Financial Inclusion in a Middle-Income Country: The Case of Chile

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Financial inclusion is an evolving concept. Not so long ago, the objective was simply to provide access to basic instruments such as savings accounts and/or individual installment credit but, today, it is considered to involve a full range of instruments, including transactional accounts, savings accounts, debit and credit cards, investment instruments and insurance products. The access of individuals and businesses to useful financial products and services has, moreover, acquired importance in the world as an effective means of improving people's quality of life whilst also supporting economic growth and development. Accessible and widely used products, such as transactional accounts and payment instruments, satisfy basic financial needs and facilitate day-to-day life while more complex products, such as investment instruments, insurance and credit, help households and businesses to plan for their needs and protect themselves against unexpected risks or emergencies, contributing to the achievement of their medium and long-term goals.

The significant advances seen in the recent years in access to different financial products and in their use have transformed them into basic services for individuals and households. The evidence shows that vulnerable and disadvantaged groups take risk, safety and security into account in their financial practices just like sophisticated investors. Strategies for addressing consumers' needs should, therefore, aim to achieve continuous progress towards the provision of access to a complete range of products, including new savings, credit and insurance options, as key elements in the overall package of financial services. The implementation of these strategies should, moreover, consider that consumers' needs tend to change over time and are likely to be greater than suggested by a specific service's level of use of at any given point in time.

Financial inclusion: much more than a poverty-alleviation strategy

As well as being an effective way of improving the quality of life of people, especially those excluded from the formal financial system, the expansion of access to financial products and services has broader positive implications. Some of these refer to the economic and financial system itself since financial inclusion makes the payment system more efficient, increases productivity among MSMEs and makes a positive contribution to financial stability.

Financial inclusion is crucial for MSMEs. In their case, adequate access to financing on appropriate conditions can translate into productivity gains, higher sales and job creation. Some financial institutions provide training, advisory services and support networks that help MSMEs to narrow gaps in management standards and contacts as compared to larger or more formal enterprises. Access to credit also contributes to the formalization of MSMEs.

Moreover, financial inclusion has important implications for financial stability. Greater financial inclusion should increase the effectiveness of interest rates as a policy tool and may facilitate central banks' efforts to maintain price stability. Financial stability may also be affected by the resulting change in the composition of savers and borrowers and, therefore the composition of banks' funding and liquidity risks. One of the lessons of recent financial crises is that banks should rely more on small depositors than on large or very large ones.

Institutional ways to catalyze financial inclusion

Financial inclusion is now on the public agenda in most countries, although their priorities vary. In advanced economies, efforts often focus on providing access for certain segments, usually the extremely poor or specific groups such as immigrants. In emerging economies, on the other hand, a significant percentage of the population is still excluded so efforts to implement successful financial inclusion strategies should consider both the public and private sectors. Banking and non-banking institutions already play a role in intermediate phases of economic development but, as the financial sector develops, banks will become increasingly important.

The public agenda and national strategies of most emerging countries have accelerated progress towards financial inclusion. In many cases, these strategies include the participation of regulators and the public sector as well as the private sector. Regulators and the public sector are likely to have responsibility for a broader range of financial inclusion topics and to have more resources and staff dedicated to these matters whereas the private sector's contribution is more likely to consist in taking advantage of specific opportunities to expand inclusion. This is the case, for example, of reforms to permit the adoption of new technologies or financial infrastructure which, by underpinning the introduction of low-cost services and lower-risk products, play a crucial role in expanding financial inclusion.

Regardless of how programs of access and usage of financial products are implemented, countries with a financial inclusion strategy or countries with a state or development bank need to have solid foundations and an adequate institutional framework. The role of the regulator is not only to ensure the financial system's security and stability. It also includes the prevention of bad commercial practices and the promotion of healthy competition and an efficient and effective financial system. In addition, regulation should be simple, flexible and proportional to risk-taking since over-regulation can result in serious limitations on financial inclusion. There is growing recognition that most barriers of access to financial services can be overcome by a well-designed regulatory framework and eventual misuse. The fact that many regulatory authorities are not familiar with new delivery technologies can, for example, result in an ill-tailored regulatory framework that does not cover the material risks arising from these new technologies. Similarly, prudential norms may need to be adjusted in line with the risk profile and systemic importance of banks or micro-finance institutions.

