Final Report

Financial Inclusion and the Linkages to Financial Stability, Integrity and Consumer Protection: Insights from the Russia Experience

*Project Name:* the joint project of the World Bank and the Ministry of Finance of the Russian Federation “Financial Education and Financial Literacy Project”

No. FEFLP/CQS-1.45

“Study of linkages and mutual influence of measures aimed on financial inclusion and financial consumer protection on the financial system stability in the Russian Federation”

*Ultimate Client:* the Ministry of Finance of the Russian Federation

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*Client:* Non-commercial Foundation for Enterprise Restructuring and Financial Institutions Development

*Consultant:* Consortium consisting of Bankable Frontier Associates (USA, lead partner) and Russian Microfinance Center (Russia)
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The legal and institutional landscape in the Russian Federation is continuously evolving. This report takes into account relevant legal changes made up until January 1, 2014 and relevant institutional changes made up until March 1, 2014.

No endorsement of this report was sought from any party, nor should any be inferred from participation in the consultative process by which it was developed. The authors are solely responsible for its content.
## Glossary

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Name</th>
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<tbody>
<tr>
<td>AFI</td>
<td>Alliance for Financial Inclusion</td>
</tr>
<tr>
<td>AML/CFT</td>
<td>Anti-money laundering and combatting the financing of terrorism</td>
</tr>
<tr>
<td>ARB</td>
<td>Association of Russian Banks</td>
</tr>
<tr>
<td>ARIA</td>
<td>All-Russian Insurance Association</td>
</tr>
<tr>
<td>ATM</td>
<td>Automated teller machine</td>
</tr>
<tr>
<td>BCBS</td>
<td>Basel Committee on Banking Supervision</td>
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<tr>
<td>BFA</td>
<td>Bankable Frontier Associates</td>
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<tr>
<td>CBR</td>
<td>Central Bank of Russia</td>
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<tr>
<td>CC</td>
<td>Credit cooperative</td>
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<tr>
<td>CGAP</td>
<td>Consultative Group to Assist the Poor</td>
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<tr>
<td>CPSS</td>
<td>Committee on Payment and Settlement Systems</td>
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<tr>
<td>DFID</td>
<td>Department for International Development</td>
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<tr>
<td>DIA</td>
<td>Deposit Insurance Agency</td>
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<tr>
<td>EMO</td>
<td>Electronic money operator</td>
</tr>
<tr>
<td>FATF</td>
<td>Financial Action Task Force</td>
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<tr>
<td>FER</td>
<td>Fund for Enterprise Restructuring</td>
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<tr>
<td>FFMS</td>
<td>Federal Financial Markets Service</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross domestic product</td>
</tr>
<tr>
<td>GPFI</td>
<td>Global Partnership for Financial Inclusion</td>
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<tr>
<td>IADI</td>
<td>International Association of Deposit Insurers</td>
</tr>
<tr>
<td>IAIS</td>
<td>International Association of Insurance Supervisors</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>I-SIP</td>
<td>Acronym used in this paper standing for the addition of Financial Inclusion to the objectives of Financial Stability, Financial Integrity and Consumer Protection.</td>
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<tr>
<td>KYC</td>
<td>Know your customer</td>
</tr>
<tr>
<td>MED</td>
<td>Ministry of Economic Development</td>
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<tr>
<td>MFO</td>
<td>Microfinance organization</td>
</tr>
<tr>
<td>MIX</td>
<td>Microfinance Information Exchange</td>
</tr>
<tr>
<td>MNO</td>
<td>Mobile network operator</td>
</tr>
<tr>
<td>MOF</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>MSME</td>
<td>Micro, small and medium-sized enterprises</td>
</tr>
<tr>
<td>MTS</td>
<td>Mobile TeleSystems</td>
</tr>
<tr>
<td>NAFI</td>
<td>National Agency for Financial Studies</td>
</tr>
<tr>
<td>NAMMMS</td>
<td>National Partnership of Microfinance Market Stakeholders</td>
</tr>
<tr>
<td>NBCO</td>
<td>Nonbank credit organization</td>
</tr>
<tr>
<td>NGO</td>
<td>Non-governmental organization</td>
</tr>
<tr>
<td>NPL</td>
<td>Non-performing loans</td>
</tr>
<tr>
<td>OECD</td>
<td>Organization for Economic Cooperation and Development</td>
</tr>
<tr>
<td>RMC</td>
<td>Russian Microfinance Center</td>
</tr>
<tr>
<td>Acronym</td>
<td>Full Name</td>
</tr>
<tr>
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<td>---------------------------------------------------------------------------</td>
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<tr>
<td>Rosfinmonitoring</td>
<td>Federal Service for Financial Monitoring</td>
</tr>
<tr>
<td>Rospotrebnadzor</td>
<td>Federal Service on Customers’ Rights Protection and Human Well-Being Surveillance</td>
</tr>
<tr>
<td>RUB</td>
<td>Russian ruble (currency)</td>
</tr>
<tr>
<td>SIM</td>
<td>Subscriber identification module</td>
</tr>
<tr>
<td>SME</td>
<td>Small and medium-sized enterprises</td>
</tr>
<tr>
<td>SME Bank</td>
<td>Russian Small and Medium Entrepreneurship Support Bank</td>
</tr>
<tr>
<td>SRO</td>
<td>Self-regulatory organization</td>
</tr>
<tr>
<td>SSB</td>
<td>Standard setting body</td>
</tr>
<tr>
<td>USD</td>
<td>United States dollar (currency)</td>
</tr>
</tbody>
</table>
1. Introduction and theoretical approach

While financial inclusion is now widely understood as a necessary condition for sustainable poverty alleviation and inclusive economic growth, the interplay and linkages between financial inclusion and the traditional financial sector objectives of financial stability, financial integrity, and financial consumer protection have not been adequately studied and put into context. In 2012 the G-20 Global Partnership for Financial Inclusion (GPFI) and the Consultative Group to Assist the Poor (CGAP) as an implementing partner launched such a study to explore linkages among financial inclusion, stability, integrity and protection (referred to collectively as the ‘I-SIP’ objectives) beginning in one jurisdiction – South Africa.¹

The study utilizes a rapid research exercise² to learn from policy makers’ experiences contending with the I-SIP linkages. The aim is the development of a methodology that supports policy makers in identifying and managing such linkages, with the ultimate goal of optimizing outcomes across all four I-SIP objectives. Subsequent I-SIP rapid research exercises in new countries are expected to strengthen the evidence base and to enable further development and refining of the methodology. Russia is the third rapid research exercise.³ This report introduces analysis of Russia’s experience pursuing financial inclusion and considering the linkages among the I-SIP objectives.

1.1. I-SIP analysis and the I-SIP Methodology

The I-SIP rapid research exercises start from the premise that at the level of outcomes, financial inclusion should reinforce the other three objectives – financial stability, financial integrity, and financial consumer protection – and is in turn reinforced by them in the long term. This view is supported by a growing body of research demonstrating the ultimate alignment between the I-SIP objectives in the long term, notwithstanding ongoing knowledge gaps.⁴

However, in the short term, and at the level of individual policy interventions, the linkages among the I-SIP objectives are often not well understood and may not be systematically considered in policy making. In particular, in many countries financial inclusion has been added explicitly to the policy making agenda only recently, alongside the longstanding objectives of preserving financial stability of both the providers and the financial system, protecting the integrity of the financial system by preventing financial crime,

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² The term “rapid research exercise,” as explained in Sec. 1.2, is used in this report to refer to the approach taken to analyzing a particular country’s experiences (e.g., Russia) addressing linkages among the I-SIP objectives in policy making. It is distinguishable from a full-fledged regulatory impact assessment.

