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**TITLE: *Assessing the suitability of the Ethiopian Laws Regulating Banking Business in
achieving the goals of the National Financial Inclusion Strategy***

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February, 2021

Addis Ababa, Ethiopia

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Declaration

I, the undersigned, hereby declare that this thesis is my original work, has not been presented for a degree in any other university and that all sources of materials used have been appropriately acknowledged.

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ACRONYMS

AMLCFL	-----	Anti-Money Laundering and Countering Financing of Terrorism
ATM	-----	Automatic Tailor Machines
BCBS	-----	Basel Committee on Banking Supervision
BC	-----	Business Correspondents
BODs	-----	Board of Directors
CGAP	-----	Consultative Group to Assist the Poor
FATF	-----	Financial Action Task Force
ICA	-----	International Compliance Association
ICT	-----	Information, Communication and Technology
KYC	-----	Know Your Customer
MFI	-----	Micro Finance Institutions
MNO	-----	Mobile Network Operator
NBE	-----	National Bank of Ethiopia
NPL	-----	Non-Performing Loan
POS	-----	Point of Sale
SMEs	-----	Small and Medium-Sized Enterprises

ABSTRACT

In recent years, financial inclusion has been broadly recognized as critical in reducing poverty and achieving inclusive economic growth that ensued various developing countries around the world to adopt financial inclusion policies in dealing with their respective financial sectors through devising National Financial Inclusion Strategies. Congruently, Ethiopia adopted its National Financial Inclusion Strategy in 2017 with the ultimate goal of achieving universal access to and use range of affordable and high quality financial products and services of regulated financial institutions by all individuals and enterprises by 2025.

Though financial inclusion is promising towards a country's economic development, inadequate financial regulation is considered to be one of the major obstacles that hinder the realization of such a promise which signifies the role of financial regulation for financial inclusion. Accordingly, the Ethiopian Financial Inclusion Strategy suggests for the reform of the existing financial laws of the country in order for the financial inclusion strategy to reach at its potential success, without specifically dealing with which financial laws should be reformed and how such reform may be conducted.

As such, this paper identifies how financial regulation should be conducted to promote financial inclusion and assess whether the financial laws are devised in a manner that promote financial inclusion by giving special emphasis on the banking business regulating laws of the National Bank of Ethiopia relating account ownership, payment system and credit facility in terms of promoting the goals of the NFIS and suggest recommendations on issues that require reform and the manner such reform should take place.

CHAPTER ONE

INTRODUCTION

1.1. BACKGROUND OF THE STUDY

Financial inclusion has been defined as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost; primarily representing access to bank account backed by deposit insurance, access to affordable credit and the payment system.¹ It is a concept that refers to the process of promoting affordable, timely and adequate access to a wide range of regulated financial products and services and broadening their use by all segments of society through implementation of tailored existing and innovative approaches including financial awareness and education with a view to promote financial wellbeing as well as economic and social inclusion.² Financial inclusion may also mean that individuals and businesses have access to useful and affordable financial products and services that meet their needs including transactions, payments, savings, credit and insurance be delivered in a responsible and sustainable manner. It may also be explained in simple terms as facilitating access to saving and transfer services and provision of credit and insurance services at an affordable cost to unbanked poor people who have little to no access for formal banking system.³

Financial inclusion has been broadly recognized as critical factor in reducing poverty and achieving inclusive economic growth since it is not by its self an end but a means to an end⁴ through intensifying competition and boosting the demand for labor. There are various studies which show that when people participate in the financial system, they are better able to start and

¹ Robert Cull, Asli Demirguc-Kunt and Timothy Lyman, “Financial inclusion and financial stability: What does research show?”, CGAP publication, (May 2012). Available at: www.cgap.org.

² Adele Atkinson and Flore-Anne Messay, “Promoting Financial Inclusion through Financial Education: OECD/INFE Evidence, Policies and Practice”, OECD Working Papers on Finance, Insurance and Private Pensions, No. 34, (2013), P. 11.

³ Genet Alemu Zwedu, “Financial Inclusion, Regulation and Inclusive Growth in Ethiopia”, Working Paper 408, (2014), P.14.

⁴ World Bank Group, Measuring Financial Inclusion around the world, The Global Findex Database 2014, Policy Research Working Paper, 7255, (April 2015), P. 2.

expand businesses, invest in education, manage risks and absorb financial shocks; that are beneficial to both individuals and firms helping to reduce income inequality and accelerate economic growth.⁵

Financial inclusion is becoming a priority for policymakers, regulators and development agencies globally as it has been identified as an enabler for 7 of the 17 Sustainable Development Goals⁶, the G20 committed to advance financial inclusion worldwide and reaffirmed its commitment to implement the G20 High-Level Principles for Digital Financial Inclusion and the World Bank Group considers financial inclusion as a key enabler to reduce extreme poverty and boost shared prosperity and has put forward an ambitious global goal to reach Universal Financial Access (UFA) by 2020.⁷

Though the successfulness of the desired objectives of these global policy makers, regulators and development agencies by the set timeline is still a questionable matter; since 2010, more than 55 countries have made commitments to financial inclusion through adopting financial inclusion policies in dealing with their respective financial sectors; and more than 30 countries have either launched or are developing their own National Financial Inclusion Strategies (hereinafter NFIS).⁸ NFISs are literally roadmaps of actions agreed and defined at the national or sub-national level which stakeholders follow to achieve financial inclusion objectives.⁹

Studies demonstrate that countries that have achieved the most progress toward financial inclusion have put in place an enabling regulatory and policy environment and have encouraged competition allowing banks and non-banks to innovate and expand access to financial services that means, the scope of financial inclusion can be expanded through state-driven intervention by

⁵ Ibid.

⁶ These sustainable development goals are goal number 1, 2, 3,5,6,7,8 and 9 namely: No poverty, Zero Hunger, Good health and wellbeing, quality education, Gender equality, clean water and sanitation, decent work and economic growth, industry, innovation and infrastructure.

⁷ Overview of Financial Inclusion <http://www.worldbank.org/en/topic/financialinclusion/overview>, (last visited: February 2020).

⁸ Ibid.

⁹ Resource Center Financial Inclusion Strategies, Overview: National Financial Inclusion Strategies, (2015); Available at: <http://www.worldbank.org/en/topic/financialinclusion/brief/national-financial-inclusion-strategies>, (last visited: February 2020).

way of statutory enactments by the regulatory bodies.¹⁰ However, creating this innovative and competitive space has to be accompanied by appropriate regulations and consumer protection measures to ensure responsible provision of financial services. With this regard, financial regulation, there by financial stability, has been given a propounding role as financial inclusion absence of proper and adequate financial regulation and regulatory framework would lead to financial instability there by financial crisis and depressions.¹¹

Like most developing countries, Ethiopia has adopted its National Financial Inclusion Strategy at the beginning of 2017. The Ethiopian National Financial Inclusion Strategy was inaugurated with the purpose of achieving various goals and objectives to be realized by the end of 2025. These goals include achieving universal access to and use range of affordable and high quality financial products and services by 2025 through promoting access and use of a range of suitable (quality and affordable) financial products and services provided by regulated financial institutions by all individuals and enterprises, through innovative and convenient channels, to promote savings mobilization, job creation, economic growth, poverty reduction and financial integrity there by financial stability.¹²

Like the growing notion and understanding of necessity of financial regulation for financial inclusion, the Ethiopian National Financial Inclusion Strategy establishes the necessity for the reform/ amendment of the existing financial laws and regulations as a roadmap or strategy for its successful execution.¹³ Though the financial inclusion strategy suggests for the reform of the existing financial laws of the country in order for the financial inclusion strategy to reach at its potential success, the strategy, however, did not specifically dealt with which financial laws require reform for the successful performance of the strategy the divulgence of which is the main intent of the author of this paper.

¹⁰ K. N. Singh and P. Kaur, “Regulatory Framework for Financial Inclusion in India”, International Journal of Engineering Technology Science and Research, Vol. 4, (September 2017), P.1. Available at: www.ijetsr.com.

¹¹ A. Aris, “Financial Regulatory Issues for Financial Inclusion”, United Nations Economic and Social Commission for Asia and the Pacific, (2017), P.1.

¹² National Financial Inclusion Strategy, National Bank of Ethiopia, (2017), P. 29.

¹³ Id., P.32.

With the abundance of various financial laws regulating various financial businesses i.e., Banking, Insurance and Micro-Finance Institutions in Ethiopia, however, it is the intention of the researcher to deal with the laws regulating the banking business rather than dwelling in all financial sector regulating laws.

1.2. STATEMENT OF THE PROBLEM

Though the Ethiopian National Financial Inclusion Strategy opts for legal and regulatory Frameworks to be reviewed for the promotion of digitalization in terms of the laws governing payment system and account ownership, how these existing laws should undertake the desired review in terms of the particular criteria that the laws should follow through the reform is yet unanswered. Besides, the desired reform of the payment system and account ownership regulation laws towards promoting digitalization, the capacity of the general public to benefit from basic credit facility from a formal bank is one of the basic concepts of financial inclusion, as it will help individuals to participate in business and investment leading them to eliminate poverty i.e., the ideal end of financial inclusion in general. Even though this is the fact, the national financial inclusion strategy, have not considered whether the laws regulating credit facility need reform in order to facilitate its successfulness; and if such laws need review how such a review should be conducted. Despite the silence of the NFIS, the NBE has issued a directive for implementation of a reformed law on credit facility. This new reform will be assessed in terms of its capacity for improved financial inclusion.

Generally, this paper deals with answering the question whether the account ownership and payment system regulating laws of Ethiopia should be reviewed and how such a review should take place in order to foster financial inclusion. In addition, this paper answers whether the laws regulating access to credit facility require further review/reform towards fostering financial inclusion; and if such question is answered affirmatively, how the review should take place will also be answered as it is the belief of the author that credit facility regulating laws has great deal of importance leading to the ultimate goal of financial inclusion i.e., reduction of income inequality and acceleration of economic growth.

1.3. RESEARCH OBJECTIVES

1.3.1. GENERAL OBJECTIVE

The general objective of this paper is to explore the alinement and/or suitability of Ethiopia's Banking Business Regulating laws in achieving the goals of the financial inclusion strategy opting to determine which laws need reform and amendment and which ones do not with the aim of providing the law maker a clear insight on the laws it need to reform and/or amend together with how the reform need to take place considering internationally accepted approaches of financial regulation to foster financial inclusion.

1.3.2. SPECIFIC OBJECTIVES

- To establish the criteria, the Laws governing Banking Business should favor of in order to foster financial inclusion.
- Evaluate the current Ethiopian banking business regulating laws against the established criteria.
- Determine whether or not the Laws meet the established criteria for the National Financial Inclusion strategy to achieve its goals.
- Set a concrete recommendation on which laws need reform and amendment and which do not for the law maker to consider and assist the NFIS to be successful.

1.4. LITERATURE REVIEW

Financial regulation has recently been recognized as one means of promoting financial inclusion as there has been various examples and experiences of countries that demonstrates the combination of innovation and sound regulation in financial services enables the private sector to improve economic opportunity and well-being for poor people.¹⁴ The examples also demonstrate that the paths leading to greater financial inclusion using the new digital technologies are multiple, evolving rapidly, and likely to be country-specific. It is also recognized that poor financial regulation is a major obstacle to financial inclusion though it is not the only one.¹⁵

¹⁴ S. Claessens and L. R. Suarez, "Financial Regulations for Improving Financial Inclusion", A CGD Task Force Report, Center for Global Development, (2016), P.2.

¹⁵ Ibid.

First, regulatory changes are often needed to enable the successful adoption and adaptation of innovations in digital finance, encourage their use, and increase competition among their providers, so that those new technologies can benefit the poor in particular.¹⁶ Second, progress in improving financial inclusion must be compatible with the traditional mandates of financial regulation and supervision namely, safeguarding the stability of the financial system, maintaining its integrity, and protecting consumers.¹⁷

Account ownership is considered to be the first step toward financial inclusion as increasing the amount of account usage and promoting diversity in the depositor base would build up a more stable retail base of deposits, reducing banks' dependence on noncore financing which is more volatile in periods of stress.¹⁸ Preliminary evidence suggests that that a 10% increase in access to bank deposits can reduce the likelihood of a withdrawal of deposits in periods of stress by 3-8% age points.¹⁹ This study supports the view that low income savers tend to maintain steady financial behavior through the economic cycle in terms of deposit keeping. Greater use of formal accounts can also improve the efficiency of the process of intermediation between savings and investments by reducing the cost of credit and facilitate business expansion through increased availability of low cost deposits.²⁰

To expand account ownership, the regulatory framework is expected to be designed to facilitate expanding account ownership, such as through licensing bank agents, introducing tiered documentation requirements, requiring banks to provide basic or low-fee accounts, and allowing the evolution of new technologies such as mobile money.²¹

The innovativeness in account ownership is directly proportional to innovativeness and digitalization of payment system which is also another aspect of financial inclusion though it

¹⁶ Ibid.