Role of financial education and responsible financial inclusion

Financial inclusion should go hand-in-hand with financial education since increased access to financial services is not synonymous with improved financial health. People may make poor financial decisions that lead to over-borrowing or under-saving. Credit, although a very good instrument, can cause damage if poorly applied. For clients, financial education is, therefore, a fundamental complement to access. Financial literacy is not a matter of the mere provision of information about products and services and their cost. It needs to go much further than that. The implementation of financial literacy programs should promote behaviors that avoid over-indebtedness, foster awareness of the importance of savings versus current consumption and boost confidence in new products and financial services. It is necessary to approach financial education with a strategy that is implemented across the board, by schools and universities as well as financial and regulatory institutions. Around the world, there are numerous examples of financial education programs for different age groups and levels of education that offer important lessons about their implementation and effectiveness. Recent research shows that many of these programs will fail if they are based on theoretical assumptions such as the idea that poor financial choices stem from a lack of knowledge or that better decisions will lead to better financial health. Programs also need to be easy to implement, tailored to individuals' needs and situations, timed to coincide with decisions and, for the participants, readily accessible and entertaining. They are also most effective when targeting those eager to learn, such as young people and those in early adulthood.

For banks and other intermediaries, it is crucial to ensure good business practices and transparency and, above all, to avoid excessive risk-taking. In the field of financial education policies, it is necessary to consider consumer protection in conjunction with the regulation of financial institutions and markets. Financial consumer protection can contribute to improved efficiency, transparency, competition and access to financial markets by reducing asymmetries of information and power between the providers and users of financial services. Also seeks to maintain an increase confidence in formal financial institutions. However, this implies the existence of a culture of responsibility promoted by financial and regulatory institutions. Where new consumers are not well protected or unable to take informed decisions about new financial services or where new products or institutions are not well monitored, the positive impacts of financial inclusion can be limited or even totally offset. This was clearly illustrated by the sub-prime housing loan crisis in the US and the micro-credit repayment crises seen in India and Morocco as well as, in Chile, by the case of a specific financial retail company which unilaterally renegotiated terms for more than 400,000 customers with years-old outstanding debts.

Financial inclusion and technological change

Technology is an important ally of financial inclusion. It has revolutionized electronic payment systems around the world. Mobile devices, in particular, have become an efficient channel in transactional systems. Technology has also reduced banks' transactional and operational costs, allowing them to pass these lower costs on to clients. Moreover, it facilitates the collection, storage and analysis of the data, which are the bedrock of measurement systems. This enables financial institutions to better understand and more accurately assess customers' needs and financial profile and, therefore, offer products and services more closely tailored to their demands. Similarly, technology provides more information for credit-scoring models, facilitating the incorporation of new segments of the population into the formal financial system through the development of relevant information about historically excluded groups such as women, immigrants, the rural population and young people.

Technology also makes it easier to monitor and measure the effectiveness and impact of financial inclusion programs. Indicators can be used to track the outcomes of key actions and their impact on target populations. This particularly important for those institutions subject to accountability for the effectiveness and efficiency of their use of capital and resources. These performance/outcome indicators are, moreover, a powerful tool for communicating with the public, policymakers, academics and private sector stakeholders.

Lessons learnt

Despite all the advances that have been achieved, financial inclusion remains a challenge worldwide. If the policy objective is to continuously increase access to financial products, one of the main lessons learned is that it is crucial to identify the principal barriers to their use from the very beginning. Only in this way can they be properly managed.

Ongoing progress in financial inclusion requires a sound and secure financial system with responsible and informed consumers. A weak financial system hampers the pursuit of financial inclusion. Success stories demonstrate the importance of a regulatory infrastructure that includes the design of products suited to users' needs, the regulation of non-formal financial providers, a flexible regulatory framework that permits the entry of new technologies and the implementation of financial education programs to promote responsible indebtedness and products' effective use. Wider access to credit may increase financial risks if it results from rapid credit growth, household over-indebtedness or the expansion of relatively unregulated parts of the financial system.