³ The second rapid research exercise was conducted in Pakistan in 2013. The results will be presented in a forthcoming CGAP report expected in mid-2014, referenced hereafter as the ‘Pakistan I-SIP Report’. CGAP (forthcoming), Inclusion, Stability, Integrity and Protection: Observations and Lessons for the I-SIP Methodology from Pakistan.

⁴ The growing body of empirical evidence to substantiate such alignment is far from complete and will require new econometric research not addressed in this rapid research exercise. The following publication surveys the available empirical evidence on the linkage between financial inclusion and financial stability and identifies gaps for attention: Robert Cull, Asli Demirgüç-Kunt, and Timothy Lyman. Financial Inclusion and Stability: What Does Research Show? Washington DC: CGAP, 2012.
and protecting customers through market conduct and consumer protection regulation. In this context, basic tools are needed both to analyze the linkages among the I-SIP objectives and to make policy that appropriately reflects their interdependence.

A first step in analyzing the linkages among the I-SIP objectives is to think of them in pairs. Though such two-dimensional analysis has many inherent limitations (as discussed further below), it is nonetheless an important exercise, particularly for policy makers who have dealt extensively with stability, integrity or consumer protection but are less familiar with policy making to promote financial inclusion. Box 1 shows potential pair-wise linkages between the I-SIP objectives at the level of market outcomes.

Box 1: Potential pair-wise linkages between the I-SIP objectives at the outcome level.\(^5\)

<table>
<thead>
<tr>
<th>Stability ↔️ Inclusion</th>
</tr>
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<tbody>
<tr>
<td><strong>Diversification</strong>: An inclusive financial sector will have a <em>more diversified, stable retail deposit base</em> which should increase systemic stability. Similarly, inclusion may improve the diversification of lenders’ loan portfolio away from large borrowers, thereby reducing systemic risk.</td>
</tr>
<tr>
<td><strong>Social stability</strong>: An inclusive financial sector with a <em>broad base of clients across a society is more likely to have greater political legitimacy</em> and thereby decrease the risk of political and social instability (which in turn could lead to financial instability).</td>
</tr>
<tr>
<td><strong>Economic stability</strong>: An inclusive financial sector is associated with a <em>more inclusive society in which individuals have more ways to generate income and manage risks</em>, thereby potentially enhancing economic stability which is an essential component of financial stability.</td>
</tr>
<tr>
<td><strong>Trust building</strong>: Stability builds <em>consumer trust in the financial sector</em> as a whole, making it more likely that individuals will want to be included.</td>
</tr>
<tr>
<td><strong>Affordability</strong>: Stability can positively impact factors (such as inflation and patterns of interest rates) that <em>can reduce key prices</em>, potentially making financial services more affordable to poor people.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Integrity ↔️ Inclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Transparency</strong>: Bringing more people into the formal financial sector strengthens integrity with improved ability to monitor cash flows.</td>
</tr>
<tr>
<td><strong>Trust building</strong>: Over time, a market that prevents AML/CFT abuse is likely to be better regarded and trusted by consumers.</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Protection ↔️ Inclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Trust building</strong>: A well-protected and educated consumer base leads to trust the market and encourages access and use of formal financial services.</td>
</tr>
<tr>
<td><strong>Reducing risks to consumers of unregulated providers</strong>: Effective access to regulated financial services allows households to avoid potential abuse and fraud by unscrupulous providers in the informal sector.</td>
</tr>
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</table>

Such pair-wise analysis can be applied to the outcomes of specific country-level policy interventions aimed at promoting (or with the potential to promote) financial inclusion – or, for that matter, any of the I-SIP objectives.

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It is useful to show such pair-wise analysis graphically. Using inclusion on the horizontal axis and consumer protection on the vertical axis as an example, Figure 1 below shows the possible combinations from such an assessment of linkages. For each objective, the linkage could be negative (i.e. a tradeoff, where the achievement of one objective negatively impacts achievement of the other), neutral (i.e. no effect) or positive (i.e. a synergy, where achievement of one supports achievement of the other objective). The tradeoff zones, shown in red below, indicate where a positive result in terms of one objective is achieved at the cost of another; whereas light green demarcates zones where one is achieved without negatively impacting another. Dark green marks the zone of synergy between objectives. In theory, a policy which would have no effect on either would be ineffective (in light gray) and therefore not considered further; and the same, even more so, would apply to policies located in the bright red zones where there is loss for no gain.\(^6\)

**Figure 1: Linkage zones: Impact on Consumer Protection vs Financial Inclusion**

<table>
<thead>
<tr>
<th>Impact on Consumer Protection</th>
<th>Impact on financial inclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Positive</td>
<td>Protection enhancing, inclusion reducing</td>
</tr>
<tr>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Negative</td>
<td>Lose-lose</td>
</tr>
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</table>

The matrix highlights both the challenge and the goal for policy makers: creating policies that lead to outcomes falling in the green zones and avoiding the gray and red zones. It is certainly difficult to anticipate all the possible outcomes of new and complex policies. However, policy makers can seek to identify the linkages triggered by a given policy intervention \textit{ex ante} and to manage them over time. The ultimate goal is to minimize tradeoffs and other negative outcomes and to maximize the synergies – in other words, to optimize the outcomes for the increasing number of countries that are committed to pursuing all the four I-SIP objectives simultaneously.

The pair-wise depiction is a necessary simplification of real world policy making. While such pair-wise analysis can be conducted using each pair of the four I-SIP objectives, policy makers have to manage all four objectives at the same time, and as such face decision making that cannot be represented by a simple two dimensional grid. Moreover, a given policy intervention will have differing potential effects on all four objectives depending on the specific country context, and the linkages among them will evolve over time. Considering more than two objectives at the same time makes the calculation of a unique Pareto optimal outcome both a practical and theoretical impossibility. Thus, policy makers’ judgment will always be required, even in the day-to-day process of managing the linkages.

Furthermore, policy objectives beyond the I-SIP objectives may shape the relevant decision making, and the I-SIP objectives are unlikely to be pursued for their own sake, but rather as enablers of broader societal ends, such as employment generation, poverty alleviation, inequality reduction or faster economic growth. With such increasingly complex decision making, the marginal utility of serial pair-wise comparisons diminishes and reliance on policy maker’s judgment becomes correspondingly more necessary.

To understand how these decisions were deliberated over and made by regulators and policy makers in practice, in 2012, a research team from CGAP and Bankable Frontier Associates (BFA) was engaged to conduct a rapid research exercise of five financial inclusion-linked policy interventions in South Africa to capture insights and lessons for policy makers and regulators in other jurisdictions. The resulting report, “Financial Inclusion and the Linkages to Stability, Integrity and Protection: Insights from the South African Experience” (hereafter, “the South Africa I-SIP Report’), offered an initial proposal of an ‘I-SIP Methodology’ to support regulators and policy makers to identify, manage, and optimize the I-SIP linkages. The results of the South African rapid research exercise and the initial I-SIP Methodology were presented at the GPFI Forum held in Cape Town in September 2012 and at the 1st GPFI Conference on Standard-Setting Bodies and Financial Inclusion: Promoting Financial Inclusion through Proportionate Standards and Guidance, hosted by the Financial Stability Institute at the Bank for International Settlements in Basel in October 2012.7 Participants in the GPFI Conference supported further development and refinement of the initial I-SIP Methodology using experiences from other countries, with the ultimate goal of informing the work of the standard-setting bodies.8

The initial I-SIP Methodology as proposed in the South Africa I-SIP Report and presented in Cape Town and Basel took the form of a set of seven propositions developed using the South African experience. I-SIP rapid research exercises in additional countries seek to confirm and build the evidence base for these propositions. To this end, in addition to the Russian rapid research exercise, a similar rapid research exercise was conducted in Pakistan, supported by the State Bank of Pakistan and CGAP to test, further develop and refine the original methodology, and further such I-SIP rapid research exercises are


8 The G20 Finance Ministers and Central Bank Governors’ November 2012 Communiqué included the following: “We welcome the first GPFI Conference on Standard-Setting Bodies and Financial Inclusion as a substantial demonstration of growing commitment among Standard Setting Bodies (SSBs) to provide guidance and to engage with the GPFI to explore the linkages among financial inclusion, financial stability, financial integrity and financial consumer protection.”
anticipated. Table 1 presents the current iteration of the I-SIP Methodology, which incorporates insights from all three rapid research exercises and is now framed as six ‘I-SIP Propositions.’

