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POLICIES FOR SHARED PROSPERITY IN MYANMAR

FINANCING THE FUTURE

Building an open, modern and inclusive financial system

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Policies for shared prosperity in Myanmar

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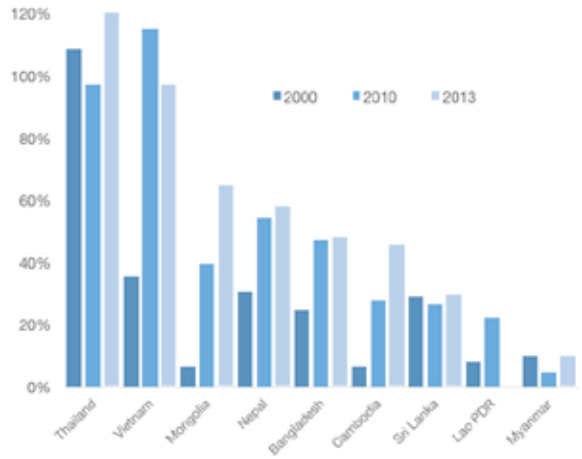
FINANCING THE FUTURE:
Building an open, modern and inclusive financial system

Myanmar's financial system is undergoing a rapid transformation. A history of economic isolation has left Myanmar with small and underdeveloped financial institutions and very low access to financial services. Since 2011, however, demands on the financial system have grown exponentially with increased trade and investment, growing household income, and expanding government operations. While recent reforms have stimulated financial sector growth, much more needs to be done to establish a competitive and vibrant financial sector that can meet the needs of Myanmar's expanding economy, boost incomes, and reduce poverty particularly among those living in rural areas. Increasing access to financial services is critical to achieving shared prosperity in Myanmar.

CONTEXT AND OPPORTUNITIES FOR CHANGE

The financial system in Myanmar has significant potential to grow and become a much larger part of the economy. The ratio of private sector credit to GDP for Myanmar in 2013 was very low at only 9 percent in 2013 (figure 1). The formal financial system consists of 23 small-scale banks and four state-owned banks. There are 48 foreign bank representative offices, and nine foreign bank branches were issued limited licenses in 2015. State-banks dominate with 50 percent of banking sector assets and accounting for the majority of bank branches. There is one state-owned insurance company in Myanmar and 12 private insurance companies were licensed in 2013. In addition, despite 251 new licenses issued to micro-finance institutions (MFI) since 2013, the industry remains small and fragile.

Figure 1: Credit to the economy (% of GDP)



Source: WDI, private sector credit/GDP

Access to basic financial services in Myanmar is extremely low. In 2014 only 23 percent of adults in Myanmar (29 percent of men and 17 percent of women) had access to an account in a financial institution (compared to 31 percent in Vietnam, 78 percent in Thailand, and 81 percent in Malaysia).[1] Other indicators of financial inclusion also point to low levels of access compared to regional economies (table 1).

The lack of access to finance is the most frequently identified obstacle to doing business in Myanmar, larger than access to land, electricity, and a skilled workforce.[2] In Myanmar increasing access to the range of financial services can allow firms to expand their businesses and individuals to borrow, save and make payments more efficiently and at lower costs. Expanding access has been shown in countries around the world to be a key building block to improving livelihoods.

As the financial sector grows in Myanmar, banks and financial institutions have the opportunity to expand and offer a greater range of products and services. The banking sector offers mostly savings and deposit accounts, and short-term loans. Electronic payment products and services (debit cards, internet banking, mobile banking and electronic transfers); and consumer credit (e.g. credit cards, automobile loans, salary advances, personal loans, and mortgages) are largely non-existent. Trade finance, leasing, export credit, life insurance, agriculture insurance, and other such products are also not yet available.