¹⁷ Ibid.

¹⁸ H.R Khan, Financial Inclusion and Financial Stability: Are they two sides of same coin? The Indian Bankers Association and Indian Overseas Bank, Chennai, (2011), P.2.

¹⁹ Ibid.

²⁰ Adrian van Rixtel and Gabriele Gasperini, Financial crises and bank funding: recent experience in the euro area, Monetary and Economic Department, Working Papers, Bank for International Settlements, (2013), P.11.

²¹ *Supra note* 11, P.3.

requires same amount of precautionary regulatory measures as the expansion of account ownership due to the involvement of new technologies.

With regard to credit facility, the business model of the banking sector is not appropriate to meet the full needs of financial services of low income populations because of the lack of credit history of poor people, rigid collateral requirements, low survival rates of small and medium enterprises (hereinafter SMEs) and high transaction cost of small amount of credit, amongst others.²² For example, according to a survey of four countries, naming China, Republic of Korea, India and Malaysia, four major barriers of financial institutions regarding SMEs' access to finance were identified as collateral and guarantees as prerequisites for loans, complicated procedures to borrow money, a strict lending policy of financial institutions, and high lending rates.²³ Some recent studies show that higher access to credit may adversely affect banking stability without good quality of supervision and regulation. This is because the redistribution of credit toward new borrower segments who are, on average, riskier clients may adversely affect the risk profile of bank lending in the presence of weak supervision making strong regulation a pre-requisite for financial inclusion in terms of credit access.²⁴

The legal aspect of a regulatory framework for financial services is often comprised of a combination of two or more of the following i.e., (a) primary enabling legislation; (b) secondary legislation issued pursuant to the enabling statutes; (c) principles, rules and codes issued by regulators; and (d) guidance or policy directives issued by the regulatory authority.²⁵

In some jurisdictions, primary legislation provides that guidelines should be treated as a law. In civil law countries, which is the blood line of the private property rights in most civil law jurisdictions, can be equated to a constitution for the protection of the private commercial rights of citizens.²⁶ For the purpose of this paper however, laws should mean those mentioned under c and d, the directives that are issued by the regulator particularly the National Bank of Ethiopia as

²² Id., P.8.

²³ Ibid.

²⁴ Ibid.

²⁵ Ibid.

²⁶ Ibid.

they are ultimately the tools of implementation of the primary and secondary legislations and regulation of the actors in the financial market.

1.5. RESEARCH QUESTIONS

1.5.1. GENERAL QUESTION

The basic research question revolves around exploring the capacity of the existing Ethiopian Banking Business regulating laws in achieving the goals of the Ethiopian National Financial Inclusion Strategy.

1.5.2. SPECIFIC QUESTIONS

- What are the criteria that Banking Business regulating laws should fulfill in order to foster financial inclusion?
- Do the Ethiopian laws regulating Banking Business meet the criteria that lead to full financial inclusion?
- Which laws are in alignment with fostering the goals of the financial inclusion and which laws are not?
- What should the law maker take in to consideration in amending/reforming the laws that are not in alignment with the concept of financial inclusion?

1.6. SIGNIFICANCE OF THE STUDY

The significance of this study is evaluating the particular Banking Business laws in light of facilitating the successful execution of the goals of the national financial inclusion strategy and provide a significant recommendation to the law maker on how and which laws need reform based on internationally accepted standards that banking business regulating laws should possess in order to facilitate financial inclusion and provide a meaningful contribution to assist the realization of the goals of the financial inclusion strategy with in the remaining time framework set for the successfulness of the strategy.

1.7. RESEARCH METHODOLOGY AND SOURCE

1.7.1. TYPE OF DATA TO BE USED

With regard to type of data to be used, the researcher will use primary data i.e., the laws governing banking business as well as secondary data from sources such as books, encyclopedia

and electronic sources (especially the internet). It is also the intention of the researcher to use secondary data to be obtained through conducting interviews with key personnel from the National Bank of Ethiopia (NBE).

1.7.2. METHOD AND INSTRUMENT OF DATA COLLECTION

This paper will gather information by using legal analysis besides the secondary data that will be collected mainly through documentary analysis, interview and browsing the internet.

1.7.3. DATA ANALYSIS

With this regard, the researcher will use a qualitative method of data analysis. Besides, the research report will be provided by following a narrative way of writing.

1.8. SCOPE OF THE STUDY

The scope of this paper is limited to financial inclusion in the context of Ethiopian law with the particular emphasis on the Ethiopian laws regulating the banking business in terms of account ownership, payment system and credit facility as enacted by the National Bank of Ethiopia; excluding other banking laws and regulations as it would be impossible to deal with all the laws governing banking business given the limitations provided under section 1.9.

1.9. LIMITATION OF THE STUDY

This study has limitation in terms of page and wording limitation as provided by the Addis Ababa University Laws School, LL.M Thesis Guideline.

1.10. ORGANIZATION OF THE STUDY

Chapter one of this paper will be the research proposal that outlines the whole research paper including the background of the study, literature review, statement of the problem, research objectives, research questions, research methodology, scope of the research, the significance of the study, limitation and organization of the research.

Chapter two is the introductory part of this paper dealing with the relationship between financial regulation and financial inclusion and the various criteria a particular financial regulation need to possess in order to promote financial inclusion.

Under chapter three, the main part of this paper, the paper will deal with the Ethiopian Banking Business regulating laws, particularly the laws related with account ownership, payment system and credit facility and discuss their features and prospects towards financial inclusion through evaluating them against the criteria financial regulation should possess in order to improve and promote financial inclusion there by facilitating the execution of the goals of the Ethiopian financial inclusion strategy.

Chapter four, the final part of this paper, will provide a concrete conclusion on the whole idea of the suitability of the banking business regulating laws for successful financial inclusion and recommends which laws should be amended and on what basis the amendments should take place in order to facilitate the successfulness of the goals of the financial inclusion strategy.

CHAPTER TWO

FINANCIAL REGULATION FOR FINANCIAL INCLUSION

2.1. THE CONCEPT AND RATIONALE OF FINANCIAL INCLUSION

Financial inclusion broadly refers to the degree of access of households and firms, especially poorer households and small and medium-sized enterprises (SMEs), to financial services. However, there are important variations in term usage and nuance. The World Bank defined financial inclusion as the proportion of individuals and firms that use financial services²⁷ while the Asian Development Bank stated it as ready access for households and firms to reasonably priced financial services.²⁸

Financial Inclusion has four commonly used lenses through which it can be defined, in order of complexity: access, quality, usage and welfare.²⁹ With this regard, the Consultative Group to Assist the Poor³⁰ (hereinafter CGAP) has a vision for a world where everyone can access and effectively use the financial services they need to improve their lives which does not mean developing separate financial markets for the poor.³¹ Finally, financial inclusion may be defined as the process of ensuring access to appropriate financial products and services needed by vulnerable groups such as weaker sections and low income groups at an affordable cost in a fair and transparent manner by mainstream institutional players.³²

²⁷ <https://www.worldbank.org/en/topic/financialinclusion> (Last visited: February, 2020).

²⁸ Meghana Ayyagari and Thorsten Beck, “Financial Inclusion in Asia: an overview”, *ADB economics working paper series*, Asian Development Bank, (September 2015) Available at: <https://www.adb.org/publications/financial-inclusion-asia-overview>

²⁹ Ibid.

³⁰ The Consultative Group to Assist the poor (CGAP) is an independent global think tank that consists the partnership of 34 leading organizations for the advancement of financial inclusion. Through their work they seek to empower poor people to capture opportunities and build resilience through financial services.

Available at: <https://www.poverty-action.org/organization/consultative-group-assist-poor-cgap>

³¹ Naoyuki Yoshino and Peter Morgan, “Overview of Financial Inclusion, Regulation, and Education”, *ADB Working Paper 591*, Tokyo: Asian Development Bank Institute, (September 2016), P. 4 Available at: <http://www.adb.org/publications/overview-financial-inclusion-regulation-and-education/>

³² The Role of Financial Inclusion in India Available at: <https://www.elsevier.es/es-revista-contaduria-adminstracion-87-articulo-role-banks-in-financial-inclusion-S0186104217300104>.

The World Bank's definition focuses on the actual use of financial services, while the other definitions focus more on the potential ability to use such services. Moreover, "access" does not mean any kind of access, but implies access at reasonable cost and with accompanying safeguards, such as adequate regulation of firms supplying financial services, and laws and institutions for protecting consumers against inappropriate products, deceptive practices, and aggressive collection practices. Of course, it is difficult to define "reasonable cost" in cases where amounts involved are small or information asymmetries exist. Therefore, a key question is the extent to which the government should subsidize such services or intervene in the market. This perspective also highlights the need for adequate financial education, as consumers cannot take proper advantage of access to financial services if they do not understand them properly.

The CGAP definition alludes to the issue of "mainstreaming," that is, access to mainstream financial institutions. The positive effects of financial access may be limited if poor households are limited to specialized institutions and financial products, such as Micro Finance Institutions (hereinafter MFIs), which have unique aspects such as group responsibility and rigid payment schedules but do not necessarily provide a stepping stone to more conventional financial access.

Access to financial services has a multitude of dimensions, reflecting the range of possible financial services, from payments and savings accounts to credit, insurance, pensions, and securities markets though this paper is limited to the former three. Another important dimension is actual usage of such products and services; for example, campaigns to increase the number of bank accounts fail if those accounts end up being rarely or never used.³³ With this regard, the researcher is using the World Bank's definition of financial inclusion as it is more relatable to what this research is all about.

Finally, the coming in to effect of the concept of financial inclusion also implies the existence of financial exclusion, also known as being "unbanked." Financial exclusion is defined as not using any financial services or products of formal financial institutions, including MFIs.³⁴ With this regard however, it is important to distinguish between those who, for whatever reason, do not

³³ Ibid.

³⁴ Financial Services Provision and prevention of financial exclusion, Directorate General for Employment, Social Affairs and Equal Opportunities Inclusion, Social Policy Aspects of Migration, Manuscript, European Commission (March 2008). Available at https://Ec.europa.eu/employment_social/spsi

wish to or need to use such services and products, and those who wish to use them but cannot do so due to insufficient funds, poor access, high costs, ignorance or lack of understanding, lack of trust, or identity requirements.

Coming to the rationales for financial inclusion, poor households are often severely cash-constrained, so innovations that increase the efficiency of their cash management and allow them to smooth consumption can have significant impacts on welfare. Greater financial inclusion can also contribute to reducing income inequality by raising the incomes of the poorest income quintile especially through access to credit facilities.³⁵ It may also contribute to financial stability by increasing the diversity of, and thereby decreasing the risk of, bank assets and by increasing the stable funding base of bank deposits.³⁶ Greater financial access can also support shifts by governments toward cash transfer programs rather than wasteful subsidies, and the greater transparency associated with electronic funds transfers can help reduce corruption.³⁷

A growing body of evidence suggests that access to financial services can reduce poverty, raise income, and promote economic growth in different countries of the world. However, the conclusions are, in some cases, still tenuous, as many earlier studies relied on macro data, which were subject to numerous issues, such as indigeneity and missing variables.³⁸ There has also been a large volume of research on the impacts of micro finance, but the reliability of the results of many studies suffer from possible selection bias.³⁹ More reliable studies with randomized control trials or natural experiments are rare. Some found evidence that

³⁵ Thorsten Beck, Asli Demirguc Kunt and Ross Levine, “Finance, Inequality and the Poor”, Journal of Economic Growth, Vol. 12, (March 2007), P. 4.

³⁶ Peter J. Morgan and Victor Pontines, “Financial Stability and Financial Inclusion”, ADB Working Paper Series No.488, Asian Development Bank Institute, July, 2014). Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2464018

³⁷ Ibid.

³⁸ *Supra note*, 36.

³⁹ Joseph P. Kaboski and Robert M. Townsend, “Policies and impact: An analysis of village-level microfinance institutions”, Journal of the European Economic Association, Vol.3, (2005).