<table>
<thead>
<tr>
<th>Table 1: The I-SIP Propositions</th>
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<tr>
<td>1. Clear definitions for each of the I-SIP objectives at the national level and at the level of specific policy interventions are needed to guide policy makers in policy design. The definitions on the policy intervention level should be detailed enough to allow for measuring the effects of the intervention with regard to I-SIP objectives.</td>
</tr>
<tr>
<td>2. A structured approach to identifying material linkages amongst I-SIP objectives that may arise in the implementation of a specific policy intervention helps to manage and optimize linkages, thereby avoiding false or unnecessary tradeoffs between objectives and maximizing synergies among them.</td>
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<tr>
<td>3. Inter- and intra-agency collaboration is critical to design, monitor, and adapt policy interventions to optimize the linkages among I-SIP objectives, as well as linkages with national objectives beyond the I-SIP objectives.</td>
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<tr>
<td>4. Regularly collected and analyzed data based on indicators and targets specific to a given policy intervention enable the monitoring of its effects on the I-SIP objectives and the management of linkages over time.</td>
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<tr>
<td>5. Periodic structured consultation with providers in proportion to the scale of the proposed changes helps to identify and manage linkages as the market develops.</td>
</tr>
<tr>
<td>6. Optimization of I-SIP linkages requires a commitment by policy makers to manage the I-SIP linkages by adapting policy and regulation as necessary in light of the data and other evidence collected and effects observed.</td>
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1.2. Developing and refining the I-SIP Methodology in Russia

As mentioned, the I-SIP rapid research exercise in Russia aims to further the development and refinement of the I-SIP Methodology using analysis of cases from Russian experience to build on the initial approach coming out of the South African and Pakistan rapid research exercises. The term “rapid research exercise” is used to distinguish the approach taken to analyzing the policy making experience addressing the linkages among the I-SIP objectives from that of a full-fledged regulatory impact assessment of each of the specific policy interventions studied. The distinction is important in two respects. First, while a regulatory impact assessment, as the term suggests, is typically focused on understanding what impact a given policy intervention had (if conducted ex post) or may have (if conducted ex ante), the I-SIP rapid research exercises have had more modest ambitions with respect to each of the studied cases, focusing as much on the policy making process as on the effects that the intervention produced or may produce (see Sec. 1.4). Accordingly, the observed effects from an intervention are relevant even if data and other available evidence are insufficient to establish definitive outcomes (and therefore impact). These observed effects are therefore not limited to market outcomes, but also include institutional changes such as changes in systems and processes, which might only lead to observable changes in market outcomes at some point in the future. The second distinguishing

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9 Pakistan I-SIP Report (forthcoming). Further investigation of the I-SIP linkages in different country contexts is an area of planned activity for CGAP under the new 5-year strategy, which commenced on July 1, 2013. Additionally, the Alliance for Financial Inclusion (AFI) chose the I-SIP objectives as the theme for its 2013 Global Policy Forum, and several AFI members have expressed interest in contributing to the development and refinement of the I-SIP Methodology using their own policy making experience.
feature of the I-SIP rapid research exercises flows from the first: while the research team in each case aimed to gather as much existing data on the policy interventions studied as possible, no new original research was conducted, and heavy reliance was placed on “soft data” – evidence gathered through structured interviews with relevant regulators, policy makers and market participants aimed at identifying the effects of the intervention in question on the I-SIP objectives and the linkages among them. This makes it possible for an I-SIP rapid research exercise to analyze multiple policy interventions within a small fraction of the time and resources that would typically be required for a full-blown regulatory impact assessment of any one of them.

Russia was selected as the third country for an I-SIP rapid research exercise because of its public commitment to financial inclusion and numerous policy interventions in support of this objective (see Sec. 2.1). The Ministry of Finance of the Russian Federation through the Financial Education and Financial Literacy Project has shown a profound interest and openness in sharing the Russian experience in addressing the I-SIP linkages.

The Russian I-SIP rapid research exercise sought to take advantage of two aspects of the broader financial sector policy landscape in the country of special relevance to developing and refining the I-SIP Methodology at the current stage. First, the prominence and salience of the consumer protection objective in the Russian market provides opportunities to analyze policy initiatives where the linkage between consumer protection and financial inclusion, stability, and integrity has been critical. The research team therefore gave particular attention not just to the pair-wise linkages between financial inclusion and the other I-SIP objectives, but also the pair-wise linkages between consumer protection and the other objectives. Second, the Russian financial sector policy landscape includes useful examples of interventions with the primary objective of stability, integrity, or protection that nonetheless may have a material effect on the country’s ultimate goal of universal financial inclusion.

### 1.3. Selection of policy interventions for study

The first critical step in applying, developing and refining the I-SIP Methodology using the Russian experience was to select a portfolio of policy interventions to study with relevance to financial inclusion and consumer protection. The specific portfolio of cases was constructed with a view to better understand policy makers’ treatment of linkages between the I-SIP objectives in the actual practice of policy making. A linkage is demonstrated when an effect of a particular policy intervention on one of the I-SIP objectives (whether intended or unintended) leads to an observed effect (again, intended or unintended) on one (or more) of the other objectives. The following criteria were used to select the cases:

- Demonstration of a linkage was expected, i.e., an intervention with an expected positive effect on one of the I-SIP objectives could also be expected to have an observable effect (positive or negative) on one or more of the other I-SIP objectives.
- Availability of relevant data and qualitative evidence to support the analysis.
- For the *ex post* cases, passage of sufficient time from the intervention to consider observable effects.
- For the *ex-ante* cases, potential for the analysis to be useful in an on-going policymaking process.
- Relevance of the case to other countries and potential to contribute to the GPFI’s international learning agenda.

Taken together, cases were chosen which manifest different pair-wise linkages between inclusion and the stability, integrity, and protection objectives. Practically, due to the relative paucity of published information, it was also critical to select cases where the research team would have access to the appropriate regulators, policy makers and industry players, in order to gain thorough understanding of
expectations at the time the policy intervention in question was developed and retroactively create a baseline as needed. As such, there was a preference for cases where first-hand information could be captured from stakeholders directly involved in the development of the intervention in question.

The following five cases were selected according to the criteria above in coordination with the Ministry of Finance.

**Special legal framework for credit cooperatives:** Introduction of Federal Law No. 190-FZ of July 18, 2009, “On Credit Cooperation”, which aimed to bring all credit cooperatives (except for agriculture cooperatives) operating under multiple legal forms under one law.

**Special legal framework for microfinance organizations (MFOs):** Introduction of Federal Law No. 151-FZ of July 7, 2010 “On Microfinance Activity and Microfinance Organizations”.

**Consumer Credit Law:** The Federal Law No. 353-FZ of December 21, 2013 “On Consumer Credit (Loan)”. The law is targeted at addressing consumer protection issues given the rapidly growing market for unsecured loans originating from banks, MFOs, and credit cooperatives. The draft law was analyzed following its adoption but before its expected implementation in July 2014, therefore the analysis is ex-ante.


**Legal framework for mobile network operators (MNOs):** Bringing MNOs (classified as communication service providers) under Federal Law No. 161-FZ of June 27, 2011, “On the National Payment System”. Similar to electronic money operators, yet subject to more relaxed rules (MNOs operating in partnership with electronic money operators).