The Chilean experience

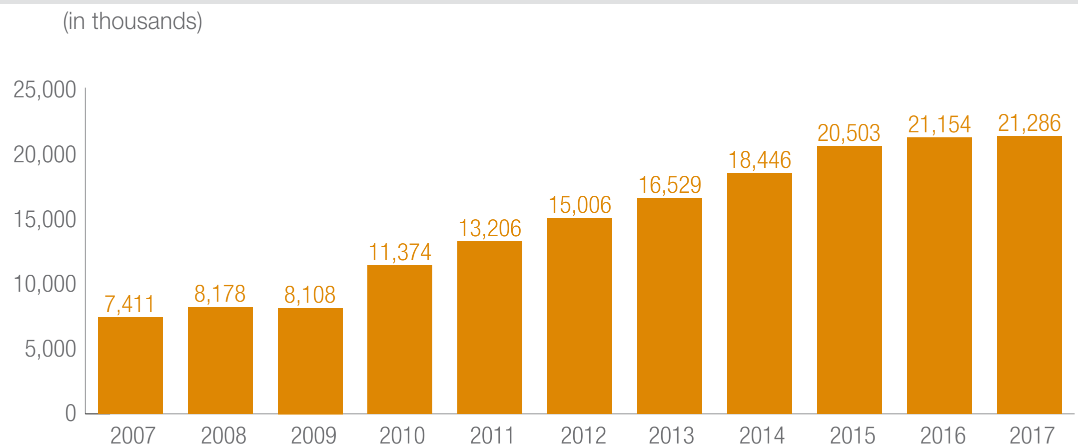
Chile is a middle income economy located in the Southern Cone Latin America. For many years, Chile showed only partial progress on financial inclusion. The only instruments with a mass reach were savings accounts and store credit cards. However, during the last ten years, remarkable progress has been achieved and is reflected in the strong growth of transactional or payment accounts and the debit cards associated with them. According to the market regulator, the Superintendency of Banks and Financial Institutions (SBIF), the number of debit cards increased from 7.4 million in December 2007 to 21.3 million in July 2017 or, in other words, by 187% (Figure 2). This puts Chile on a par with the average for the Organisation for Economic Co-operation and Development (OECD) (Figure 3).

Figure 1. Chilean economy at a glance

GDP	(2017)	current US$ 264.8bn
GDP per cápita	(2016)	current US$ 13,6m
GDP annual growth	(2017)	2,2%
Population	(2017)	18,5 million
Inflation	(Oct. 2017)	1,9%
Unemployment rate	(Oct. 2017)	6,7%

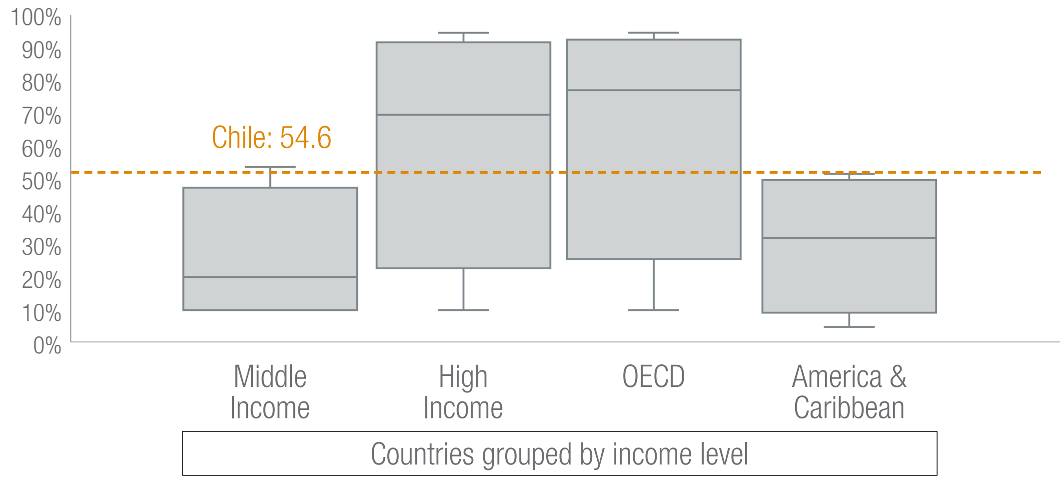
Source: Central Bank of Chile, National Institute of Statistics (Chile).