Available at: [http://onlinelibrary.wiley.com/journal/10.1111/\(ISSN\)1542-4774/issues](http://onlinelibrary.wiley.com/journal/10.1111/(ISSN)1542-4774/issues).

increased numbers of bank branches reduced poverty and raised income and employment levels.⁴⁰

Despite the differences in literature, what is acceptable recently is that financial inclusion has been recognized to possess a great deal of importance for inclusive growth with stability based on the principle of equity that renewed the attention of policy makers internationally.⁴¹ Considerable evidence indicates that the poor benefit enormously from basic payments, savings, and insurance services. For firms, particularly the small and young ones that are subject to greater constraints, access to finance is associated with innovation, job creation, and growth. But dozens of microcredit experiments paint a mixed picture about the development benefits of microfinance projects targeted at particular groups in the population.⁴² It improves the efficiency of the process of intermediation between savings and investments while facilitating change in the composition of the financial system with regard to the transactions that take place, the clients that use the various services, the new risks created, and possibly the institutions that operate in newly created or expanded markets.⁴³

It will also enable the Government to provide social development benefits and subsidies directly to the beneficiary bank accounts, thereby drastically reducing leakages and pilferages in social welfare schemes like pension schemes.⁴⁴ Thus, financial inclusion could be an instrument to provide monetary fuel for economic growth and is critical for achieving inclusive growth. Further, expanding the reach of financial services to those individuals who do not currently have access would be an objective that is fully consistent with the people-centric definition of inclusive growth⁴⁵ which attempts to bridge the various divides in an economy and society,

⁴⁰ M. Bruhn and I. Love, “The real impact of improved access to finance: Evidence from Mexico”, the Journal of finance, (June 2014). Available at: <https://www.researchgate.net/publication/262387220>.

⁴¹ *Supra note*, 18.

⁴² Financial Inclusion, “Global financial development report on financial report”, International Bank for Reconstruction and Development /World Bank/, (2014). Available at: www.worldbank.org.

⁴³ *Ibid*.

⁴⁴ *Supra note*, 18.

⁴⁵ Nisada Wedchayanon and Sunisa Chorkaew, “The sufficiency economy and people-centered development: the case of the Huay Sai Royal Development project in Thailand”, European Journal of Training and Development, Vol. 38, Issue, 9, P.1.

between the rich and the poor, between the rural and urban populace, and between one region and another.

2.2. THE CONCEPT OF FINANCIAL REGULATION

Financial regulation refers to the rules that are applied by financial regulators in the fulfillment of their functions; that include such prudential rules as those influencing the conditions of access to the market (intended to prevent the emergence of entities with doubtful reputation or without financial capacity necessary for the operations they intend to implement) and those aimed at controlling the risks associated with financial activities, corporate governance and internal control systems, conduct-of-business rules and methods of supervision.⁴⁶

Though there is no unified theory of financial services regulation, it has the objectives of ensuring that markets are fair, efficient and transparent, reducing systematic risk, protecting investors to help build their confidence in the market, protecting financial services businesses from malpractice by some consumers such as money laundering and maintaining consumer confidence in the financial system.⁴⁷ Although there are some commentators such as the International Compliance Association (ICA), the body that is issuing a regulation must also have the authority to supervise compliance with the rules and the power to issue sanctions against breach of these rules⁴⁸ though this is not always the case in all countries.

One key objective of financial regulation is to redress the information imbalance that sometimes exists between the consumer financial service providers in favor of consumers through consumer protection regimes. This is usually done by imposing upon financial services minimum standards of business conduct. Moreover, the fairness of the financial markets depends in part on the degree of the consumer protection laws or provisions inserted in financial regulation laws.

⁴⁶ International compliance association, international Diploma in compliance-manual, (2003). Available at: <https://www.int-comp.org> .

⁴⁷ D. T. Liewellyn, “Institutional structure of Financial Regulation and Supervision: The basic issues, in Aligning Financial Supervisory structures with country needs”, World Bank Institute, (2006), PP.36-37.

⁴⁸ K. K. Mwenda and A. Fleming, “International Developments in the organizational structure of Financial services supervision”, paper presented at a seminar hosted by the World Bank financial sector vice-presidency, Part I, (2002), PP. 7-18. Available at: www.worldbank.org/archive/website00972/WEB/PDF/INTERNAT.PDF.

In general, regulation attempts to strike a balance, protecting the market place from itself without stifling legitimate risk-taking.⁴⁹ One method of doing so is prevention of financial business failures by imposing capital and internal control requirement in order to ensure that the financial business entitles to have sufficient liquidity to meet their obligation, making them less vulnerable to hasty withdrawals by depositors and investors and to their market shocks.⁵⁰

In many countries, financial regulation particularly regulation of banking sector in terms of deposit-taking activity and investment (securities) businesses has been given priority.⁵¹ Recently, however, regulation has been introduced to control the conduct of trust and company service providers and to curb financial crimes like money laundering.⁵²

This being said about the scope of financial regulation, it is historically evident that the development of financial services regulation in many countries has followed a pattern of following the development of public policy apart from other causes which includes the lacuna in the existing legal framework including the National Constitution, the impact of international best practices or movements toward regional integration,⁵³ though the focus of this paper is on the first cause of financial regulation i.e., the introduction of financial inclusion in countries' financial policies.

2.3. THE ROLE OF FINANCIAL REGULATION IN PROMOTING FINANCIAL INCLUSION IN THE BANKING BUSINESS SECTOR

Financial inclusion, more particularly when promoted in the wider context of economic inclusion, can uplift financial conditions and improve the standards of lives of the poor and the disadvantaged.⁵⁴ Access to affordable financial services would lead to increasing economic activities and employment opportunities for rural households with a possible multiplier effect on

⁴⁹ *Supra note*, 46.

⁵⁰ *Supra note*, 47.

⁵¹ P. Kyle, "Making Regulatory structures effective: establishing legal consistency for integrated regulation", in J. Carmichael et al., eds, PP.11-14.

⁵² *Supra note*, 46.

⁵³ *Supra note*, 51.

⁵⁴ *Supra note*, 18.

the economy.⁵⁵ It could enable a higher disposable income in the hands of rural households leading to greater savings and a wider deposit base for banks and other financial institutions.⁵⁶

Despite all the promises of financial inclusion, there are various obstacles that hinder the realization of such a promise; inadequate financial regulation and subsequent legal uncertainties being the major ones in addition to the inadequate infrastructure, weak institutional frameworks that discourages private investment, and finally unstable economic and political conditions.⁵⁷ Though all the aforementioned obstacles are of major importance to be dealt with, this paper however, is limited to the former hurdle i.e., inadequate financial regulation.

Addressing Financial inclusion through changes in regulation is essential for two major reasons:⁵⁸

- Regulatory changes are often needed to enable the successful adoption and adaptation of innovation in digital finance and encourage their use and competition among their providers so that those new technologies benefit especially the poor.
- Progress in improving financial inclusion must be compatible with the traditional mandates of financial regulation i.e., safeguarding the stability of the financial system, maintaining its integrity and protecting consumers.

This is so because there are various risks to financial stability emanating from greater financial inclusion. The pursuit of financial inclusion has often been attempted through low cost delivery channels, innovative products and outsourcing agencies.⁵⁹ These developments come with their own set of risks which could jeopardize financial stability. For example, during times of stress, financial innovation can further complicate the transmission of monetary policy. In any case, during periods of financial instability, it may be difficult to predict the consequences of financial innovations thereby adding an additional element of uncertainty to an already uncertain economic environment.

⁵⁵ Ibid.

⁵⁶ Ibid.

⁵⁷ *Supra note* 14.

⁵⁸ Ibid.

⁵⁹ *Supra note*, 18.

Outsourcing of activities by banks, the other means of inflating financial inclusion, also poses reputational and fidelity risks⁶⁰ which may impact the health of the institution and of the financial system.⁶¹ In particular, the reputation risks associated with outsourcing may impact the activities of the entire bank and not just the outsourced activities in case of any mishap or misdemeanor by the outsourced agents.⁶² There are also systemic risks⁶³ associated with the entire banking industry relying on a single or a few vendors, as is frequently the case, especially in the early stages of innovations/outsourcing. These risks need to be carefully managed by banks, in particular, through a well-designed regulatory system of checks and balances which could, inter alia, involve well defined contractual arrangements, standards for due diligence, exposure monitoring, cash and other limits, rating of the agents/Business Correspondents (BCs), periodic audit/inspection, etc. and the use of information, communication and technology (ICT) for managing operational and financial risks. Further, the design of appropriate compensation structures, including performance based features in banking through agents, can ensure a reasonable fee to the agents while ensuring adequate incentives for preventing misuse of the system by the agents.

Coming to the issue of credit access extension to the economically disadvantaged, over-extension of credit has the potential to affect the quality of the credit portfolio of banks and financial institutions and could have sown the seeds of financial fragility and ultimately of financial instability.⁶⁴ The position may be further aggravated by regulatory or governmental

⁶⁰ Reputational risk is a threat or danger to the good name or standing of a business or entity that may occur through other peripheral parties, such as joint venture, partners or suppliers and fidelity risk in addition to other causes like the doing of the company itself and the doings of employees. Fidelity risks on the other hand is defined as the risk of losing the trust and faith of financial customers on a financial institution as a result of the doings of either the financial institution its self, its employees and/or other peripheral parties. See; <https://www.investopedia.com>.

⁶¹ The Report of the Internal Group to Examine Issues relating to Rural Credit and Microfinance (Chairman: Shri. H. R. Khan), Reserve Bank of India, July 2005 (Khan Committee).

⁶² Ibid.

⁶³ Systematic risk is a risk that is inherent to the entire market or market segment that may at times be unpredictable and impossible to completely avoid. See; <https://www.investopedia.com>.

⁶⁴ R. G., Raghuram, "Fault Lines: How Hidden Fractures Still Threaten the World Economy", (2010). Available at: <https://press.princeton.edu/titles/9552>.

forbearance which has the potential to vitiate the credit culture amongst the target group.⁶⁵ It is also elucidated that “easy credit” as a response to bridge the gap between the haves and the have-nots could prove to be a costly way of redistribution and create a fault line along the financial sector where enormous stresses could build up and lead to an instability in the system akin to the subprime crisis of recent times⁶⁶ demonstrating the necessity need to balance between the moves to financial inclusion and putting in place of appropriate and sufficient regulation.

2.4. FINANCIAL REGULATION OF BASIC BANKING SERVICES TOWARDS FINANCIAL INCLUSION

2.4.1. FINANCIAL REGULATION OF ACCOUNT OWNERSHIP AND PAYMENT SYSTEMS

Account ownership is a first step towards financial inclusion. Increasing the amount of account usage and promoting diversity in the depositor base would build up a more stable retail base of deposits, reducing banks’ dependence on noncore financing which is more volatile in periods of stress. Preliminary evidence suggests that a 10% increase in access to bank deposits can reduce the likelihood of a withdrawal of deposits in periods of stress by 3-8 percentage points.⁶⁷ This study supports the view that low income savers tend to maintain steady financial behavior through the economic cycle in terms of deposit keeping. So, broadening deposit access by including low income savers will tend to raise the stability of deposits, which enhances the liquidity conditions of banks in stress periods.⁶⁸

There are many barriers that prevent people from opening an account in financial institutions, such as high account fees, onerous documentation requirements, travel distance, legal hurdles and other market failures. Nevertheless, there is growing recognition that most of the barriers that limit access to financial services can be overcome by a well-designed regulation and regulatory

⁶⁵ Ibid.

⁶⁶ Ibid.

⁶⁷ H. Rui, and M. Melecky, “Financial Inclusion for Financial Stability: Access to Bank Deposits and the Growth of Deposits in the Global Financial Crisis”, Background paper to the 2014 World Development Report, Policy Research Working Paper, (2013).

⁶⁸ *Supra note 18*.

framework. To expand account ownership, the regulation and regulatory framework is expected to be designed to facilitate expanding account ownership, such as through licensing bank agents, introducing laid-back documentation requirements, requiring banks to provide basic or low-fee accounts, and allowing the evolution of new technologies and digitalization such as mobile money. In this respect, a proportional approach to regulation that balances the costs and benefits of regulation relating to financial stability, integrity and inclusion can be an essential means for promoting financial inclusion as increased competition in innovation and digitalization can give rise to trade-offs between greater inclusion, consumer protection, and the soundness of the overall financial system since entry regulations that are too stringent can constrain the growth and depth of financial services, including digitally based services and regulations that are too lax can create risks for consumers and endanger systemic financial stability.

Coming to the issue of payment systems, a well-functioning and inclusive payments system; one that allows all participants to send and receive payments in the most efficient, least costly, and safest ways not only is essential to meeting the most basic financial needs of the poor but also can serve as their entryway to other, more advanced financial services, such as deposit accounts, credit, and insurance. After all, except for cash transactions, no financial transaction however sophisticated or complex does not involve using the payments (and settlement) system. In addition, advances in and expansion of digital provision have, to date, been greatest in the payments field, with many new platforms introduced that greatly facilitate financial inclusion. Indeed, a system that combines fixed and mobile access points (Automatic Teller Machines /ATMs/, phones, Point of Sales /POS/), enables payments among various classes of agents (businesses, governments, individuals, and others), maximizes coverage, and is reliable, of high quality, and interoperable seems increasingly feasible for most countries.

2.4.1.1. PROPORTIONATE REGULATION AND INNOVATION

New delivery technologies, such as mobile banking, no-frills bank deposits and agent banking, hold promise for promoting account penetration as they cut across various regulatory domains, including banking, telecommunications, payments systems, and anti-money laundering regimes. Further, with new technologies being increasingly deployed by financial institutions to reach unserved and underserved customers, the speed with which risk grows or concentrates in such institutions may be different from that historically observed in conventional banks. Therefore,

the regulatory authority should be familiar with the risks of new delivery technologies to adequately assess these risks. However, in many cases, service providers are not banks (such as mobile network operators), it makes a consistent supervisory and regulatory approach more difficult.