### 1.4. The I-SIP approach to analyzing policy interventions

Through the rapid research exercise in Russia, for each case the research team systematically sought to understand:

I. Did policy makers **identify** potential linkages between financial inclusion, financial stability, financial integrity, and consumer protection at the time of designing the intervention?

II. What discussions and actions took place (if any) to **manage** potential tradeoffs or synergies between the I-SIP objectives?

III. What has been the observed effect of the intervention on the I-SIP objectives to date using available supporting data? From currently available evidence, to what extent could the process be characterized as an attempt to **optimize** outcomes (i.e., minimize tradeoffs and other negative effects and maximize synergies)?

In short, the analysis focuses on how regulators and policy makers have **identified** and **managed** the linkages between the I-SIP objectives within a particular case context, and from the current vantage point whether the outcomes thus far appear optimal.10

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10 It is important to note that at the time of developing a particular intervention, or even in its implementation, policy makers may well not have explicitly recognized that they were “identifying” or “managing” a linkage. The cases seek to note whether either activity occurred, regardless of whether it was recognized at the time.
Through the review of key documents and data, the team sought to begin with a basic understanding of the case and the linkages that may have been identified. For each case, the team developed a structured “case table” that captured key information about the case and policy makers’ decision-making:

- **Scope**: The scope of the intervention and the primary I-SIP objective(s) driving the intervention;
- **Key stakeholders**: Regulators, policy makers, market participants driving and affected by the intervention;
- **Identification**: Which linkages (whether potential synergies or potential tradeoffs) among the I-SIP objectives were identified at the time the policy was developed?
- **Management**: How were the identified linkages – including any additional linkages identified *after* development of the policy – addressed in the development of the intervention or over time in its implementation, if at all?
- **Observed effect**: Using available quantitative and qualitative evidence (including interviews with relevant regulators, policy makers and market participants), what has been the effect of the policy intervention and the management of linkages on the I-SIP objectives?

For each case, a set of hypothetical linkages was developed to understand the universe of linkages that might be triggered by the specific policy intervention in question and to allow for more strategic questioning during the interviews. An example of this, pertaining to the legal framework for MFOs, can be found in Annex A. The hypothetical linkages mimic the first step that policy makers must contend with in policy making aimed at managing and optimizing the I-SIP linkages: *identifying* potential linkages.

With this foundation in place, the research team worked with the Ministry of Finance to assemble a list of primary stakeholders related to each policy intervention to interview and to test, substantiate and corroborate initial understanding of the decision making around identifying, managing, and optimizing the I-SIP linkages. Interviews were conducted from November 11-16, 2013 in Moscow. The full list of interviews can be found in Annex C.

Using this structured approach to analyzing the cases, and with the goal of further developing and refining the I-SIP Methodology, the research team:

1. looked for evidence that effective linkage management may have resulted in positive outcomes overall, which could provide instruction on good decision-making generally where policy makers desire to optimize the I-SIP linkages;
2. considered whether the lessons learned are aligned with the current I-SIP Propositions or present new lessons (i.e., did they build the supporting evidence base for the I-SIP Propositions or suggest respects in which the I-SIP Proposition should be adjusted); and
3. considered where linkages appear to have been insufficiently managed what might have been done differently.

### 1.5. This Report

The research for this Final Report was conducted by a joint team from Bankable Frontier Associates and the Russian Microfinance Center, with support from CGAP.

This Final Report begins with relevant background information on the financial inclusion objective in Russia (Sec. 2). Section 3 presents the analysis of the five policy interventions listed above through the I-SIP lens. Section 4 presents observations that cut across the cases and makes proposals for the further development and refinement of the I-SIP Methodology in general and the I-SIP Propositions in particular, using insights from the analysis of the studied cases.
2. Russian Context

2.1. The Russian Federation’s demonstrated commitment to financial inclusion

As far back as 2007, President Vladimir Putin identified the closing of the then vast financial access gap as an important priority of his administration, and it has remained so since. Russia reinforced this priority as an international commitment, announced in November 2010 as a part of the G-20’s Seoul Development Consensus for Shared Growth in the areas of infrastructural deficit, food market volatility and increased access to financial services. Under the Seoul Consensus, Russia committed to:

- Development of a national action plan for increasing access to financial services;
- Participation in the Global Partnership for Financial Inclusion;
- Creation of a flexible system for small and medium-sized enterprise financing.

Russia has made progress towards this goal, particularly in the regulatory infrastructure for financial inclusion. Russia has made strides in financial inclusion, and in certain aspects – such as the penetration of bank branches per 100,000 adults – Russia has now moved ahead of some highly developed countries. The issue of financial inclusion in Russia has its own specifics – more typical, perhaps, for developed countries that have all the basic prerequisites for financial inclusion. For example, for city dwellers, access to a range of financial services has become more and more commonplace, with uniquely Russian innovations in retail payment services emerging to make usage of such services increasingly convenient for customers. Yet, for residents of smaller cities, towns and rural areas, access to safe, high quality financial services remains a far greater challenge.

The Russian penchant for innovation, as well as strong local traditions of mutual assistance, have shaped the market of financial service providers in distinctive ways. Particularly in areas where bank penetration is weak, a multiplicity of different forms of financial cooperatives have emerged, some growing to be substantial institutions and at the same time, the number, size, and diversity of providers of retail credit have increased dramatically, even in rural and more remote areas.

Notwithstanding the dynamism of privately and member-owned financial service providers, state-owned institutions remain important players in the Russian financial sector, including – even especially – that part of it most relevant to lower income Russians. State controlled financial services providers such as savings bank Sberbank, VTB24, and even the Russian Post, are critical in providing financial services in many remote communities. There has been a marked trend toward improving both business practices and service among state-owned providers, and in many areas and market segments (such as among the elderly) they appear to be competing favorably with private financial service providers.

12 President Putin’s address to the State Council, November 2007.
Russian policy towards financial inclusion demonstrates openness to state involvement, often to stimulate or subsidize private providers. In recent years, billions of Rubles were channeled into SME lending, microfinance institutions, and credit cooperatives – through the state-owned Russian Small and Medium Entrepreneurship Support Bank. The Ministry of Economic Development is instrumental in launching the Universal Electronic Card – the ambitious e-government initiative that aims, among many other goals, to establish universal access to banking services.

Beyond the emphasis on improving statistics on financial inclusion for lower income Russians, Russian policy has also actively focused on the quality of formal financial services on offer, their appropriateness to the needs of customers, the market conduct of providers, and the financial literacy and capability of financial consumers. These policy priorities, so much discussed internationally in the wake of the global financial crisis, have distinct relevance in the Russian context. Rapid market development – particularly in retail credit – has sometimes resulted in a lag between the introduction of questionable or unacceptable market practices and a regulatory response. There are several Russian initiatives underway related to the quality and appropriateness of financial products on offer and the financial literacy and capability of financial consumers, including plans for establishing a financial consumer protection Ombudsman in Russia and the ambitious multi-year Financial Education and Financial Literacy project in partnership with the World Bank aimed at improving the financial literacy of Russian citizens as well as strengthening the foundations for consumer protection in financial services.

The fact that the Ministry of Finance has supported this I-SIP rapid research exercise in Russia and that Russia has also in March 2014 officially joined the Alliance for Financial Inclusion (AFI) (with the CBR and the Ministry of Economic Development (MED) being the principal members of AFI) is further evidence of Russia’s commitment to advance financial inclusion.

2.2. Status of financial inclusion in Russia

The limited data available on usage of formal financial services among lower income Russians paints a picture of financial exclusion in Russia. Financial exclusion disproportionately affects remote and rural areas, and older and lower-income people. Over a third of the population has low financial literacy levels, a factor recognized as a serious impediment to financial inclusion.

