with the consumer protection requirements in this regulation, including for registering complaints at financial institutions and at SSF and CPA (the current text is ambiguous in this regard).

b. Include in the NPB4-46 provisions to explicitly prohibit abusive loan collection practices and give short examples of abusive practices.

c. Determine a common maximum time for resolution of consumer complaints by financial institutions, in line with international good practices.

d. Explicitly require financial institutions to use the information generated by the complaints handling unit about complaints statistics and root causes of problems reported by consumers, for periodic reporting with recommendations for improvements to the Board, by the consumer protection executive (*Oficial de Atención al Usuário).*

e. Consider substituting the requirement for publication, by each financial institution in its website, of complaints statistics only when complaint volumes are over the equivalent to 3 percent of the users (clients, not customers), for periodic publication, by SSF or BCR, of complaints statistics, including by institution and by type of complaint.[93]

114. **The BCR, SSF and CPA should review their policy on prohibiting service fees** on financial services (related to Art. 12-A of the CPL), particularly on transactional services such as withdrawals, to ensure that profitability can be achieved for services geared towards low-income customers.

115. **With respect to credit information, the authorities should implement specific improvements to enhance consumer rights**, particularly with regard to consent clauses and access to, correction and cancelation of information in credit bureaus.[94]

[92] Several examples and explanations for specific improvements described here and others are found in the World Bank Good Practices for Financial Consumer Protection available online at http://responsiblefinance.worldbank.org/publications/financial-consumer-protection.
[93] An example is found in the website of the Central Bank of Brazil: http://www.bcb.gov.br/ranking/index.asp.
[94] More detail about the recommendations on credit information is in the FSAP Technical Note on Financial Infrastructure.

ANNEX 1 – EXAMPLE OF KEY FINANCIAL INCLUSION INDICATORS

Global Indicators	Global Data Source(s)	Indicator breakdown
Product Diversity and Appropriateness for Individuals		
% adults with a store-of-value transaction account % adults using an electronic payment instrument % adults saving in a regulated financial institution % adults with credit from regulated financial institution % adults citing cost/distance/documentation as barrier	Global Findex	By gender, income, education, rural/urban
Product Diversity and Appropriateness for SMEs		
% of SMEs with a loan or line of credit % of SMEs with an account at a regulated Financial Institution % of SMEs identifying access to finance as major constraint	Enterprise Surveys	By firm size, sector, region, management/ownership gender
Provider Reach, Diversity, and Sustainability		
# of financial access points per 100,000 adults - Of which, branches - Of which, non-branches (agent, ATM)	IMF FAS / GPSS[95]	By institution type
% adults citing distance as barrier	Global Findex	By gender etc.
Financial Consumer Protection		
Financial consumer protection regulatory and supervision index	GRFI[96]	-
Financial Capability		
Financial literacy index	S&P GFLS[97]	-

[95] Global Payment Systems Survey (WBG)
[96] Global Responsible Financial Inclusion Survey (forthcoming, results expected in October 2016).
[97] Standard & Poor's Global Financial Literacy Survey