Since innovation of new delivery technologies are not familiarized to regulatory authorities, spending a lot of time and energy in developing a comprehensive framework without first observing and understanding risks and how the market is developing can result in an ill-tailored regulatory framework that does not cover material risks arising from these new technologies. Regulators should therefore immediately define the role of these new actors that was not previously subject to financial regulation and supervision. In this respect, a proportionate regulatory stance allows for experimentation and pilot testing of approaches that could promote financial inclusion. This stance also provides the necessary flexibility to determine and measure risks related to these products and find ways to manage those risks. For example, a “test and see” approach is seen as a more effective approach which allows regulatory authorities enough time to follow the market to identify perceived risks and to approve operations of these firms on ad hoc basis. In this way, regulations can be carefully tailored to market needs by fully considering the risks arising from new technologies.

2.4.1.2. PROPORTIONATE REGULATION AND ANTI-MONEY LAUNDERING AND COUNTERING FINANCING OF TERRORISM (AML/CFL)

Disproportionate implementation of the AML/CFL regimes may have unintended consequences such as excluding individuals and legitimate businesses from the formal financial system. For example, the documentation requirements arising from money laundering regulations for opening an account may exclude workers in the rural or informal sector who are less likely to have wage slips or formal proof of residence. According to the 2014 Global Findex data base, 18% of unbanked respondents in the world cited the documentation requirements for opening an account as a key reason they did not have a formal account.⁶⁹

⁶⁹ *Supra note 4.*

The Financial Action Task Force (FATF)⁷⁰ recognized that reinforcing financial inclusion and formal services to be secure and easy at a reasonable cost is important for any regime combating money laundering operations. In this respect, FATF overcame the adverse effects of documentation requirements on financial inclusion arising from money laundering regulations by abolishing documentation requirements imposed before 2012 which were required to be respected at all levels and by all financial sectors regardless of their size and the nature of the services provided as well as the risk volume they were exposed to. FATF's new requirements bring the application of proportionality principles into the implementation of the money laundering law. In accordance with these new requirements, when clients have a low-risk profile the regulator should have the option of allowing an exemption from AML/CFT controls for certain limited transactions and application of reduced or simplified customer due diligence procedures where appropriate. This is important as overly-strict AML/CFT rules can prevent unserved and underserved customers from accessing formal financial services and products and potentially increase the risk of money laundering and terrorist financing by shifting transactions to the informal economy.⁷¹

2.4.1.3 PROPORTIONATE REGULATION AND CONSUMER PROTECTION LAWS

Financial inclusion being all about providing access to the segments of the society that were previously excluded from financial services particularly, farmers, women, poor and low-income customers, and since those segments of the society have little experience with formal financial institutions, they generally face challenges to understand the innovative products and services offered as well as their rights and responsibilities as financial consumers.⁷² Without basic protective measures, previously excluded and inexperienced consumers may be subject to abusive sales and collections practices and risk being sold products that do not fit their needs and may even be harmful.⁷³

⁷⁰ The Financial Action Task Force (FATF) is an intergovernmental body aimed at combating money laundering, terrorist financing, and related threats to the integrity of the international financial system.

⁷¹ The Basel Committee on regulation and supervision for financial inclusion, BBVA Research, Lucia Pacheco / David Tuesta, (2016).

⁷² *Supra note* 11, P.7.

⁷³ *Id*, P. 12.

For example, the 2014 Global Findex data from the World Bank showed that 13% of adults without a formal account state lack of trust in banks as a reason for not having an account. A proportionate consumer protection regime can address the issue of trust by balancing between protective measures and the cost of these measures for financial institutions. In this context, a proportionate consumer protection regime should be designed in a way that does not set the bar so high that responsible providers are dissuaded from entering the market or offering new services by tailoring regulation and supervision to the specific risks observed in the market.⁷⁴ In particular, countries that have lower levels of regulatory and supervisory capacity should use the principle of proportionality in their regulations and supervisions, which requires careful prioritization of the most important risks observed and incremental phasing-in of consumer protection measures over time as markets and regulatory and supervisory capacity develop. Cambodia is a good example on how taking fairly simple first steps can lay the groundwork for fair, competitive, and efficient delivery of financial services. In Cambodia, little consumer protection regulation was in force which focused on basic protection. Then, the central bank took the step of prioritizing problems facing microloan customers such as transparent pricing and implementing simple rules on price calculation and disclosure. In this context, as a first step, it is recommended that countries that have lower levels of regulatory and supervisory capacity should focus on basic protections, such as transparent pricing and fair treatment and avoid setting the consumer protection bar so high that responsible providers are dissuaded from entering the market.⁷⁵

The development of consumer protection in the region varies from country to country. For example, in Japan, a consumer hotline for consumer protection established by the Financial Services Agency provides a valuable source of information for the regulator. In Thailand, the Bank of Thailand opened its Financial Consumer Protection Center to inform consumers about

⁷⁴ Global standard-setting and financial inclusion for the poor toward proportionate standards and guidance, a white paper prepared by CGAP on behalf of the G-20's Global Partnership for Financial Inclusion, (2011). Available at: <https://www.cgap.org/sites/default/files/CGAP-White-Paper-Global-Standard-Setting-Bodies-Oct-2011.pdf>.

⁷⁵ L. Brix and K. McKee, "Consumer Protection Regulation in Low-Access Environments: Opportunities to Promote Responsible Finance", Consultative Group to Assist the Poor No. 60, (2010). Available at: <https://www.cgap.org/sites/default/files/CGAP-Focus-Note-Consumer-Protection-Regulation-in-low-access-environments-opportunities-to-Promote-Responsible-Finance-Feb-2010.pdf>.

their rights and responsibilities as consumers of financial services to reduce consumers falling prey to fraudulent practices, and to facilitate informed decision making by consumers. However, consumer protection programs seem less well developed in India, Indonesia, and the Philippines.⁷⁶

2.4.2 FINANCIAL REGULATION IN CREDIT FACILITY

Though providing access to credit facility to the financially unprivileged is one of the core ideologies of financial inclusion, the business model of the banking sector is not appropriate to meet the full needs of financial services of low income populations because of the lack of credit history of poor people, rigid collateral requirements, low survival rates of SMEs and high transaction cost of small amount of credit, amongst others.⁷⁷ For instance, according to a survey of four emerging economies in Asia, the four major barriers of financial institutions regarding Small and Medium Enterprises' access to finance were identified to be the following⁷⁸;

- (i) Collateral and guarantees as prerequisites for loans,
- (ii) Complicated procedures to borrow money,
- (iii) A strict lending policy of financial institutions, and
- (iv) High lending rates.

Though there are some scholars who suggest that increased lending to smaller firms leads to greater diversification of bank assets which could reduce the overall riskiness of a bank's loan portfolio, the expansion of credit without appropriate regulatory and prudential tools, however, can lead to financial crises.⁷⁹

With this regard, although Basel frameworks are prepared for international banks, most countries apply these rules to regulate their local banks' access to credit. There are three types of Basel Regulatory Frameworks implemented by countries, named Basel I, II and III.⁸⁰ Since Basel I was

⁷⁶ *Supra note*, 31.

⁷⁷ S. Shinozaki, "Capital Market Financing for SMEs: A Growing Need in Emerging Asia", Working papers on Regional Economic Integration, No. 121, Asian Development Bank, (2014).

⁷⁸ *Ibid*.

⁷⁹ *Supra note*, 18.

⁸⁰ <https://www.bis.org> see also; <https://www.cfr.org/backgrounder/basel-committee-banking-supervision> (Last visited: February 2020).

criticized for not being risk-sensitive, Basel II that is more risk sensitive than Basel I was developed.⁸¹ However, global financial crises demonstrated that Basel II rules do not work as intended. For example, regulatory capital calculated under Basel II could not absorb losses well enough. So, Basel III introduced a new capital definition and liquidity and leverage ratios and increased risk weights for some assets in the calculation of the capital adequacy ratio.⁸²

While Basel I consists of only Pillar I, Basel II and III are structured around three pillars. Pillar I illustrates how the minimum capital requirements should be calculated for what a bank must hold to cover its exposure to credit, market and operational risk. On the other hand, since the Pillar I approach is unlikely to cover the entirety of risk exposures, such as credit risk concentration or reputational risk, the second pillar of the framework was developed to fill this gap. Pillar II is concerned with supervision reviews that aim to ensure that a bank's capital level is sufficient to cover its overall risk. Since credit risk concentration or reputational risk is difficult to quantify, Pillar II includes more qualitative provisions than Pillar I and requires using supervisory judgment to measure such risks. In accordance with the Pillar II framework, the supervisory authority has a chance to differentiate regulatory prudential limits where appropriate, and apply criteria of materiality in order to determine the applicability or otherwise of particular rules to different classes of institutions. However, most of the low income countries implement Basel I, which does not include Pillar II. For this reason, they do not have a chance to differentiate prudential limits for their different classes of institutions by using Pillar II tools of the Basel framework. These countries can overcome this problem by migrating to a risk-based supervision approach that entails a departure from 'one-size fits-all' requirements applied uniformly to all banks regardless of their size or risk profiles. Meanwhile, Pillar III relates to details of minimum levels of public disclosure.

Therefore, while countries are dealing with financial inclusion in terms of access to credit, it is possible to refer to the Basel framework as a basis for coming up with their own regulatory statutes or use the standards in the Basel framework as it is without designing and coming up with their own statute regulating access to credit of Banks.

⁸¹ Ibid.

⁸² Ibid.

2.5. PRINCIPLES FOR PRO-INCLUSIVE REGULATION

Once the relevance of financial regulation for greater financial inclusion is established and how proportionality is a key factor of regulation in order to foster financial inclusion, as per the Center for Global Development Task force report on the role of financial regulation for financial inclusion, there are different principles countries may follow in order to regulate their respective financial sectors for a better and effective financial inclusion that may be used either individually or in combination i.e., Similar regulation for similar function, regulation based on risk and balance between ex-ante and ex-post regulation.⁸³

2.5.1. SIMILAR REGULATION FOR SIMILAR FUNCTION

Financial inclusion will be best served when regulation follows a functional approach that is, when financial services providing essentially the same functions are regulated in essentially the same way, whether the provider is a traditional bank, some other type of financial institution, or even an entity whose primary business is not financial services at all (for example, an MNO). As per this approach, regulation of banks and non-bank agents should be through similar set of rules with regard to the operation of similar financial products and services that are being served by both entities.

2.5.2. REGULATION BASED ON RISK

Regulation should also follow a risk-based approach, in which the stringency of regulatory requirements on any financial activity is commensurate with the risk that activity poses to the individual participant (whether the consumer or the provider) and to the stability and integrity of the overall financial system.

2.5.3. BALANCE BETWEEN EX ANTE AND EX POST REGULATION

Regulation should be sufficiently well specified ex ante to give providers clear rules of the game and enable competition for the market, but regulators should also have the authority to intervene ex post as the financial system evolves and regulatory or market development issues emerge. The challenge is to strike an adequate balance between these two.⁸⁴

⁸³ *Supra note 14.*

⁸⁴ *Supra note 14, Annex 2.*

Based on the above principles, regulatory frameworks and regulations should advance the areas that are related with competition policy, leveling the playing field and know-your-customer (KYC) rules. competition policy matters especially in developing Countries as it leads to greater variety of products and services, higher efficiencies and lower costs which ultimately means potential customers currently on the side lines will be more easily included through encouraging new providers to enter the Financial Market.

Leveling the playing field is a concept that is about regulations ensuring that functionally similar services are treated equally and in the same manner as long as they pose similar risks to the consumers of the service or to the financial system as a whole. It is critical to ensure that all providers compete on equal basis as equal treatment based on service matters for financial inclusion as it allows more consistent consumer protection across service providers, because it can help expand the market frontier for financial services on which greater inclusion depends often differ greatly from one another in their structure and business models. In addition, a level playing field reduces the scope for regulatory arbitrage and other distortions.