The outreach of financial services among the Russian population has been growing in recent years, but still leaves the majority of the population without a bank account. In 2008, about 48 percent of the adult population did not use any banking services; while at the end of 2011 this number was reduced to 22 percent.\(^{15}\) However, 48 percent of the adult population (age 15 years and above) reports having an account at a formal financial institution. This number is much lower than the use of banking services, as many people use banks for payment services without opening a bank account.\(^{16}\) The share of the

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\(^{15}\) Unless noted otherwise, the source of data for this section is NAFI. “One Hundred Facts on the Financial Behavior of Russians.” 2012. In their research NAFI uses a statistically representative sample of 1,600 adults.

population with access is even lower when only looking at the bottom 40 percent of the population in terms of income (40 percent) and for people with primary education or less (24 percent).

Table 2: Use of Banking Services by the Adult Russian Population as of October 2011

<table>
<thead>
<tr>
<th>Types of services</th>
<th>Percent</th>
<th>Breakdown of users</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plastic cards</td>
<td>46%</td>
<td>To receive salary</td>
<td>89%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Debit card</td>
<td>12%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Credit card</td>
<td>8%</td>
</tr>
<tr>
<td>Regular payments</td>
<td>28%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit services</td>
<td>24%</td>
<td>Consumer credit</td>
<td>89%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Car loan</td>
<td>11%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Mortgage loan</td>
<td>11%</td>
</tr>
<tr>
<td>Deposit services</td>
<td>18%</td>
<td>Current account/Demand deposit</td>
<td>67%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Term deposit</td>
<td>42%</td>
</tr>
<tr>
<td>Remittances</td>
<td>8%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internet banking</td>
<td>1%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposit box</td>
<td>0%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>None of the above</td>
<td>22%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: NAFI. 2012. *The totals exceed 100 percent as multiple responses were allowed.

Some of the reasons for the low or passive use of formal financial services include: distrust in financial institutions, low levels of financial literacy, low income levels, and supply side constraints. In general, the most financially excluded Russians tend to be those living outside of large cities, who are less educated and older, have lower income and are less technologically savvy.

The majority of the Russian population use traditional channels for financial services – e.g. 68 percent of people prefer making regular payments through bank branches and 33 percent through the Russian Post. Very few people currently use mobile banking, e-money or internet banking to make payments (according to customer survey data, in 2012 these figures stood at 2, 1 and 1 percent respectively, though most leading retail banks offer this possibility). At the same time, in the last few years there has been a shift in preferences towards the use of innovative payment solutions such as automated payment acceptance terminals (a specific Russian innovation) and mobile payments.

2.3. Definition and measurement of financial inclusion in the Russian Federation

Russia is currently developing definitions and indicators to measure financial inclusion nationally. The Ministry of Economic Development (MED) was initially commissioned by the government with this task. MED responded in late 2010 with the report “The Realization of Measures of Increasing Accessibility of Financial Services, Including Credit, for the Population and Entrepreneurs”. Financial inclusion is

17 Ibid. Russia has the lowest access figures for people with low education among the BRICS countries (Brazil, Russia, India, China, and South Africa) and among developing countries in Europe and Central Asia.
18 Demirguc-Kunt & Klapper (2012). The World Bank Global Findex Database provides more data on mobile phone usage: In 2011, 1.7 percent of adults above 15 years used a mobile phone to pay bills, 1.8 percent to receive money, and 1.5 percent to send money. See http://bit.ly/W7uux9.
defined in the report as “territorial and technological accessibility of five basic types of financial services – credit, savings, money transfers (payments), insurance and leasing.” The report notes that access to basic financial services should be viewed not only as a right, but also as a fundamental need of every citizen and ‘subject of entrepreneurship’ (i.e. a business or an individual entrepreneur).

The MED report states that the Government of the Russian Federation intends “to harmonize the country’s domestic financial inclusion policy with that of other G-20 countries.” Furthermore, the measurement system should be harmonized with international organizations’ indicators (in particular, with the Financial Access Survey of the World Bank and CGAP) to ensure comparability, and be in line with the UN Fundamental Principles of Official Statistics. However, it is emphasized that the system must also be independent and comprehensive, to allow decision making in the area of economic policy. The system should allow monitoring by financial products, by geographical and infrastructure accessibility, as well as by consolidated indicators allowing comparison with international indicators. The system should also include indicators of financial literacy and financial consumer protection.

In June 2011 the Government of the Russian Federation approved the action plan on measures to increase financial inclusion outlined in the MED report, and in June 2012 MED shared its suggestions for the first stage of the implementation of the financial inclusion measurement system with the Ministry of Finance, the Central Bank of Russia (CBR), and the Federal Financial Market Service (FFMS, now integrated in the Central Bank) for their feedback.

At this initial stage, MED suggested using indicators of physical access and use of financial services – credit, deposits, payments, and insurance. MED noted that the dimension of quality is more difficult to measure, and will be addressed at a later stage. The proposed indicators can be found in Annex C. These indicators would be calculated by settlement (taking into account population size), by subject of the Russian Federation, by Federal District, and at the national level.

Overall, this provides an indication of Russia’s strong commitment to financial inclusion, though the implementation has proved challenging in practice, as to date the definition and indicators have not been adopted officially. Thus, they have not yet been used to create a common understanding of financial inclusion across government and industry stakeholders or to support identification and management of potential linkages between financial inclusion and the other I-SIP objectives. This is now going to change as the CBR has recently established a Directorate General on Financial Inclusion and Microfinance, which works on updating the indicators and then making suggestions on how to adopt and implement them.

to point 76 of the “Plan of the Realization of the Main Anti-Crisis Activities and the Policy for the Modernization of the Russian Economy of the Government of the Russian Federation”.

3. Analysis of policy interventions

In this section we present the initial analysis of the five policy interventions, using the I-SIP approach described above. The five cases can be divided into two clusters: in the first group we have policy interventions aimed at formalizing and developing the market for microfinance organizations and credit cooperatives – institutions that have played a significant role in the provision of credit. The ex-ante analysis of the Consumer Credit Law follows for its relevance to the market for consumer credit and these providers. The second group includes the two policy interventions that are a part of the Law on the National Payments System: the legal framework for electronic money operators (EMOs) and the legal framework for mobile network operators (MNOs).

3.1. Law on Credit Cooperation

3.1.1. The policy change

In the years prior to 2009, there was a rebirth of credit cooperatives (CC) in the Russian Federation. Though the exact size of the growing sector was difficult to quantify, credit cooperatives were known for serving a small proportion of the population, but through a wide presence in remote areas that were not served by banks. Highly visible instances of fraud and financial pyramid schemes posing as credit cooperatives tainted the reputation of the growing sector, though the extent of these incidents was unknown. In response, Federal Law No. 190 FZ on Credit Cooperation was introduced in 2009 to establish the rules of the game in the credit cooperative sector and to understand the extent of the financial flows. The law aimed to streamline the previously fragmented regulatory framework, bringing all existing cooperatives engaged in lending as a primary activity under a variety of laws, under one single law. In the final version of the law, all CCs of both individuals and legal entities were covered – with the exception of agricultural cooperatives.

The law requires credit cooperatives with membership of 15+ natural persons or 5+ legal entities that want to continue taking savings from their members to register under the new law, along with 2nd tier cooperatives made up of credit cooperatives. Under the 2001 Law on Consumer Cooperatives of Citizens, under which most credit cooperatives had previously been registered, the maximum number of members for a CC was 2000. The new law abolished this ill-favored limit, providing minimum prudential requirements instead. Broadly, the law defines credit cooperatives’ activities, registration requirements, admission, rights, and duties of members/shareholders, and management and governance structures. Notably, the law also includes key normative financial standards – prudential requirements and ratios – for the credit cooperatives.