A good example to illustrate the huge potential of financial inclusion for poverty reduction is domestic remittance flows. A recent World Bank study showed that 69 percent and 55 percent of migrants from Ayeyarwady and Magway remit funds back to their families, who use the money overwhelmingly for food and basic consumption. Remittances enable such families to smooth income in the face of volatile agricultural incomes. Domestic migrants in Myanmar overwhelmingly send money home through relatives or friends, or when they return to their villages themselves, which carries personal risk, and which limits the ability of migrants to send money at regular intervals. Financial inclusion can therefore help to ensure that rural households with migrants can receive more regular, safer remittances.

Table 1: Selected financial inclusion indicators, 2014

	MYANMAR	CHINA	LAO PDR	THAILAND
Domestic bank deposits/GDP (%)	25.6	137.3	49.0	82.2
Bank branches per 100,000 adults	3.14	8.06	2.7	12.7
Bank accounts per 1,000 adults	163	45	390	1,523

Source: IMF FAS 2014 (Lao is 2013, and Central Bank annual report for deposit data)

1 Global FINDEX, 2014, WBG
2 WBG, "Myanmar Investment Climate Assessment: Sustaining Reforms in a Time of Transition" (2015)

Reforming state-owned banks (SOBs) could promote competition, expand financial inclusion, and the development of the financial sector. The four main SOBs jointly account for more than 50 percent of total bank assets and half of all bank branches.[3] They provide subsidized credit to specific sectors and their corporate governance arrangements make them vulnerable to political interference. As a result, SOBs often crowd out private sector financial institutions from niche markets such as agriculture finance.

A modern legal and regulatory framework is needed to create the enabling environment for financial access. Myanmar's existing financial sector legal framework was designed for a closed economy, not for a market-based economy. As a result, the financial system remains restricted for foreign-owned institutions, which are only allowed to do a limited range of operations with foreign corporate clients and imposes severe restrictions for domestic banks. Interest rates for both deposits and loans are heavily regulated by the Central Bank of Myanmar (CBM), preventing proper pricing of financial products and undermining the risk management and profitability of financial institutions.

3 IMF, "Myanmar Article IV Report, Selected Issues," September 2015..

There are heavy legal restrictions on loan maturities, preventing bank financing of long-term investment. In addition, there is no legal and regulatory basis for lenders to take movable assets as security. Banks rely on collateral (such as land and buildings, and occasionally gold and jewelry) to grant loans, given the lack of a good secured transactions system that enables lenders to use movable assets as the basis for lending at low cost. Without reform of the legal framework, the sector will not be able to flourish.

Modernizing the payments system is needed to reduce dependence on cash transactions. The absence of an electronic system has high costs in terms of efficiency of the financial sector—creating risks and resulting in a large dependence on cash, manual, and paper-based processing of payments. While some important payment systems reforms are underway (such as the development of the CBM-Net with the help of the Japan International Cooperation Agency), further enhancements are urgently needed to allow banks to process large volumes of financial transactions on a rapid, cost-effective, and secure basis.

As part of the overall payment systems reform, the regulatory framework for mobile financial services also needs to be established to help take advantage of the unique potential to scale up financial services to the underserved and those living in rural areas. Mobile financial services can make it possible to move away from cash to digital payments, even when brick-and-mortar banks are too far away or are not serving poor people.

Strong financial sector regulation and supervision capacity can help to reduce financial sector risk. The capability of financial sector supervisors to identify, monitor, and control risks in regulated institutions is limited. The enforcement of existing laws and prudential regulations is uneven. Moreover, accounting and auditing standards are not aligned with international standards, making it difficult to assess the true health of the financial sector and take corrective measures to avoid systemic problems.

expand financial inclusion

Financial liberalization reforms in the past four years have helped to gradually expand access to financial services. Deposit rates have been made more flexible within a fixed band. The capital-to-deposit restriction was removed which improved incentives to compete for deposits. Four new domestic banks were licensed and the additional capital requirements for branch expansion were removed. Banking sector deposits between 2012 and 2014 grew on average by 50 percent a year.