CHAPTER THREE

THE ETHIOPIAN NATIONAL FINANCIAL INCLUSION STRATEGY AND THE BANKING BUSINESS REGULATING LAWS

3.1. THE ETHIOPIAN NATIONAL FINANCIAL INCLUSION STRATEGY

The Ethiopian financial inclusion strategy which was launched based on the Findex survey⁸⁵ of the World Bank in studying the current state of financial inclusion in Ethiopia, describes the identified key barriers hindering financial inclusion in Ethiopia, which turned out to be underdeveloped infrastructure either financial or other, inadequate supply of suitable financial products, services and access points, inadequate financial consumer protection and low levels of financial capability and awareness⁸⁶ and goes on the different strategies that it is going to implement in order to realize its goals. These identified barriers of the strategy seem to be well addressing of the actual issues in Ethiopia as it is identified by a survey conducted for a literature. Based on the abovementioned survey, the use of financial services in Ethiopia is unevenly distributed and it depends on higher population density and greater proximity to access points; densely populated few urban areas have higher density of bank branches, Automatic Teller Machines (hereinafter ATMs), agents and POS terminals and have greater use of financial services than rural areas. Generally, the barriers to access and usage of financial services by individuals in Ethiopia are identified to be of three types i.e., physical, bureaucratic and financial barriers.⁸⁷ Physical barriers include access to bank branches and ATMs while bureaucratic barriers are the ones that such as difficulty to get credits and saving products by poor, due to market failures such as constraints to access due to regulations and structure of the financial institution; Financial barriers on the other hand are the barriers like costs of opening a saving account and fixing transaction costs.⁸⁸

Once the root barriers are identified, the next step would be properly addressing the problems which are distance, cost, credit and documentation barriers and in case of market failures and

⁸⁵ *Supra note 4.*

⁸⁶ *Supra note 12.*

⁸⁷ *Supra note 2.*

⁸⁸ *Ibid.*

behavioral problems that tend to be addressed through designing of appropriate financial products and services. Accordingly, the strategy goes on with putting the main strategies to avoid the aforementioned barriers and achieve universal access to and use of affordable and high-quality financial products and services in Ethiopia as its vision for 2025. The strategy provides different solutions for the outlined problems starting from the significant one i.e., strengthening financial and other infrastructure as lack of infrastructure is the main reason of financial exclusion in Ethiopia; and go to finding solutions to the other problems for the inadequate supply of suitable financial products through ensuring the supply of adequate range of financial products, services and access points through digitalization of payments for example; for the inadequate financial consumer protection by building a strong financial consumer protection and for the low level of financial capability and awareness through building framework and improving financial capability.⁸⁹ These ways of solving the problems by the strategy seems to be covering all the three types of barriers of financial exclusion in Ethiopia.

The strategy, to realize the aforementioned solutions for financial exclusion also provides priority actions which include reviewing the role, regulation and oversight of technological service providers, given their potential to facilitate adoption of transaction accounts and the emergence of convenient and ubiquitous access points. In addition, the review of the laws and regulations pertaining to information and communication technologies will ensure that there are no relevant obstacles for the massive deployment of mobile phones, Automatic Telling Machines (ATMs) and Point of Sales (POS). It also promised for the regulations on agent banking branches and sub-branches expansion will be explored to ensure that there are no remaining obstacles through providing evaluation and monitoring mechanisms to assess and follow up the measures that are taken by the respective stake holders though it is beyond the scope of this paper.

The other issue here is that the financial inclusion strategy is in line with the development goals of Ethiopia as demonstrated on the Growth and Transformation Plan II planning to achieve the two overarching goals of Growth and Transformation Plan 2015/16-2019/20 by increasing domestic savings and jobs by fostering a vibrant productive sector.⁹⁰ The two tracks of financial

⁸⁹ *Supra note 12.*

⁹⁰ *Ibid.*

inclusion; saving mobilization and fostering job creation will support Ethiopia's transformation from agricultural to manufacturing industrial economy and provides background for the National Financial Inclusion Strategy.⁹¹

The strategy in order to achieve its goals however, has considered reforming the laws regulating banking business as a crucial strategy. Through the past years since its adoption, various legal reforms have been conducted for the improved usage of financial products and services and realization of its set goal by 2020. Most of the legal reform however, has been conducted in 2019 and 2020 demonstrating the goals set to be met by 2020 could not be achieved but the possibility for the ultimate goals of the strategy to be met by 2025 is still there. As such, the following section would deal with whether or not the laws regulating banking business (the reformed and unreformed) relating to account ownership, payment system and credit facility are in line with the accepted standards of regulation for promotion of financial inclusion and in line with the principles of pro-inclusive regulation.

3.2. THE SUITABILITY OF THE ETHIOPIAN LAWS REGULATING BANKING BUSINESS IN ACHIEVING THE GOALS OF THE FINANCIAL INCLUSION STRATEGY

Though financial regulation is recognized and accepted as a key tool for financial inclusion, it has been established in the previous chapter that the suitability of the laws regulating financial institutions towards financial inclusion depends up on three factors i.e., their capacity to promote innovation and competition, existence of adequate customer protection rules and their ability in protecting the integrity and stability of the financial system. To this end, this section will evaluate the banking business regulating laws against these main criteria and determine their status in promoting financial inclusion.

⁹¹ Growth and Transformation Plan II (GTP II), National Planning Commission, (May 2016).

3.2.1. ACCOUNT OWNERSHIP AND PAYMENT SYSTEM REGULATING LAWS AND PROMOTION OF COMPETITION, CONSUMER PROTECTION AND ABILITY TO MAINTAIN INTEGRITY

3.2.1.1. THIRD AMENDMENT OF BRANCH OPENING DIRECTIVE NO. SBB/66/2018

With the aim of creating sound and prudent practices to manage risks effectively, the NBE has issued the Third Amendment of Branch Opening Directive No. SBB/66/2018 that provides for the fulfilment of various requirements for a bank to open a new branch in terms of acquiring the adequate infrastructure, placement of appropriate manpower, having proper security in place, suitability of cash loading and unloading area, display of the signboard of the branch stating the branch name and the name of the bank and having insurance policy at least for fire and other perils that may occur in the bank's own premises, cash and valuables in premises and in transit and fidelity or appropriate provisions for such risks.⁹²

Looking at the requirements provided by such directive, though the directive provides for the prior approval/ authorization by the NBE by providing various requirements, one may state that it gives due regard to consumer protection as it stresses on the issues of security by requiring insurance coverage of different perils within the branch premises to be mandatory. With this regard, the requirements of insurance cover are not expressive enough in terms of the perils that are mandatorily needed to be covered as it only expresses fire as the peril that requires insurance coverage that gives an analogical expression to other perils that needed to be covered by an insurance cover. Especially, with the current prevailing condition of the country, it is the recommendation of the researcher that insurance covers should be provided for perils that may have political motivation through political and terrorism insurance cover in addition to perils that are recognized to be plain and more likely to happen frequently. In addition, in order to avoid the insufficient fund attitude, increase the integrity of the Banks and develop the sense of trust of customers in the Banks which was recognized to be one reason for financial exclusion in Ethiopia, introduction of deposit insurance scheme⁹³ mandatorily together with creation of

⁹² Licensing and Supervision of Banking Business Third Amendment of Branch Opening Directives No. SBB/66, National Bank of Ethiopia, (2018), Art. 4.

⁹³ Deposit Insurance is a protection provided by a government agency to depositors against risk of loss arising from failure of a bank or other depository institution. Deposit Insurance pays claims from a pool of funds to which every

financial knowledge especially in the rural community may be determinant in order to create a sense of trust from the society on financial institutions. The directive also limits the operations of sub-branches from engaging in international banking and trade, finance and loan processing and underwriting⁹⁴ that may be considered to have the intention of protecting the stability and integrity of the financial system in general thereby protecting financial customers. This however have a huge negative impact on accessibility of such services as accessing such services require customers extra time and cost especially, those that reside in rural areas.

Based on the aforementioned discussion, it is feasible to conclude that the directive on branch opening is more focused on protecting the integrity and stability of the banking sector rather than inclusiveness through accessibility of branches since it does not provide duty on banks as to the urban-rural proportion regarding location of branches they open, inclusivity in terms of accessibility of branches by persons with disability and inclusiveness in terms of providing responsibility for financial awareness creation regarding the benefits of using formal banking sector to avoid insufficient fund attitude of the society and create societal trust on the financial sector.

This being said about the branch opening directive regarding protecting the integrity and stability of the banking sector, one should take note that there are different directives regulating account ownership with different provisions that promote consumer protection and the stability and integrity of the banking system including directive no. SBB/55/2013 that provides reserve requirements on all banks, directive no. SBB/65/2017 putting limitation on Investment of banks and even the recently issued directive no. SBB/75/2020 that provides for method of handling unclaimed liabilities of banks giving consumers an extended period of time to request their

depository institution regulatory contributes. However, it covers a fixed maximum amount per an account holder. See; <https://www.businessdictionary.com/definition/deposit-insurance.html>

Currently, the adoption of deposit insurance scheme is recognized to be essential for securing consumers of the banking business sector and the draft regulation has been ratified by the council of ministers; though it is yet to be published.

⁹⁴ *Supra note 94*, Art. 5.

claims⁹⁵ even by surpassing the 10 year period of limitation for rights emanating from contracts adopted by the Civil Code.⁹⁶

3.2.1.2. CASH WITHDRAWAL LIMIT DIRECTIVE NO. FIS/03/2020

This directive was issued with the multiple purposes of promoting use of non-cash payment instruments and ensuring safety and efficiency of the payment system, to mitigate the risk of robbery, fraud, money laundering, tax evasion, illicit activities including smuggling, counterfeiting and other criminal activities which are illegal and immoral, increasing the use of non-cash payment instruments to minimize liquidity risk and ensuring the soundness of the financial system and minimization of the huge cost related to printing, processing and handling of physical cash⁹⁷ that will be applicable both on cash withdrawal and encashment of cheques.⁹⁸

Looking at the various provisions of the directive however, it may reflect unintended implications from the consumer perspective as consumers are used to a market that is more of a cash based market and it is safe to conclude that financial consumers were using formal banking system believing that they may cash out their account balance any time. Not being able to do so as a result of this directive may have a discouraging effect than encouraging for individuals to use formal banking when it is combined with the general mistrust and insufficient funds attitude of the public on the banking sector as identified by the findex study as one reason for financial exclusion⁹⁹ that may have an adverse effect on the NBE's effort towards full financial inclusion.

⁹⁵ Unclaimed liabilities of a bank Directive No. SBB/75, National Bank of Ethiopia, (2020), Arts. 2, 4 (5) and 6 (4). In addition to the 10-year period of time limit for making the information publicly available after the lapse of 15 years of not being claimed, there is no limit for requesting unclaimed liability. It also put an obligation on banks to maximize profit for the 15-year period where the liability has not been claimed if the account is interest based account.

⁹⁶ Civil Code of the Empire of Ethiopia, *Negarit Gazzet*, Proclamation no. 165, 19th year, no. 2, (1960), Art. 1845.

⁹⁷ Cash Withdrawal Limit Directive No. FIS/03, National Bank of Ethiopia, (2020), Preamble.

⁹⁸ *Id.*, Art. 3.

⁹⁹ Insufficient funds attitude and lack of trust combined constitute 79% of the key barriers for financial inclusion the former constituting 78% and the latter 1%. *See*; National Financial Inclusion Strategy, National Bank of Ethiopia, P. 26.

3.2.1.3. INTEREST RATE DIRECTIVE NO. NBE/INT/12/2017

The other Directive that regulates account ownership is the interest rate directive No. NBE/INT/12/2017 that dictates the interest rates of deposits. With regard to the interests that depositors should receive annually, the directive provides for minimum interest rates on saving and time deposits while it gives the power of determining the maximum percentages per annum to be freely determined by each bank.¹⁰⁰ Such openness of the directive leaving the interest rates of the deposits to be determined by the respective banks is highly appreciable as it would create a room for competition among the banks leading to the ultimate benefit of the customers. The fact that the directive provides for the minimum interest rate on saving and time deposits is on the other hand demonstrating the directive's approach towards consumer protection as it tries to protect financial consumers to use bank deposit service by setting the minimum interest rate they should receive and leaving them a room for a choice for the sake of their protection that is achievable through creating a competitive environment among the services providers.

This however, also have an implication on the integrity and stability of the banking sector as unlimited upsurge of interest rates on deposit services under the guise of competition may lead to fragility of banks that may lead to the disruption of the system. With this regard, though the existence of wider competitive environment is of great importance, the NBE may fix a maximum interest rate that banks are prohibited to surpass through providing a wide range between the minimum and maximum interest rates that may be extended by banks through maintaining the balance between high competition and maintaining integrity and stability of the banking sector.

3.2.1.4. DIRECTIVE TO LICENSE AND AUTHORIZE INTEREST FREE BANKING BUSINESS NO. SBB/72/2019 (FIRST REPLACEMENT)

Based on the increasingly strong public demand for interest free banking products in Ethiopia¹⁰¹, the NBE has issued a directive to authorize the business of interest free Banking No. SBB/51/2011 that was subsequently repealed and replaced by directive no. SBB/72/2019 that was introduced with the intention of promotion of financial inclusion, to conduct such a business

¹⁰⁰ Interest Rate Directives No. NBE/INT/12, National Bank of Ethiopia, (2017), Art. 1.