The law calls for an authorized executive body to serve as the supervisor for the credit cooperative sector. Initially this was the Federal Financial Markets Service (FFMS), with the Ministry of Finance acting as the regulator of the sector. In September 2013 the FFMS was merged with the Central Bank of Russia which became the regulator and supervisor for the credit cooperative sector. The law requires the creation of non-profit self-regulatory organizations (SROs) which take on the role of delegated supervisor, to which their member credit cooperatives must report. All credit cooperatives must be members of an SRO, and for those smaller than 5,000 members, SROs serve as delegated supervisors and support their compliance with the law. SROs must also establish compensation and emergency funds for the benefit of their members. Because cooperative members are shareholders and are supposed to have a common bond, by law, there is an expectation that they are aware of the workings
of the credit cooperative of which they are members. As such, even with the introduction of the law on credit cooperatives, they were still not covered under the Consumer Protection Law, even though CCs are covered under the Law on Consumer Credit.

Today, approximately 1,483 member based credit cooperatives that are members of SROs report more than RUB 34.3 billion (approx. USD 1 billion) in member savings and RUB 32.2 billion (approx. USD 920 million) in the current outstanding loan portfolio (as of January 1, 2013).

3.1.2. Which linkages were identified and managed?

During the development of the Law on Credit Cooperation, policy makers had to consider various linkages between I-SIP objectives.

The main objective of the law was to provide the legal certainty and set standards for the growth and development of a stable credit cooperative sector to further financial inclusion. The official justification for the law indicates that CCs are intended to help fill a gap in credit and financial security for the small business and agricultural sectors. Though credit cooperatives have been granted legal status under the Civil Code (article 116), the justification indicates that the lack of regulation guiding the establishment and activities of CCs has hampered the development of credit cooperatives.

**Linkage between stability and financial inclusion**

Policy makers identified both positive and negative linkages between stability and financial inclusion and were careful to try and strike a balance. Policy makers aimed to bring the existing credit cooperative sector under one regulatory framework, and provide the legal certainty for new credit cooperatives to enter and expand financial inclusion. They identified a linkage between a stable CC sector and financial inclusion. The aim was to create a uniform, stable sector with CCs in good financial health with sound management structures that could serve clients well. The credit cooperatives engaged in legal activities (other than pyramid schemes registered as CCs) do not themselves pose a threat to systemic stability, because of the limited size of the CCs.

Policy makers focused their efforts on creating sound institutions as evidenced by Article 6 of the Law on Credit Cooperation that addresses “Maintaining Financial Stability of a Credit Cooperative” and includes key financial ratios to be monitored for all credit cooperatives registered under this law. Regulations on management, governance, annual general meetings, the creation of 2nd tier credit cooperatives to provide financing to credit cooperatives, and SROs that are supposed to protect credit cooperative members through emergency and compensation funds are also aimed at ensuring sound and stable credit cooperatives. The creation of a new category of institutions with prudential requirements much less onerous than those required for banks was a means of creating a stable cooperative sector.

The potential for tradeoffs between the dual objectives of stability and financial inclusion required some management by policy makers to ensure that the negative impact on inclusion — even in the short term — was not overwhelming. Policy makers were conscious that they may see a decrease in credit cooperatives as non-compliant credit cooperatives are wound-up and liquidated. However, in the longer

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22 Data collected by FFMS from SROs, January 1, 2013.
23 Explanatory note to the draft federal law “On Credit Cooperation”. Online link not available.
run, they expected that consumer trust in credit cooperatives and a clear legal framework for setting up cooperatives would allow for new credit cooperative entrants and sustained client use of services. The law allowed for the large cooperatives to keep growing and strengthen, through funding from 2nd tier cooperatives, other legal entities, as well as the government.

To manage the linkage between stability of the sector and ensuring financial inclusion, lawmakers have taken a risk based approach to addressing the stability of cooperatives through prudential requirements, based on the size of the cooperative. Larger cooperatives are subject to more stringent requirements and outside supervision:

- Credit cooperatives with more than 200 members must create a ‘counting commission’ to ensure quorum and count member voting and must have a supervisory council or audit committee to perform functions of control and audit.
- Credit cooperatives with more than 1000 members must establish a loan committee.
- Credit cooperatives with more than 2000 members must have a mandatory external audit. Furthermore, according to the Law on Audit Activity, credit cooperatives with RUB 400 million in sales or RUB 60 million in assets must also have a mandatory external audit.

Recognizing that supervisory resources are limited and smaller credit cooperatives present lower risks to stability, the law provides for delegated supervision of credit cooperatives with fewer than 5,000 members by SROs. Larger cooperatives (5,000+) must also belong to an SRO, but report to both the SRO and CBR (previously FFMS). Furthermore, those with more than 5,000 members as well as 2nd tier credit cooperatives must notify the CBR 30 days in advance of their general assembly. Finally, the financial normative standards for credit cooperatives functioning for less than 2 years are slightly more lenient than those for older credit cooperatives.

Finally, in implementation of the law, FFMS aimed to limit the negative impact on inclusion by promoting the mergers of weak credit cooperatives into stronger credit cooperatives, which would allow credit cooperative members to continue receiving financial services from a local credit cooperative and to maintain trust in their relationship with a cooperative. FFMS also recognized that newly merged cooperatives may struggle to meet the requirements for financial health initially, but this is not accounted for in the law. This linkage appears to have been identified by policy makers at the time of drafting the law, as there is evidence of balancing stability provisions with potential impact on outreach.

**Linkage between consumer protection and financial inclusion**

Policy makers also identified consumer protection challenges for credit cooperative members: some of them had been subject to instances of fraud, loss of member savings, and financial pyramids taking place under the banner of credit cooperatives. A linkage between consumer protection and financial inclusion was highlighted by some policy makers who believed that even limited fraud and consumer protection violations at credit cooperatives could have a very negative impact on the general level of consumer trust and thus their willingness to use formal financial service providers in the future. Conversely, an improved, consistent regulatory framework was expected to have a positive impact on consumer protection. The stability and consumer protection measures for credit cooperatives were

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24 This type of “re-organization” is allowed under the law.
intended to bring greater legitimacy to cooperatives and make clients feel more protected, not to curtail the sector.\textsuperscript{25}

The 2013 Consumer Credit Law (Sec. 3.3) applies to credit cooperatives in order to ensure consistency across lending services providers. The new law addresses a subset of consumer protection challenges for clients of credit cooperatives with the potential to drag down inclusion. However, the relationships between credit cooperatives and their members are still not covered under the broader Consumer Protection Law\textsuperscript{26}. With the recent inclusion of credit cooperatives under the CBR, credit cooperatives now fall under the consumer protection mandate of the CBR, though how this applies in practice is yet to be seen.

\textit{Linkage between stability and consumer protection}

Policy makers identified linkages between consumer protection and stability. Policy makers were concerned that the high visibility of pyramid schemes posing as credit cooperatives with high returns and preying on consumers could erode consumer trust in the rest of the financial sector. These spillover effects could have negative repercussions for stability in the rest of the financial sector.

Policy makers also recognized that creating a strong, stable sector would curb an existing consumer protection challenge. By creating strong, regulated credit cooperatives to safeguard customer funds, policy makers identified and made use of the perceived positive linkage between stability and consumer protection, i.e. that sound institutions would better protect clients and their deposits (savings). However, this may not adequately compensate for credit cooperatives being left out of the wider consumer protection framework as noted above. In addition, the deposit guarantee protection does not apply to credit cooperatives under the law (though credit cooperatives are permitted to provide their own insurance) and there are no provisions on market conduct rules.\textsuperscript{27}

The linkages between stability and consumer protection were viewed as positive in both directions, and as such did not promote active management.