Automatic Teller Machines have been allowed to operate since early 2012. To facilitate foreign trade, a formal foreign exchange market is operating and an inter-bank payment network has been put in place. With the end of economic sanctions, local banks are able to access SWIFT for international bank transfers and they can establish relations with correspondent banks abroad.

To expedite technology transfer and investment, nine new international banking licenses were issued in 2015 to foreign banks. These foreign banks will focus on wholesale lending to foreign firms and are not allowed to intermediate retail deposits. A number of MFIs have entered the market, which should help modernize the microfinance sector as they operate using a sustainable business model with new products, risk management policies and procedures, and modern core banking systems.

In addition, major reforms have been implemented to strengthen regulation and supervision and build confidence in the financial system. A new CBM Act was passed by Parliament in July 2013, which established an independent central bank. The Act mandates the CBM to: (i) promote monetary stability, (ii) enhance financial system stability; (iii) develop efficient payments and settlement system; (iv) support the general economic policy of the Government; and (e) promote a sustained economic development.

In addition, the Anti Money Laundering and Counterterrorism Law was enacted in 2014, although substantial deficiencies remain in the AML/CFT regime. Going forward, it will be important for Myanmar to strenghten the AML/CFT regime as recommended by the Financial Action Task Force (FATF), the global standard setting body for anti-money laundering and combating the financing of terrorism. In the June 2015 statement, FATF has encouraged Myanmar to continue to work on implementing its action plan to address these deficiencies, including by: (i) adequately criminalizing terrorist financing; (ii) establishing and implementing adequate procedures to identify and freeze terrorist assets; (iii) ensuring an operationally independent and effectively functioning financial intelligence unit; and (iv) strenghtening customer due diligence measures.[4]

To improve regulation of the non-bank financial sector, the Financial Regulatory Department (FRD) of MOF was established in 2014 with the responsibility for oversight of microfinance institutions, private insurance, state lotteries, and state owned banks. In 2011, Myanmar Microfinance Supervisory Enterprise (MMSE) was formed to supervise MFIs. The Microfinance Law also was passed in November 2011 allowing for local and foreign investors to establish fully privately owned microfinance institutions, laying the groundwork for sustainable growth of the industry.

4 FATF - GAFI Public Statement, June 2015

Thailand

The recovery of Thailand's financial system from the 1997 Asian Financial Crisis offers lessons that may be relevant for Myanmar in how to address large scale financial sector challenges. The Thai financial system incurred massive costs in terms of a drop in asset quality (43 percent Non-Performing Loan ratio) and profitability, which prompted a comprehensive, emergency restructuring plan. Whilst Myanmar's financial system is not in a crisis, elements of the restructuring in terms of special audits of weak banks, followed by recapitalization, debt restructuring and corporate governance reforms provide useful experience for restructuring Myanmar's SOBs.

After containing the immediate crisis, the Thai authorities aggressively pursued financial regulation and supervision reforms. Key elements of the reforms centered on risk-based supervision under Basel II (an accord on banking regulations), consolidated supervision and the phased implementation of IAS 39 (a more rigorous method of measuring financial transactions). These reform efforts were coordinated under the broad agenda of the Financial Sector Master Plan Phase I (2004–08) which aimed to improve the financial system's efficiency, broaden access to finance, and improve consumer protection. Underpinning this Plan was a strong dialogue between the Bank of Thailand and industry associations.

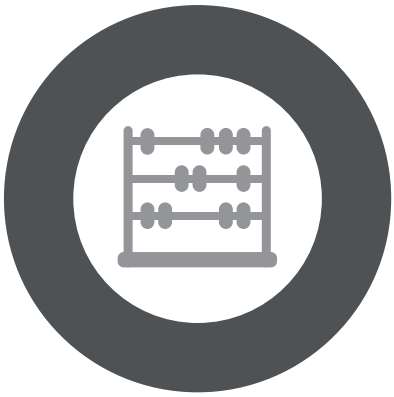
By mid-2007, when the global financial crisis erupted, many weaknesses in Thailand's regulatory and supervisory framework had been reduced. Consolidation in the financial system brought the number of deposit-taking institutions down to 45 from 124 before the 1997/98 crisis, while the process of deleveraging in the private sector was more or less complete, with the debt-to-equity ratio declining from 1.2 in 1998 to 0.7. The domestic capital market also grew rapidly in response to the funding needs of Thailand's government and firms, further strengthening the system's resilience. Importantly, these improvements resulted in much stronger balance sheets for firms and banks.