¹⁰¹ Directive to Authorize the Business of Interest Free Banking No. SBB/51, National Bank of Ethiopia, (2011), Preamble.

with a safe and sound manner and the need to review the regulatory framework in light of the current banking sector reform.¹⁰² Interest free banking business is a banking business in which mobilizing or advancing funds is undertaken in a manner consistent with Islamic law or sharia principles¹⁰³ and interest free banking window is a unit in a conventional bank exclusively offering interest free banking services.¹⁰⁴

The directive require conventional banks to obtain prior approval from NBE before opening interest free banking window through submitting a duly completed application together with various documentations¹⁰⁵ and once a bank obtains the approval of NBE it should comply with the requirements of keeping separate books of accounts in respect of interest free banking operations and ensure proper maintenance of records for all transactions for segregation of funds in addition to reporting their interest free banking business activities every month to the NBE¹⁰⁶ that is similar to the requirements of the repealed directive.

Previously, it was an area of concern that there was no indication whether or not the interest free window service is limited to deposit mobilization services only or whether it may be extended to the credit facility services as well. The conventional meaning of interest free banking is a banking system where interests are not used i.e., banks do not offer a fixed rate of return on deposits and do not charge interest on loans¹⁰⁷ that at least mentions whether the service is interest free for both deposits and credit facility services. Besides, the repealed directive though it took the initial step of introducing the interest free banking service in Ethiopia, it fails to address with how the particular service is to be operated by respective banks.

According to Mr. Solomon Desta, Director of Bank Supervision Directorate of NBE, the operation of commercial banks in delivering interest free banking service under the repealed directive was limited to deposit service as the risk of providing interest free credit facility service

¹⁰² Directive to License and Authorize Interest Free Banking Business No. SBB/72, National Bank of Ethiopia, (2019), Preamble.

¹⁰³ Id., Art. 2 (2).

¹⁰⁴ Id., Art. 2 (3).

¹⁰⁵ The list of documents that the NBE require banks to provide does not include operational and policy procedure manual.

¹⁰⁶ Id, Art. 6.

¹⁰⁷ <https://www.igi-global.com/dictionary/interest-free-banking/5836d>. (Last visited: February 2020).

is much higher and capable of disrupting the financial system if it is launched without proper regulation put in place.¹⁰⁸ Though the banks are limited only to providing interest free banking service only to the deposit mobilization service, interest free credit facility has been provided by MFIs particularly the Somali Micro-Finance Institution based on sharia rules boosting the financial inclusion of communities which formerly felt excluded from the country's banking sector as a result of their Islamic religion as soon as the introduction of interest free banking service by the NBE.¹⁰⁹ The current directive on licensing of interest free banking business however, has launched the provision of such service in credit facility service facility as well which may be inferred from the introduction of a full-fledged Islamic banking system by the directive¹¹⁰ which was also an area of concern from the aspect of financial inclusion of the Muslim population as there are a variety of banking products and services that a full-fledged Islamic banking could provide¹¹¹ that were previously limited being implemented by conventional banks through interest free banking windows.¹¹² With this regard, the Director of Bank Supervision Directorate of NBE Mr. Solomon Desta, in March 2019, stated that the reason that the NBE opted for starting with interest-free window banking services was due to lack of experienced personnel in Ethiopia on Sharia-based banking services and products without denying the role that introduction of a full-fledged Islamic banking system would play in boosting financial inclusion indicating that Ethiopia would soon launch an Islamic Banking system in its full sense which is now realized.¹¹³

Evaluating the directive in terms of its suitability for boosting financial inclusion, the current introduction of full-fledged interest free banking system can be considered as significant progress towards better financial inclusion since the introduction of the interest free banking

¹⁰⁸ Interview with Mr. Solomon Desta, Financial Institutions Supervision Cluster, Bank Supervision Directorate Director, (March 2019).

¹⁰⁹ <https://www.aljazeera.com/indepth/features/islamic-banking-ethiopia-offers-muslims-financial-inclusion-190404192204542.html>

¹¹⁰ *Supra note* 104, Art. 4 (1).

¹¹¹ Handbook of Islamic Banking Products and Services, State Bank of Pakistan, Islamic Banking Department.

¹¹² [https://www.prime-ethiopia.org/wpcontent/uploads/2015/07/policy%20on%20Ethiopia%20Interest%20Free%20Banking%20\(IFB\)%20Directive.docx](https://www.prime-ethiopia.org/wpcontent/uploads/2015/07/policy%20on%20Ethiopia%20Interest%20Free%20Banking%20(IFB)%20Directive.docx).

¹¹³ *Supra note* 110.

window through conventional banks by itself had its own contribution. Looking at the silence of the directive as to the particular interest free banking products and services that may be provided by banks (both the conventional and interest free banks), it provides a room for competition among fellow banks engaged in interest free banking to become innovative and adopt different type of products that has a positive effect on the consumer protection aspect of financial inclusion; as boosted competition among banks results in quality products with affordable price and of course a better consumer protection.

Looking at the directive in terms of its effort in protecting the integrity and stability of the interest free banking business, it requires an interest free bank to fulfill the requirements that are laid out under Directive No. SBB/56/2013 as any other bank¹¹⁴ apart from the bundle of requirements for conventional banks that are engaged in operating interest free banking windows.¹¹⁵ Regarding regulating the operation of interest free banks, the directive states that the banks should comply with the regulatory and supervision provisions except for the interest rate directive¹¹⁶ and requires the board of directors of interest free banks to develop detailed policies and procedures on Shariah oversight.¹¹⁷

Looking at the aforementioned provisions however, may be considered as the slack of the NBE as the financial regulator since there is absence of detailed regulatory framework that are tailored to the interest free banks as it is different from conventional banks and there is high risk involved relating to financial stability especially in interest free credit facility system requiring a well-researched regulation rather than just adopting same provisions as the conventional banks though accessibility of interest free banking services is well served through the provisions of the directive. Besides, the NBE's requirement on interest free banks to merely develop policies and procedures lacks clarity of the NBE's role of regulation as it does not state how it makes sure if those procedures are in fact in line with the Shariah principles and the would be measures of un-alignment of those policies and procedures with the Shariah principles. Finally, the enactment of this directive as the first replacement, may be a demonstration of the NBE's approach of

¹¹⁴ *Supra note* 104, Art. 4 (1).

¹¹⁵ *Supra notes* 107 and 108.

¹¹⁶ *Supra note* 104, Art. 7 (1).

¹¹⁷ *Id.*, Art. 7 (2).

progressive regulation of interest free banking as it is a new experience in Ethiopia that will be improved through time considering the aforementioned points and new developments that may occur on the market.

3.2.1.5. LICENSING AND AUTHORIZATION OF PAYMENT INSTRUMENT ISSUERS DIRECTIVE NO. ONPS/01/2020

The National Bank of Ethiopia (NBE) issued a directive that allows non-traditional financial institutions to engage in the business of issuing payment instruments which may be considered as a significant step forward in Ethiopia's financial services sector in its effort to competition through innovativeness. Services that are traditionally considered to fall in the banking service, such as cash-in and cash-out; local money transfer including domestic remittance, load to card or bank account, transfer to card or bank account, inward international remittance; domestic payments including bill payment services; and micro-saving, micro-credit, micro-insurance and pension products can now be provided by non-bank companies that fulfill the criteria under this directive¹¹⁸, a subsidiary legislation to the National Payment System Proclamation No. 718/2011, that is issued by repealing and replacing the 2012 Directive on Mobile and Agent Banking Services.

Licensed banks and micro-finance institutions are by default allowed to issue payment instruments without obtaining a specific license for this purpose.¹¹⁹ They are only required to submit an application to the NBE to get authorization for the issuance of payment instruments.¹²⁰ Apparently, the general licenses they hold for engaging in the banking sector implicitly allows them to engage in issuance of payment instrument and as such they are not required to get a separate license. However, any other person should submit application and obtain a license from the NBE in order to do business in the issuance of payment instrument.¹²¹ The Directive defines

¹¹⁸ Oversight of the National Payment System; Licensing and Authorization of Payment Instrument Issuers Directive No. ONPS/01, National Bank of Ethiopia, (2020), Art. 6.

¹¹⁹ *Id.*, Art. 4 (1).

¹²⁰ *Ibid.*

¹²¹ *Id.*, Art. 4 (2).

payment instrument as “any instrument whether tangible or intangible that enables a person to make payments or transfer money including electronic money”.¹²²

Despite the appetite and high expectations of foreign financial and technology firms to invest in payment transaction services (including mobile money services), the directive has limited ownership of payment instrument issuer companies only to Ethiopian nationals, the Ethiopian Government and foreign nationals of Ethiopian origin (Ethiopian diaspora)¹²³ that is the result of Ethiopia’s closed door policy of not allowing the operation of foreign banks and financial institutions domestically that may be considered as a constraint towards better competition and quality products that may have been provided if capable foreign financial service providers were allowed to function.

The directive requires a minimum paid-up capital of Birr fifty million (50,000,000 ETB) for getting licensed as a payment instrument issuer.¹²⁴ In contrast to the Commercial Code that requires a minimum of five shareholders for a share company¹²⁵, the directive requires a minimum of ten (10) shareholders to establish a share company that engages in the business of payment instrument issuance except for a public enterprise owned by the government¹²⁶ that demonstrate the consumer protection aspect of the directive and its attempt of taking in to consideration financial stability. It also provides that no shareholder can hold more than 20 % of the share capital of a company as payment instrument issuer¹²⁷ which also does not apply for a public enterprise showing same intention. This requirement however, contrasts with the maximum share capital ownership requirement for banks, where a person cannot hold more than 5% of the shares in a bank as per the Banking Business Proclamation No. 592/2008¹²⁸ that may be the result of the better capacity of formal banks in shock absorption as they are more established and better regulated.

¹²² Id., Art. 2 (18).

¹²³ Id., Art. 4

¹²⁴ Ibid.

¹²⁵ Commercial Code of the Empire of Ethiopia, Negarit Gazeta, Proclamation No. 166, 19th year, No. 3, (1960), Art. 307.

¹²⁶ *Supra note* 125.

¹²⁷ Ibid.

¹²⁸ Banking Business Proclamation, Federal Negarit Gezet, Proclamation No. 592, 25th year, No. 50, (2008).

In addition, an applicant should meet a number of requirements in order to obtain a license under the Directive. An applicant should provide a number of comprehensive documents, including a document that shows its ability to manage the system and allocate necessary resources to operate an efficient system.¹²⁹ Moreover, a licensed payment instrument issuer should appoint directors, chief executive officers and seniors officers that meet the higher educational qualifications and many years work experience requirements in the Directive.¹³⁰ Their appointment should get prior written approval from the NBE. In general, payment instrument issuers need to allocate huge amount of resources and meet a number of strict requirements to obtain a license and continue to do business which are apparently, in place to ensure sound financial transactions and provide customers protection and efficient service. Other than this, the directive, maintained customer due diligence requirements including adherence to money laundering and financing terrorism laws in addition to its requirement for maximum protection from payment instrument issuers in performing their business.¹³¹

Looking at the preamble of the directive however, this directive is put in place for promotion of innovative payment instruments as they are important to increase the use of financial services. The services that the payment instrument providers are allowed to provide, however, all of them¹³² are what one may consider as traditional banking services (in addition to the insurance services) that were more or less existent in Ethiopia. With this regard, the directive's move of allowing the licensing of non-financial institutions to engage in providing financial services, the directive, in order to increase the usage of financial services, widened the parameters for payment service providers to operate rather than opening up the space for the payment service providers to come up with innovative payment services for better usage of financial services. Though this have a positive implication for financial inclusion through making affordability of service charges and accessibility of access points means of competition among banks, it still does

¹²⁹ *Supra note* 120, Art. 4.

¹³⁰ *Id.*, Art. 5.

¹³¹ *Id.*, Arts. 11 and 12.

¹³² Cash-in and cash-out; local money transfer including domestic remittance, load to card or bank account, transfer to card or bank account, inward international remittance; domestic payments including bill payment services; and micro-saving, micro-credit, micro-insurance and pension products.

not provide a room for innovativeness in the type of payment instruments to be issued by payment instrument issuers; which was its main goal as per the preamble.

3.2.1.6. LICENSING AND AUTHORIZATION OF PAYMENT SYSTEM OPERATORS DIRECTIVE NO. ONPS/02/2020

Previously, there was no directive or regulation relating to payment system operators and thus there were no payment system operator licenses granted in the past. As such, the Directive on Operators can be deemed the first of its kind in providing specific regulations on the licensing and authorization in payment system operation that may be appreciated in Ethiopia's move towards digitalized payment system.

Regarding the requirements for engaging in payment system operator's business, like the payment instrument issuers directive, the directive on operators only allows Ethiopian nationals and foreign nationals of Ethiopian origin to engage in payment system operating business as it states that an applicant intending to be licensed as payment system operator should be established as a company, where the ownership should be vested on Ethiopian nationals and foreign nationals of Ethiopian origin.¹³³ Thus, foreign investors are not allowed to engage in the payment system operating business. However, as will be noted in the next section below, foreign investors can provide their technology platforms/services to operators, if and when the operators outsource their technology services.¹³⁴

The directive further states that any person, other than a financial institution, should be licensed by the NBE in order to do business as a payment system operator.¹³⁵ That said, licensed financial institutions are by default considered to be authorized as payment system operators. However, the financial institutions are allowed to use the payment system only for their own use (activities that are related to their routine financial transactions).