\textit{Linkage between stability and integrity}

By becoming a part of the regulated financial sector, credit cooperatives are now subject to Federal Law No. 115-FZ of August 7, 2001, “On Countering the Legalization of Illegal Earnings (Money Laundering) and the Financing of Terrorism” (the AML/CFT Law). Complying with requirements under the law may introduce costs that limit outreach by credit cooperatives. Though some special AML/CFT regulations exist for nonbank organizations with regards to internal controls and reporting suspicious transactions, anecdotal evidence suggests some credit cooperatives believe certain compliance costs limit outreach and are not aligned with the risks. For example, credit cooperatives generally lack the resources needed to identify the “end beneficiaries” of their members which are legal entities as this requires access to information/databases that are costly. It is possible that many credit cooperatives are at risk of non-compliance with the AML/CFT Law. At this time, the materiality of the linkage is unknown, and enforcement of the law at this time is uneven due to resource constraints to supervise a large number of covered providers. More investigation is required.

\textsuperscript{25} Interview with Federal Financial Markets Service (FFMS), November 13, 2013.

\textsuperscript{26} Federal Law No. 2300-1 of 7 February, 1992 “On the Protection of Consumer Rights.” (as amended).

\textsuperscript{27} These may be addressed in the future via standards for CCs under a new law on self-regulation on financial markets.
3.1.3. What has been the observed effect on the I-SIP objectives?

Assessing the impact of the law on the I-SIP objectives is difficult because of the lack of comprehensive data prior to the law. In particular, it is a challenge to identify the effect on development of the sector since prior to the law, CCs were registered as lenders under various laws and the Civil Code. Estimates from 2008 indicate that the largest group, consumer credit cooperatives, numbered 1,271 serving 316,355 retail borrowers with a loan portfolio of USD 489,864,652 and an average loan balance of USD 1,548.\(^{28}\) We can assume the actual credit cooperative sector was larger. FFMS, the previous supervisor for the sector, estimated roughly 3,000 credit cooperatives prior to the law. The law is, in part, aimed at understanding the size and scope of the market.

**Inclusion: The observed effect on inclusion is difficult to determine.** Today, credit cooperatives that are members of SROs (1,483 credit cooperatives with approximately 1.1 million members, as of January 2013) report more than RUB 34.3 billion (approx. USD 1 billion) in member savings and RUB 32.2 billion (approx. USD 920 million) in the current outstanding loan portfolio (as of January 1, 2013). It will be useful to track loan and savings volumes as the entire sector is covered by reporting to SROs, both to gauge the increase in lending and savings, but also to monitor the number of members to understand outreach.

**Stability: The observed effect on stability appears to be positive.** Credit cooperatives were mandated to join SROs in 2011 and now there are 10 SROs in place charged with monitoring credit cooperative performance and stability ratios enshrined in the law. Since the implementation of the law, of the roughly 3,000\(^{29}\) cooperatives in existence, 1,483 credit cooperatives were reporting data to an SRO as of January 1, 2013 and approximately 1500 were not yet members of an SRO. Of these, 600 have been liquidated, and 400 were found to be inactive and will be taken off the register.\(^{30}\) The liquidation of 600 credit cooperatives based on their inability to meet the requirements set in the law is a sign of improved quality of the sector. Data on the financial performance of credit cooperatives are not publicly available and therefore it is not possible to fully assess the effectiveness of the law to date in improving the stability of providers, but this should be monitored by the supervisor. There are no publicly available time series data on the credit cooperatives sector since the law was introduced, and as such it is not possible to confirm with figures the assertion that there has been both an increase in the number of cooperatives formed and the number of members per credit cooperative.

The status of the other 500 credit cooperatives which are active, but still not SRO members is unknown or undecided, and this should be addressed to have the desired positive impact on stability. To meet the objective of stability, the SRO model of delegated supervision requires well-regulated, diligent SROs to ensure credit cooperative compliance. To date, SRO standards have been somewhat inconsistent, and the law may have created some opportunities for supervisory arbitrage that pose challenges for stability.\(^{31}\) CCs that are unable to meet compliance standards may be asked to leave the SRO and have three months to seek out a new SRO, and in the interim must report directly to the supervisor (CBR).

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\(^{29}\) As reported in interview with FFMS November 2013.

\(^{30}\) Ibid.

\(^{31}\) Efforts are underway on a law for SROs in financial markets that sets standards for consumer protection, information disclosure, and operations.
There are signs that the SRO regime will strengthen: FFMS warned those of the 10 registered SROs that had turned a blind eye to member non-compliance after audits that took place prior to November 2013; this should continue as supervisory powers transition to CBR.

The registration of five 2nd tier credit cooperatives bodes well for the stability of the sector as these 2nd tier institutions provide funding and support for the primary credit cooperatives. However, without performance data on 2nd tier credit cooperatives, this cannot be confirmed. There are indications that the Law on Credit Cooperation may have created an arbitrage opportunity for providers registered under the Microfinance Law to mobilize natural persons’ savings by creating or joining credit cooperatives (Sec. 3.2).

**Consumer protection:** There is limited evidence of a positive effect on protection. A large number of credit cooperatives are now regulated and supervised, thus meeting new financial standards aimed at protecting customer funds. When it comes to direct protection of consumers, it is unclear whether the SRO compensation funds will provide SRO members with the insurance that they need to protect their member savings.

Although improving trust in credit cooperatives was one of the initial reasons for introducing the Law on Credit Cooperation, a 2012 NAFI poll indicates that more than a third of the adult respondents lacked trust in credit cooperatives at the time. Additional research or polls of the same nature would be useful in understanding the evolution of client perceptions, in particular since the CC membership with an SRO became mandatory at the end of 2011 and client perceptions may take time to change. Understanding client perceptions about consumer protection at cooperatives will require additional research.

The effect of the CBR as the new consumer protection regulator for the sector and the new Consumer Credit Law is yet to be seen.

**Integrity:** The effect on integrity should be positive, however, there are no data to support this observation. The AML/CFT Law is applicable in a uniform manner across financial sector providers, thus financial flows should now be traceable through formalized credit cooperatives, thus improving integrity. Furthermore, credit cooperatives’ reporting and supervision as related to AML/CFT requirements is handled by the CBR since September 2013, rather than a direct relationship with Rosfinmonitoring (Federal Service for Financial Monitoring).

3.1.4. What have we learned about managing linkages and optimizing results?

The creation and implementation of the Law on Credit Cooperation in Russia offers valuable insights for other regulators on how to consider identifying and managing the linkages between the four I-SIP objectives.

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33 The poll reports that 63 percent of Russians were not aware of consumer credit cooperatives – perhaps because of the specific client base of credit cooperatives that tend to work in areas that are not covered well by banking services. The results also showed that of the 94 percent of Russians that do not use, or plan to use, credit cooperatives, 37 percent have no need to use credit cooperatives and prefer other financial institutions, while 26 percent cited a lack of knowledge or information on credit cooperatives.
Providing legal definition for the sector and introducing light regulation was considered an effective first step to understanding the scope and scale of the market. When dealing with the credit cooperative market where there was limited information on size of transactions and flows, policy makers interceded to use light regulation as a first step to understanding the scope and scale of the market. It was expected that low regulatory barriers could support the registration of market providers and support a test and learn approach where the first step is for the regulator to extend its oversight to the market. Some policy makers were clear that high regulatory barriers should be avoided as they would push many providers in the “gray” market and facilitate a limited understanding of the market. The former regulator, FFMS, had begun actively collecting information from the credit cooperatives and their SROs and this will likely continue as the responsibility for the sector shifts to the CBR. However, it is still to be seen whether the new understanding of the market and data collection will be geared towards understanding the risks and managing them through future regulatory or legal action where needed. Furthermore, defining the credit cooperative sector does not appear to have provided the legal basis for any unwanted players to enter the market, which stands in contrast to the experience with MFOs introduced in the following case, perhaps because of the clear definition of credit cooperative offered in the law.