Figure 2. Evolution of debit cards in Chile



Source: Chilean Superintendency of Banks and Financial Institutions (SBIF)

Figure 3. Percentage of over-15s with at least one debit card from a formal financial institution



Source: SBIF based on World Bank data

Factors behind this rapid progress

This progress has been underpinned by the soundness of Chile's financial system. In the last 25 years, despite episodes that have affected individual institutions, there has been no systemic crisis. In line with this, the system has enjoyed the confidence of the public.

A second important factor is the role played by BancoEstado. Without belittling the contribution made by private banks, it has provided remarkable leadership, not only in terms of financial inclusion but also through its decision to innovate and push ahead with the implementation of an efficient network of 21,000 bank correspondences throughout Chile as well as 400 full branch offices (the only bank of the system in 120 counties), 107 small-type branch offices and 2,400 ATMs.

BancoEstado is a state bank but competes with other banks under the same rules. With its long history in the market and its hallmark tradition of providing mass services, it was well equipped to lead a process of this nature. In the past, its services consisted principally in savings accounts but it has always focused on serving the greater part of the country's population.

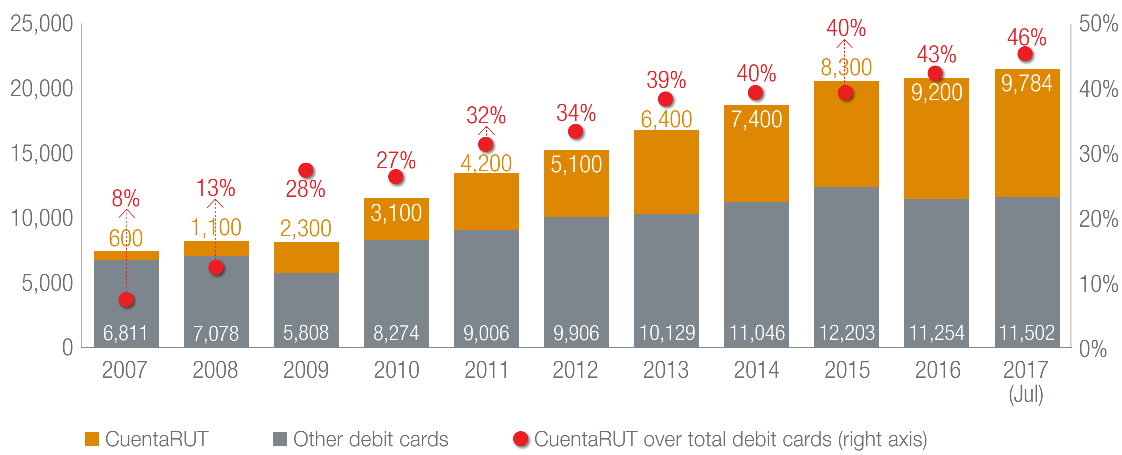
It has offered a CuentaRUT account to everyone with a taxpayer number (RUT), which is also used as the number of the account, hence its name. These accounts, which are similar to a basic transactional account, are being used as a tool to promote financial inclusion, often serving as an easy gateway to other financial services and facilitating transfers to and from the government or other banks as well as retail payments or transactions at ATMs and with PSPs. Currently, some 10 million Chileans have a CuentaRUT, up from 6 million with an active CuentaRUT at the end of 2013. As of end-2016, 46% of total debit cards in Chile corresponded to a CuentaRUT (Figure 4).