Malaysia

Malaysia's post-Asian Financial Crisis experience points to the potential value of devising and implementing clear and comprehensive financial sector development plans. A ten-year Financial Sector Master Plan covering 2001–2010 period, led by the Bank Negara Malaysia, and a parallel Capital Market Masterplan led by the Securities Commission, supported a restructuring and consolidation of the financial sector and establishment of a strong regulatory and supervisory framework.

Implementation of these two strategic plans has enabled Malaysia to diversify and modernize its financial sector, establish a stable financial system, and strengthen regulatory capacity. Similar to Thailand, there was a significant consolidation with commercial banking groups reducing from 22 in 1986 to 8 currently. Financial and capital markets moved in parallel such that the share of financing activity between financial institutions and capital markets is almost equal at 54 and 46 percent respectively.

Malaysia has achieved one of the highest levels of financial inclusion in the world at 92 per cent and taken advantage of mobile phones and online banking to expand access. Whilst Myanmar's current starting point is different to that of Malaysia in the early 2000s, advances in mobile financial services could help Myanmar to substantially expand access. In Myanmar, the mobile penetration rate has increased significantly since the liberalization of the telecom market. Telecom operators are now negotiating business partnerships with local banks to offer mobile financial services to their customers. However, an adequate regulatory and oversight framework needs to be in place for non-banks to provide services.



FINANCING THE FUTURE

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POLICY OPTIONS

Prioritized strategy for financial sector reform: In 2014 the government developed and adopted the Myanmar Financial Inclusion Roadmap 2015-2020 with actions to remove barriers to financial inclusion. A Financial Sector Development Strategy (FSDS) 2015-2020 has also been adopted, with actions to build a large, more efficient and more competitive financial system sequenced over three phases: (i) building the necessary financial infrastructure underpinning the banking system by end 2016; (ii) implementing broader structural changes in the financial sector by end 2018; and (iii) deepening of the financial sector by enabling a wider range of markets, financial instruments and services by end 2020. Implementation would benefit from strong leadership, which could take the form of a High Level Steering Committee.

Strengthened financial sector legal, regulatory, and supervisory framework: Moving towards internationally recognized good practices in financial sector regulations should help to establish the legal certainty required to foster competition and investment in the sector. The new Financial Institutions Law should help address these challenges and provide the basis for a well-structured, modern, and comprehensive legal framework for financial sector development. Such a sound legal framework could prove essential to financial inclusion as well - providing the legal basis and stability for private banks to operate in rural areas and provide new products and services tailored to the unserved and the poor. Improving banking supervision and building capacity of the CBM also remains a top priority.

Modernized financial sector infrastructure: Modernizing the financial sector infrastructure by reducing manual, paper-based processes, and high levels of cash transaction should help reduce costs, risks and inefficiencies. Important policies in this regard include: a Real time Gross Settlement system (RTGS); a Centralized Securities Depository; a robust card payments network; an Automated Clearing House for retail payments; and telecommunications services and electricity in many locations.