The Directive on Operators specifies five (5) types of systems a payment system operator is allowed to operate. These are: National Switch Operator; Switch Operator; Automated Teller

¹³³ Oversight of the National Payment Systems; Licensing and Authorization of Payment System Operator's Directive No. ONPS/02, National Bank of Ethiopia, (2020), Art. 4.

¹³⁴ Id., Art. 20 (4).

¹³⁵ Id., Art. 20 (1).

Machine (ATM) Operator; Point of Sale (PoS) Device Operator and Payment Gateway Operator.¹³⁶ A company is allowed to operate in more than one of any of these systems, except for the national switch operator (which shall be owned only by single entity formed between financial institutions and the NBE). Additionally, a company that intends to operate more than one system is required to meet the sum of the minimum capital requirements of each system. The minimum capital requirement for each system is as follows: for a national switch operator: Ethiopian Birr (ETB) 300 (three hundred) million; for a switch operator: ETB 40 (forty) million; for an ATM machine operator: ETB 20 (twenty) million; for a PoS operator: ETB 10 (ten) million; and for a payment gateway operator: ETB 3 (three) million.¹³⁷

Further, a person's ownership in a company that engages in payment system operation should not exceed 40% (forty percent) (this requirement does not apply for a national switch operator). A minimum of ten (10) shareholders is required if a company intends to operate more than one system. For a company that operates one system, the minimum shareholder requirement for a share company (five shareholders) provided under the Commercial Code shall apply. In addition to meeting the conditions described above, an applicant is required to submit documents that demonstrate the applicant's capacity to manage the system, documents detailing the features and modalities of the system, and any other information the NBE may request.

A payment system operator is not allowed to engage in any other business, including payment instrument issuer business. Should an entity/person engaged in other business be interested in the payment system operator business, it should establish a new separate company that exclusively engages in the payment system operation that implies NBE's strong intension in protecting the integrity of the system.

Regarding outsourcing technology platforms/Services, it is described as an arrangement between a payment system operator and a third party provider through which the latter handles a process, service or an activity otherwise handled by the payment system operator. With the exception to operational functions related to maintenance and deployment of two systems, namely ATM and PoS terminal, the list of services subject to outsourcing have not been outlined under the Directive on Operators. However, this does not mean that other outsourcing services, particularly

¹³⁶ Id., Arts. 9 – 13.

¹³⁷ Ibid.

the provision of technology platform, is prohibited. Outsourcing services, however, shall not relate to the primary business activities of the payment system operators.

Further, the directive unlike payment instrument issuers directive, does not exclude foreign investors from offering outsourced services permitted by the NBE. Thus, foreign investors may engage in the business of outsourced services, including the provision of technology platforms to system operators that may be considered as an improvement towards the gradual opening up the financial market.

As noted earlier, the Directive on Operators recognizes five (5) systems, one of which is payment gateway operator. A payment gateway operator provides the services of integrating merchant's website, mobile tablet application or licensed e-commerce platform. In this regard, apart from domestic payment gateway operators, the Directive on Operators has introduced a rule on the basis of which a foreign payment gateway provider is permitted to offer online payment processing for activities that involve domestic and foreign transactions. A foreign payment gateway provider is allowed to provide online payment processing upon fulfilling two conditions: (i) Entering into an agreement with a licensed financial institution or the national switch operator for authorization, switching, clearing and settlement of payments purposes; and (ii) The presentation of the agreement and approval of the same by the NBE.

The NBE, since it allowed outsourcing, may as well have tried opening the operation market to foreigners as it will have a positive implication not only for better competition and innovativeness, but also to Ethiopia's move towards opening up the financial market to the foreign service providers.

3.2.2. CREDIT FACILITY REGULATING LAWS AND PROMOTION OF COMPETITION, CONSUMER PROTECTION AND ABILITY TO MAINTAIN STABILITY AND INTEGRITY OF THE BANKING SYSTEM

The NBE has been issuing various directives regarding credit facility provision by banks long before the adoption of the national financial inclusion strategy. These directives are of various nature and rather than going through each directive, this section deals with the directives classifying them based on their roles in promoting competition and stability of the financial sector.

3.2.2.1. PROMOTION OF COMPETITION THROUGH INNOVATION AND CONSUMER PROTECTION

The innovativeness of a credit service to the poor portion of the society may stretch from providing credit without a collateral as lack of property to attach as collateral and absence of credit history are the main barriers preventing individuals and small businesses from accessing credit facility, providing credit service against personal guarantee to credit access against attachment of collateral either pledge or mortgage.

In Ethiopia, access to credit from financial institutions has always been limited due to the inability of individuals and businesses to attach their properties as mortgage which was considered to be the main reason for excluding majority of individuals and small businesses from accessing the service as a result of these bureaucratic barriers. With this regard, the NBE has recently adopted operationalization of movable collateral registry Directive no. MCR/01/2020 based on the proclamation issued to allow using movable properties as a collateral for credit service proclamation No. 1147/2019 to ensure the latter's effectiveness.¹³⁸

The adoption of Proclamation No. 1147/2019 and Directive no. MCR/01/2020 have been praised by medias and officials of the NBE as they claim it to financially include most of the poor and rural population who were previously excluded due to their inability to attach mortgages in accessing credit facility; once it commences its implementation.

The directive requires banks and other financial institutions that are involved with providing financial service to fulfil including formulation of policies and procedures for secured transaction, assigning of administrator with the mandate of overseeing the collateral registry, assigning of a security administrator, duty of registering accurate, non-misleading and complete information in the registry¹³⁹ that have the notion of consumer protection and maintaining the integrity and stability of the credit system.

The directive also requires all banks to allocate at least 5% of their credit disbursements of a year for the agricultural sector including individuals, cooperatives, unions, micro, small and medium

¹³⁸ Operationalization of Movable Collateral Registry Directive No. MCR/01, National Bank of Ethiopia, (2020), Art. 4 (1).

¹³⁹ Id., Art. 7.

enterprises against movable collaterals that should commence since July 2019.¹⁴⁰ This is a step that should be appreciated as individuals and small enterprises in the agricultural sector have been identified as marginalized from accessing credit service.¹⁴¹ Looking at Art. 14 of the directive, the full implementation of the directive requires registering, codifying and assigning serial numbers for movable properties that are used as collateral demonstrating the directive's attempt of following the collateral. This however, may be difficult to apply since some movables especially in the agricultural sector like livestock are difficult for registration that will impede the implementation of the directive that are considered to be barriers for the agricultural sector benefit from this privilege within the time it is intended to commence i.e., as of July 2020.

Article 14 further states that motor vehicle trailer, agricultural machinery, industrial machinery to be considered as a serial numbered collateral in addition to vehicles. This however defeats the intention of the law maker to provide access to credit to the marginalized poor as such persons who can attach such collaterals with expensive market value (though movable) are far from being poor and marginalized from accessing credit. Here, the researcher considers the directive to still not addressing the poor; rather it is widening the opportunity for persons who can access credit even before the coming in to force of proclamation no. 1147/2019 due to their financial capability. With this regard, the researcher believes that there should be a swift mechanism devised for assigning serial numbers on movable properties like livestock by NBE. In addition, it is the belief of the researcher, the financial market should soon devise a mechanism of accessing credit without property collateral (against cash and/or personal guarantee) from formal banks if the goal of including individuals, households and small businesses in accessing credit service is to be met; after devising an adequate regulatory platform.

Another directive with this regard, is Interest rate directive that was issued to regulate interest rates. Regarding credit service, the directive allows commercial banks to freely determine interest rates¹⁴² that have the implication of promoting competition among banks by providing lower interest rates for desired customers. It, however, has an adverse effect on consumer protection as well as accessibility of credit service due to absence of limitation on the maximum

¹⁴⁰ Id., Art. 19 (1).

¹⁴¹ *Supra note* 12, P. 39.

¹⁴² *Supra note* 102, Art. 2.

interest rate banks may fix rather than just requiring banks' Board of Directors (BODs) to submit lending rates and the criteria they are based on. Here, the NBE should consider the fixing of maximum interest rate on credit services banks may set to promote accessibility and consumer protection.

Regarding consumer protection of credit service facility, credit exposures to single and related counterparts Directive No. SBB/53/2012 prohibits commercial banks from extending loans to related parties on preferential terms with respect to conditions, interest rates and terms and conditions normally applicable to borrowers.¹⁴³

3.2.2.3. MAINTAINING THE INTEGRITY AND STABILITY OF THE BANKING SYSTEM.

The NBE directives prevent unsustainable extension of credit provided by commercial banks by regulating these financial institutions. The directive no. SBB/53/2012 stated that maximum amount of credit that commercial banks can provide should not exceed 25% of their total capital for single borrower and 15% of their total capital for a related party.¹⁴⁴

The directive also stipulated the maximum outstanding loan relative to the total capital. It is indicated, 'The aggregate sum of loans extended or permitted to be outstanding directly or indirectly to all related parties at any one time shall not exceed 35% of the total capital of the commercial bank'.¹⁴⁵ In addition, the NBE has established a unit that provide credit history services to commercial banks on individual applicant so as to reduce ex post risks. The directive obliges banks to craft and work out Non-Performing Loan (NPL) reduction plan to bring about behavioral change in the banking system and result in stable and sound banking sector.

The legal reserve directive requiring every bank to transfer annually 5% of all birr and foreign currency deposit liabilities held in the form of demand deposits, saving deposits and time

¹⁴³ Licensing and Supervision of Banking Business, Credit Exposures to Single and Related Counterparts Directive No. SBB/53, National Bank of Ethiopia, (2012), Art. 6 (4).

¹⁴⁴ Id., Art. 6 (1) and (2).

¹⁴⁵ Id., Art. 6 (3).

deposits that has the purpose of ensuring prudential regulation that may result from credit risks.¹⁴⁶

With the objective of enhancing commercial banks and capacity to absorb unexpected or unusual losses, the NBE promulgated directive No. SBB/50/2011 that sets the minimum paid up capital for new and existing commercial banks. Since September 2011, new commercial banks shall raise birr 500 million as a minimum startup capital, which was 75 million birr in the form of paid up capital. Currently, it is reported that the NBE has planned to raise the minimum capital requirement to 2 Billion and instructed commercial banks to do so by the end of 2020¹⁴⁷ though there is no directive formally enacted to same effect. This would help the financial sector to withstand difficulties, preserve its solvency and enhance its lending capacity as it is argued that banks with strong capital are in a better position to withstand shocks and enhance the confidence of depositors or borrowers.¹⁴⁸

With regard to adopting the international banking supervision mechanism, the Basel Accord issued by the Basel Committee on Banking Supervision, the NBE is trying to implement it; though not in full. When it comes to adopting Basel I, the NBE is doing well. With regard to Basel II and III however, there is no full-fledged implementation so far. As per my discussion with Mr. Solomon Desta, the NBE is not using the Basel accord phase by phase by moving from Basel I to higher levels of Basel II and III. Here, Mr. Solomon Desta emphasized that the NBE, rather than implementing Basel II and III as a package, it simply takes instruments that fit in to the Ethiopian context which includes the adoption of ‘good governance directive’ that has disclosure requirement forcing all commercial banks to avail information for the market based on pillar 3 of Basel II that obliges banks to disclose their external audit.

¹⁴⁶ Licensing and Supervision of Banking Business, Reserve Requirement (6th replacement) Directive no. SBB/55, National Bank of Ethiopia, (2013), Arts. 2 & 3.

¹⁴⁷ <https://www.export.gov/apex/article2?id=Ethiopi-Banking-Systems#:text=Ethiopia%20Banking%20Systems%20-%20Systems&text=Under%20the%20and%20Transformation.to%20amount%20by%202020> (Last visited: December, 2019).

¹⁴⁸ Mohamad Hasin Shaari, Analyzing Bank Negara Malaysia’s Behavior in formulating monetary policy: An Empirical Approach, a thesis submitted for the degree of doctor of philosophy of the Australian National University, College of Business & Economics, Center for Applied Macroeconomic Analysis (CAMA), (December 2008).

It should be noted, however, that this sophisticated methods of supervision requires capacity in terms of human and financial aspects. This may not be found in full at the NBE. The non-existence of foreign banks in the country may have also reduced the incentive by NBE authorities to adopt Basel II and III in full.