Universal access to transactional accounts has been accompanied by infrastructure that favors their use, an area in which BancoEstado has made a significant contribution in terms of national coverage. In this, a key role has been played by its CajaVecina network, the country's largest network of retailers acting as correspondents. It currently comprises over 20,000 points of attention (Figure 5) and provides transactional services that include money transfers, deposits, the transfer of funds between accounts and payments of various kinds. This model, which requires only a POS at the point of attention, has proved very successful, due in part to its low costs. At the same time, it provides a boost to the activity of affiliated retailers and represents important progress for a product that seeks to measure its effectiveness. In addition CajaVecina retailers are part of BancoEstado's more than 600,000 SMEs clients.

In a bid to extend the system's reach, BancoEstado launched a new network, Compraquí, in October 2017. It seeks to help thousands of merchants to grow their business by enabling them to accept payment via credit and debit cards in a cost-efficient way whilst also contributing to reduce informality by increasing these merchants' banking penetration rate. Compraquí's goal is to provide its service to 150,000 merchants within the next 5 years.

Figure 4. Evolution of CuentaRUT accounts over total debit cards

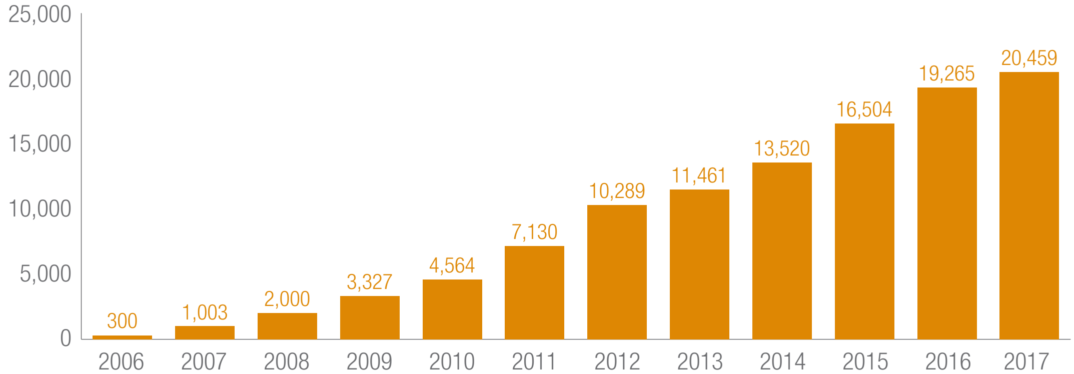
(in thousands, percentage)



Sources: Chilean Superintendency of Banks and Financial Institutions (SBIF) and BancoEstado

Figure 5. Evolution of CajaVecina points of service

(number of locations)



Source: BancoEstado

However, it does not follow from Chile's experience that the presence of a state bank is a necessary condition for progress in financial inclusion. BancoEstado has played a key role but the process could equally have been led by the private sector in cooperation with the government.

A number of other factors can also be identified as having contributed to Chile's progress, including principally:

- **Multiple channels.** Financial inclusion is facilitated by the provision of services through multiple channels, including some that are digital, such as internet and mobile telephony, and others that are more traditional, such as branches, ATMs and correspondent networks. These are mutually reinforcing and can respond adequately to the needs of different segments of the population, with differing levels of progress in terms of access to services and the effective use of financial instruments.