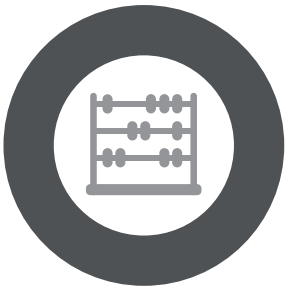
Reformed state-owned banks: Government ownership of banks is typically associated with lower financial development, more financial instability, and slower economic growth.[5] Myanmar faces a similar situation with major SOBs (including Myanmar Economic Bank, Myanmar Agricultural Development Bank, Myanmar Investment and Commercial Bank, and Myanmar Foreign Trade Bank) suffering from a lack of financial sustainability, overlapping mandates and outdated technology. The government has therefore identified the restructuring of SOBs as a central theme of its overarching reform strategy. Key next steps could

5 Rethinking the Role of the State in Finance, World Bank, September 2012

include a review of the overall level of involvement of the state in Myanmar's financial sector and clarification of policy mandates and the objectives of state-ownership.

Expanded financial sector depth: As Myanmar's economy grows, the goal will be to increase the size and scale of the financial sector to meet the increasing needs of firms, households, and the government. The entry of foreign banks to the sector as a result of liberalization of the sector is expected to help stimulate innovation, facilitate technology transfer. Although the insurance sector is very small, a more conducive insurance sector regulatory framework could help facilitate the provision of agricultural insurance, disaster risk insurance, life insurance, and other products to mitigate financial risks over the medium term. Efforts are also underway to stimulate the sound development of Myanmar's growing microfinance sector through an improved legal and regulatory framework.

Special efforts should also focus on fostering financial innovation through new financial instruments and products that are tailored to the needs of the un-banked, such as through mobile financial services. This may also require particular attention to or mechanisms for those in rural and remote areas, who as discussed above currently lack access to even basic financial services. Expanding financial inclusion could be particularly important to helping bolster social and economic development in conflict affected areas.



The table below proposes short-term (within 1 year) and long-term (within 3-5 years) policy options for the next five years (2016-2020) to help deliver on the above objectives of a strengthened financial sector legal and regulatory framework; a modernized financial infrastructure; reformed state-owned banks; and expanded the depth of the financial sector through new product development.

OBJECTIVES	SHORT-TERM OPTIONS	LONG-TERM OPTIONS
Strengthened financial sector legal and regulatory framework	Implement Financial Institutions Law. Priority actions: (i) revise and issue new regulatory and supervisory regulations under the BFI law; and (ii) build capacity of the supervisors to implement and enforce their respective laws.	Improve overall financial sector supervision. Priorities include: (i) upgrade legal and regulatory framework in debt collection and creditors rights; (ii) further strengthen the supervisory and regulatory capacity of CBM; and (iii) establish an effective crisis management system.
Modernized financial infrastructure	Establish the legal and regulatory basis for the National Payments System including mobile financial services. Priority actions: (i) establish the payment infrastructure in CBM (ii) adopting a National Payments Strategy; and (iii) issue supporting regulations for payment system and mobile financial services offered by non-banks.	Develop and implement a National Payment System. Priority actions: (i) establish the necessary payment infrastructures, (ii) ensure adequate transaction account and payment product design, (iii) allow establishment of readily available access points, and (iv) leverage recurrent large-volume payment streams (e.g. government payments) to increase financial access.
Reformed state-owned banks	Conduct due diligence on the two largest state-owned banks, Myanmar Agricultural Development Bank (MADB) and Myanmar Economic Bank (MEB). Priority actions: (i) transfer ownership of the MADB to the MOF, and (ii) complete international financial audit and due diligence assessment.	Develop and implement strategic reform plans for MEB and MADB. Priority actions: (i) enhance operational efficiency; (ii) upgrade IT systems and risk management systems; and strengthen bank corporate governance frameworks.
Expanded the depth of the financial sector through new product development	Build microfinance and insurance supervisory capacity and technical skills (MOF-Financial Regulatory Department). Priority actions: (i) strengthening FRD to enable it to conduct effective risk-based supervision by training staff; (ii) upgrade manuals and procedures; (iii) enhance financial reports and databases and upgrading IT infrastructure to support surveillance.	Accelerate access to financial services for those in underserved areas. Priority actions: (i) support consumer protection, and (ii) support market development initiatives for the non-bank sector.

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