3.3. BANKING BUSINESS REGULATING LAWS AND PRINCIPLES OF PRO-INCLUSIVE REGULATION

It has been established on the previous chapter, pro-inclusive regulation has three principles to follow i.e., similar regulation for similar function, regulation based on risk and balance between ex-ante and ex-post regulation.¹⁴⁹

Regarding similar regulation for similar function, the directives that are issued by the NBE are more of categorized by the business model of providing financial services as Banking Business, Micro-finance institutions and Insurance Business; each having their own set of regulations. The former two are involved with more or less similar services while the latter differs in the service it provides. Providing same types of services, account ownership and credit facility, the regulations for each is different which may be considered as not in alignment with the principle of similar regulation for similar function. Recently, however, there is development in adopting similar regulation for similar function regarding some functions including authorization of payment system operators, licensing and authorization of payment instrument issuers that regulate variety of financial service providers when engaged in similar services.

The 2nd principle of regulation based on risk that requires stringency of regulatory requirements to depend on the risk that activity poses to the individual participant (whether the consumer or the provider) and to the stability and integrity of the overall financial system.¹⁵⁰ With this regard, the NBE is issuing various directives on various services considering risk that may be demonstrated from the progressive approach (through amendments and replacements)¹⁵¹ it follows while regulating the financial system through continuous evaluation of risks posed by a service.

¹⁴⁹ *Supra note 14.*

¹⁵⁰ *Ibid.*

¹⁵¹ *Ibid.*

Regarding the 3rd principle of balance between ex ante and ex post regulation, through giving providers' clear rules of the game and enable competition for the market, but regulators should also have the authority to intervene ex post as the financial system evolves and regulatory or market development issues emerge.¹⁵² As per this principle, regulatory frameworks and regulations should advance the areas that are related with competition policy, leveling the playing field by ensuring that functionally similar services are treated equally as it allows more consistent consumer protection across service providers and know-your-customer (KYC) rules with customer due diligence requirements. Looking at the NBE practice, it introduces a service through adoption of directives providing its method of delivery and has the mandate of intervening in emergence of new risks due to various risks. The regulation environment is also considerate of promoting competition as it opens the space for competition among financial service providers in terms of affordability of services, accessibility of access points and innovation of product and service development by service providers. In addition, the know-your customer rule is highly adopted in various directives as a mechanism of ensuring customer due diligence. The consumer protection aspect, on the other hand, has recently exhibited a significant development as the NBE has issued a new comprehensive consumer protection directive¹⁵³, applicable across financial service providers, enacted with the sole purpose of consumer protection for better financial inclusion in addition to the consumer protectant provisions that were dispersed throughout various directives. The NBE's authority to engage ex post to address new risks that resulted from the evolvement of the financial sector or market development that is demonstrated from the various amendments and replacements of regulations. To claim that the NBE is keeping the balance between ex ante and ex post risks however, requires further research considering factors that demonstrate the existence of such a balance.

¹⁵² Ibid.

¹⁵³ Financial Consumer Protection Directive No. FCP/01, National Bank of Ethiopia, (2020).

CHAPTER FOUR

CONCLUSION AND RECOMMENDATIONS

4.1. CONCLUSION

Financial inclusion broadly refers to the degree of access of households and firms, especially poorer households and small and medium-sized enterprises (SMEs), to financial services having four commonly used lenses through which it can be defined i.e., access, quality, usage and welfare when listed in their order of complexity. It is the process of ensuring access to appropriate financial products and services needed by vulnerable groups such as weaker sections and low income groups at an affordable cost in a fair and transparent manner by mainstream institutional players. Greater financial inclusion can contribute to reducing income inequality by raising the incomes of the poorest income quintile especially through access to credit facilities. It may also contribute to financial stability by increasing the diversity of, and thereby decreasing the risk of, bank assets and by increasing the stable funding base of bank deposits. Greater financial access can also support shifts by governments toward cash transfer programs rather than wasteful subsidies, and the greater transparency associated with electronic funds transfers can help reduce corruption.

Due to the various benefits financial inclusion brings about to overall development of a nation, Ethiopia; like most developing nations, has adopted a National Financial Inclusion Strategy with the goal of achieving universal access to and use range of affordable and high quality financial products and services by 2025 through promoting access and use of a range of suitable (quality and affordable) financial products and services provided by regulated financial institutions by all individuals and enterprises, through innovative and convenient channels, to promote savings mobilization, job creation, economic growth, poverty reduction and financial integrity there by financial stability.

For the improvement of financial inclusion, however, financial regulation plays a vital role that may require reforming/ changing existing regulations in a way that fosters financial inclusion. Understanding the necessity of financial regulation for financial inclusion, the Ethiopian National Financial Inclusion Strategy establishes the necessity for the reform/ amendment of the

existing financial laws and regulations as a roadmap or strategy for its successful execution of its goals.

In order to improve financial inclusion, changes in financial regulation may be required for two main reasons i.e., to enable the successful adoption and adaptation of innovation in digital finance and encourage their use and competition among their providers so that those new technologies benefit especially the poor on the one hand and to make sure that progress in improving financial inclusion is compatible with the traditional mandates of financial regulation i.e., safeguarding the stability of the financial system, maintaining its integrity and protecting consumers.

Accordingly, financial regulation of basic banking services of account ownership and payment systems should be considerate of the proportionality of regulation while dealing with issues of innovation, anti-money laundering and counter financing of terrorism and consumer protection to promote financial inclusion. Regulation of credit facility, in addition to the above requirement of proportionality in innovation and consumer protection, should be considerate of preventing the expansion of credit without appropriate regulatory and prudential tools preventing banks from financial crisis that may be conducted by adopting the Basel Regulatory Framework.

Regarding the suitability of the directives of NBE for the achievement of the financial inclusion strategy, directives relating to account ownership are the first assessed. Looking at the third amendment of branch opening directive no. SBB/66/2018, it is more focused on protecting the integrity and stability of the banking sector rather than inclusiveness through accessibility of branches as it does not provide duty on banks as to the urban-rural proportion regarding location of branches they open, inclusivity in terms of accessibility of branches by persons with disability and inclusiveness in terms of providing responsibility for financial awareness creation regarding the benefits of using formal banking sector to avoid insufficient fund attitude of the society and create societal trust on the financial sector. Cash withdrawal limit directive no. FIS/03/2020 though it has the role of promoting use of non-cash payment instruments and ensuring safety and efficiency of the payment system, it also discourage individuals from using formal banking by limiting access to their money when it is combined with the general mistrust and insufficient funds attitude of the public having negative implication on financial inclusion. The interest rate directive, on the other hand, is more focused on competition and consumer protection than

protecting the stability of the banking sector as it sets minimum interest rates on saving and time deposits by leaving the power of determining the maximum interest rate to be freely determined by each bank. The directive to license and authorize interest free banking business has a significant contribution towards better financial inclusion through the introduction of full-fledged interest free banks even if there is high risk involved relating to financial stability especially in interest free credit facility system as the directive fails to provide tailored regulation of such services considering their unique feature other than the regulations that are applicable to conventional banks.

Regarding payment system related directives, the NBE issued licensing and authorization of payment instrument issuers directive No. ONPS/01/2020 that allows the licensing of non-financial institutions to engage in providing financial services which increases the accessibility and affordability of financial services as it widens the parameters for payment service providers to operate. It, however, does not open up the space for the payment service providers to come up with innovative payment services that would have improved quality and range of payment instruments which was supposed to be the main reason for its issuance. It also limits foreigners from engaging in financial instrument issuing business that would have led to the adoption of quality and universal payment instruments; if not prohibited. The NBE also issued a directive for licensing and authorization of payment system operators, that is the first of its kind, as a result of its move towards full financial inclusion. Towards maintaining the integrity of the financial sector, the directive provides for prohibition of foreigners from engaging in payment system operation save for outsourced activities by licensed operators. It also prohibits payment system operators from engaging in any other business including payment instrument issuing, except for the formal financial institutions, without obtaining the necessary license to protect consumers and the integrity of the market. With this regard however, since the directive allowed foreigners to engage in outsourced activities by licensed operators, it may as well allow foreigners to engage in operating business even without outsourcing as it contributes to obtaining quality services as result of their better exposure and technological advancement boosting competition in accessibility and affordability of payment system usage. It would also have been a step forward towards the gradual opening of the financial market to foreign competitors.

Coming to directives of NBE regulating credit facility in promoting competition and consumer protection, the NBE has adopted Directive no. MCR/01/2020 in order to implement proclamation No. 1147/2019 allow using movable properties as a collateral for credit service by establishing a collateral registry. Though the directive brought about a significant change towards including individuals from the agricultural sector who were previously marginalized from accessing credit services, there is still an impediment in the implementation since some movables in the agricultural sector like livestock are difficult for registration. The directive also states that motor vehicle trailer, agricultural machinery, industrial machinery to be considered as a serial numbered collateral in addition to vehicles while listing movable collaterals that may be used. This however, may be considered the directive not addressing the targeted poor since the types of collaterals have expensive market value. Another directive on credit service, Interest rate directive, allows commercial banks to freely determine interest rates that promotes competition among banks on the one hand and has an adverse effect on consumer protection as well as accessibility of credit service due to absence of limitation on the maximum interest rate by banks. Regarding maintaining the integrity and stability of the banking sector there are various directives including directive no. SBB/53/2012 providing the maximum amount of credit by commercial banks, the legal reserve directive that requires every bank to transfer annually 5% of their total deposits, Directive No. SBB/50/2011 that sets the minimum paid up capital for new and existing commercial banks to be 500 Million, though it has been informally increased to be 2 billion in order to make banks to be capable of absorbing unexpected shocks. However, the NBE slacks to adopt the international banking supervision mechanism of the Basel committee that is accepted throughout nations.

In addition, the pro-inclusiveness of the NBE directives was also assessed. With this regard, there is variation in adopting principle of similar regulation for similar function as there are different regulations for same function regarding some financial services among different providers especially in account ownership and credit facility; though there is a recent improvement of regulating variety of financial service providers in a similar manner when engaged in similar services in payment system regulation. Regarding the principle of regulation based on risk that requires stringency of regulatory requirements to depend on the risk that activity poses to the individual participant, it can be observed that the NBE follows this principle that may be demonstrated from the progressive adoption of regulation based on the posed risks

and subsequent amendments and replacements through continuous evaluation of risks posed by a service. Regarding the principle of balance between ex ante and ex post regulation, the NBE introduces a service through adoption of directives providing its method of delivery and has the mandate of intervening in emergence of new risks due to various risks though determining the existence of balance is difficult without further research. Looking at all the aforementioned moves of the NBE, it may be stated that the banking regulation by NBE, though not fully, leans towards adopting principles of pro-inclusive regulation.

To sum up, looking at the various legal reforms of the NBE and the level of adopting the principles of pro-inclusive regulation, the researcher has concluded that the banking business regulating laws relating account ownership, payment system and credit facility are somehow suitable towards the successfulness of the goals of the financial inclusion strategy; though the NBE is required to further consider reforming and amending such regulations towards improving their suitability for the achievement of the financial inclusion strategy.

4.2. RECOMMENDATIONS

Based on the findings of this paper, the author has lined out the following recommendations.

- The NBE should amend the branch opening directive in a way that promotes accessibility by the rural population through providing urban-rural proportion of branches while choosing location of new branches they open, inclusivity in terms of accessibility of branches by persons with disability and inclusiveness in terms of providing responsibility on banks that ties branch opening with financial awareness creation and improvement.
- The NBE should consider amending the cash withdrawal limit directive based on an inclusive research of its impact on the attitude of the society and the possible negative effect on usage of regulated services.
- The NBE should consider fixing a maximum interest rate that banks are prohibited to surpass on deposits through providing a wide range between the minimum and maximum interest rates to balance between high competition and maintaining integrity and stability of the banking sector while considering to fix maximum interest rate on credit services to promote accessibility and consumer protection.
- The NBE should issue a directive on the operation of interest free banks while providing credit facility as it is associated with higher risk of disrupting the stability of the financial market due to its high demand compared to credit facility by conventional banks if not provided with proper regulation and supervision.
- The NBE, as the financial regulator and supervisor, should consider adopting proper regulation as to the confirmation of Interest free banks with the principles of shariah and the consequences thereof at times of deviation together with procedures of supervising their operation.
- The NBE, should consider pushing towards opening up the space for foreign payment service providers that would cause improvement with innovativeness and competition of payment services for better usage of financial services.
- The NBE should also consider pushing towards opening the operation market to foreigners as it will have a positive implication not only for better competition and innovativeness, but also to Ethiopia's move towards opening up the financial market to the foreign service providers.

- The NBE should consider devising a swift mechanism of assigning serial numbers on movable properties like livestock to avoid the impediment of implementing the proclamation that adopted movable property as collateral for loan and the directive's requirement of allotting 5% of banks' annual loan to the agricultural sector.
- The NBE should consider adopting the international banking supervision mechanism by the Basel committee by improving its capacity in terms of human and financial aspects making it a fit financial regulator capable of handling sophisticated financial system as the opening of the financial sector for foreign service providers is inevitable in the near future.

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