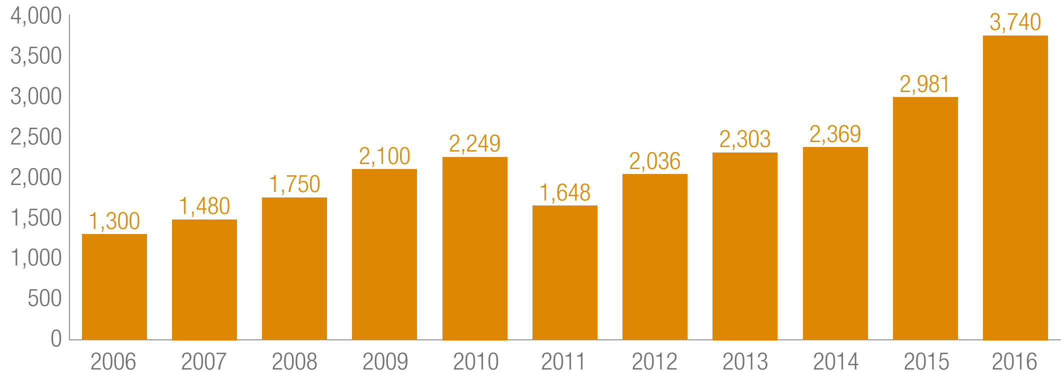
- **Proportionate regulation.** This is an effective way to reduce access barriers in the form of requirements for the opening of transactional accounts, with careful prioritization of key risks. In Chile, more flexible requirements for non-checking accounts were introduced while those for current accounts were left unchanged.

- **Adjustment of fees on the simplest accounts to customers' needs.** The fixed charges, independent of movements, traditionally associated with current accounts were not well suited to the new transactional accounts and were replaced by a charge based on movements. Charges are always a matter of concern to customers and it is important that their rationale is explained and that they are applied with great transparency.

- **Promotion of use of transactional accounts through online payment of state subsidies and benefits.** In 2016, more than 3 million people received benefits in their CuentaRUT and the private sector encourages employees to have an account for the direct and automatic payment of their wages (Figure 6).

Figure 6. Social benefits and pensions paid by BancoEstado

(thousands of recipients)



Source: BancoEstado

- **ID systems.** It was thanks to Chile's ID system that BancoEstado was able to offer a CuentaRUT to every citizen born in the country and immigrants with a taxpayer number.

Chile’s Challenges

Despite the progress achieved in recent years, Chile still, however, faces important challenges and pending tasks as regards financial inclusion.

Digital transformation

By lowering the cost of supplying products, digital financial inclusion makes it easier to address the needs of lower income-segments whilst also ensuring that the new business models are profitable for the financial institutions adopting them. Demand for financial products and services using smartphones is also growing among young people and in emerging sectors of the population. However, if effective financial inclusion across all the population is to be achieved, the rapid advance of technology must be matched by ongoing progress in the digital transformation of processes and, for example, the use of data analysis as a tool through which to gain a better understanding of customers’ needs.

Financial education

Financial education should seek to promote financially responsible behavior across all segments of the population and, since this is a task that begins at school and continues through university, it should be addressed jointly by both the educational and financial authorities. The most vulnerable population - women, the rural population and those living in remote parts of the country and different minority groups, who have historically been excluded from the formal financial sector - generally have greater difficulty in understanding innovative products and services and their rights and responsibilities.

Remittances for immigrants through banking institutions

An estimated 490,000 immigrants live in Chile and tend to use service providers that are not banks, making a supervisory and regulatory approach more difficult. These unregulated service providers may also pose risks related to the identification and monitoring of money laundering and the financing of terrorism. Remittances are, however, a type of recurrent payment that can favor financial inclusion since the senders seldom have a transactional account to help them manage their daily financial affairs, despite having a reasonably constant inflow of cash.

Implementation of Basel III and financial inclusion

The global capital and liquidity standards set by Basel II and III have significantly increased the required amount and quality of both the capital and liquid assets held by banks, reducing the incentives for them to provide riskier loans, particularly to retail SMEs and low-income households. In order to counterbalance the potential negative impact on financial inclusion, these exposures have been granted preferential risk weights (75% for retail SMEs and 35% for residential mortgages) and the guarantees on them provided by the state or government agencies are fully recognized as risk mitigators. European regulators have, moreover, set the supporting factor - the ratio between the Basel II requirement (8%) and the final Basel III requirement (10.5%) - to reduce the relative cost of capital for SME exposures. In my view, Chilean regulators should implement these international standards and replicate this preferential treatment of SME and retail exposures so as to continue to promote financial inclusion, ensure a level playing field for the country’s financial institutions and support economic and job growth.

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