Policy makers and regulators have taken a risk based approach to ensuring the soundness of credit cooperatives by prohibiting them from taking savings from non-members and introducing additional safeguards for larger credit cooperatives (as described above). Furthermore, the use of delegated supervision by SROs is indicative of a risk-based approach to ensuring financially sound providers: policy makers estimated that the low risks to systemic stability for credit cooperatives with fewer than 5,000 clients do not warrant the use of direct supervisory resources. However, to understand whether these barriers are indeed low enough to support inclusion, protection, and stability in the longer term, the newly collected supervisory data should be used to understand the landscape and financial health of the sector. In particular, it may be used to understand whether there is a need for adjusting the regulation to better reflect the different risk profiles of credit cooperatives which may not be driven by size of the credit cooperative alone.

High visibility of consumer protection infractions by financial pyramids under the cooperative name (prior to the Law on Credit Cooperation) presented an important issue for policy makers; however, this interest may be considered out of proportion with the systemic significance of the markets in question. Policy makers were decisive in addressing consumer protection challenges in the credit cooperative sector that are highly visible and can have a negative impact on the overall confidence of small savers in the financial sector. Through the implementation of stability measures in the law on credit cooperation, the instances of financial pyramids have decreased as a result of regulation and increased attention of the regulator to raising awareness amongst consumers of the distinction between regulated credit cooperatives and potential pyramids.

Ensuring that providers (especially depositories) are financially sound is a necessary but insufficient mechanism to ensure consumers are protected. Though policy makers and regulators in Russia have clearly understood the linkage between soundness/stability of providers and protecting consumer deposits through effective prudential supervision, they have also recognized the need for complementary tools in the credit sector such as transparency, disclosure, and market conduct regulation, as demonstrated by their ongoing work on the Consumer Credit Law (Sec. 3.3).
3.2. Law on Microfinance Activity and Microfinance Organizations

3.2.1. The policy change

Nonbank microlending activities in Russia started in the mid-1990s with international NGOs and were later adopted by local NGOs, government and municipal funds for small and medium entrepreneurship support, as well as commercial companies. Most of these lenders provided loans to microentrepreneurs, although commercial companies also engaged in consumer lending. Before 2010, there was no legal definition for microfinance (microlending) activities, and these institutions worked under the general provisions of the Civil Code governing lending activities.

Prior to the adoption of the Law on Microfinance Activity and Microfinance Organizations (the Microfinance Law) in 2010, about 280 non-banking organizations identified themselves as engaged in microlending; more than half were government and municipal funds and the vast majority of the remaining ones were registered as NGOs. Collectively, these organizations served over 71,000 borrowers, and their loan portfolio was about USD 111 million.\(^{34}\) The total size of the microlending sector at the time of the law is not known as some microlenders might not have identified themselves as such. None of the microlending organizations were engaged in deposit taking, since only banks are permitted to take deposits. However, any legal entity can take loans from natural persons or other legal entities without any restrictions on size, which allows for quasi-deposit-taking under the guise of borrowing.

Since 2007, when President Putin identified closing the financial access gap as a priority for his administration,\(^{35}\) the government has focused on measures aimed at developing small and medium entrepreneurship (an important segment lacking access to finance), including the adoption of a special law for this purpose.\(^{36}\) During the global financial and economic crisis of 2008-2009, the Russian government identified support of micro, small and medium-sized enterprises (MSME) as a substantial part of the government’s anti-crisis Action Plan.\(^{37}\) The Action Plan included additional funding for microlending to be provided by the Ministry of Economic Development (MED) and the state-owned Russian Development Bank (now SME Bank). To channel government funds into this sector (which was expected to catalyze private funding later on) and to track progress in MSME funding, MED felt that a clear legal definition and minimum standards were essential, and thus the Action Plan also included the adoption of a microfinance law.

At the same time, many existing microlending organizations felt that more legal clarity on their status was necessary because of frequent questioning on the legality of their activities by various authorities. Although the Civil Code grants lending rights to all legal entities, it was not clear to some whether lending could be done as their sole activity.

\(^{34}\) These statistics are estimates. Sapundzhieva et al. (2011)

\(^{35}\) President Putin’s address to the State Council, November 2007.


The combination of these two complementary forces – (1) policy makers striving to increase outreach of financial services to MSMEs and; (2) industry players wishing more legal clarity for their microlending activities – resulted in the adoption of the Microfinance Law. The law establishes the definition of a microloan as a loan up to RUB 1 million (approx. USD 27,800) and microfinance activities as activities of microloan issuance. A microfinance organization (MFO) is defined as an organization engaged in microfinance activities. The definition does not mention a social mission or any other qualitative characteristic of an MFO. It is therefore broad enough to accommodate different types of loans provided by MFOs such as loans to MSMEs, but also consumer loans.

The law appointed a government agency in charge of the regulation and supervision of MFOs. Initially, this was the Ministry of Finance, then the regulatory and supervisory powers were split between the Ministry of Finance and the FFMS, respectively, and from September 1, 2013, all these powers were transferred to the CBR due to the merger of the FFMS with the CBR.

3.2.2. Which linkages were identified and managed?

The stated main goal of the Microfinance Law was the creation of the legal basis for activities of microfinance organizations. The law defines these activities, the procedure and conditions of microloan extension, the order of MFO establishment, activity and reorganization, as well as rights and responsibilities of the federal executive authority in charge of microfinance. The main need to regulate microfinance activities was the observed growth of the microlending sector and its perceived importance in terms of meeting financial needs of micro and small enterprises. Since at that time there were no reliable statistics on the microfinance sector, defining microfinance and MFOs was regarded as a way to allow for an assessment of the market size, its main activities including the extent of consumer and business lending carried out by MFOs, and its performance.

MFOs were perceived as complementary to the banking sector because the MFOs worked with market segments where banks were absent. According to the Explanatory Note to the Draft Law, it was planned that the MFOs covered under the Microfinance Law would include organizations with a social mission (e.g. providing loans for business start-up and development to individuals, including the unemployed, for business equipment purchase, for staff development, and for increasing the range and quality of services offered by businesses) which will provide loans “to small businesses and population having difficulty in accessing financial services”. Thus, financial inclusion for specific underserved categories, namely micro, small and medium-sized enterprises, seemed to be a primary objective for the government with regards to the I-SIP objectives. Lawmakers did not explicitly mention consumer protection as their goal, yet the law was also expected to create “conditions for the protection of lawful rights and interests of MFOs, their customers and investors”. Specific provisions of the Microfinance Law limiting MFOs’ borrowing from natural persons (i.e. to prevent unlicensed financial intermediation using public quasi-deposits) were aimed at maintaining financial stability – a secondary objective of the Microfinance Law from the point of view of the I-SIP objectives. In sum, through increased legal certainty, the law was expected to enable increased financial inclusion, better understanding and monitoring of the sector, as well as consumer protection while maintaining financial stability.

39 With a few exceptions, the law allows most legal forms to engage in microfinance activities.
40 Explanatory Note to Draft Law No. 359066-5 “On Microfinance Activity and Microfinance Organizations”.
41 Ibid.
**Linkage between stability and financial inclusion**

From the very beginning policy makers identified and managed a linkage of financial inclusion with stability. To prevent unregulated public deposit taking and financial intermediation of the deposits, the law allowed MFOs to borrow from natural persons only in amounts exceeding RUB 1.5 million (approx. USD 41,700), i.e. from those considered more sophisticated investors. MFOs taking loans from natural persons and legal entities became subject to two prudential requirements – on capital adequacy and liquidity, introduced in subsequent regulations of the Ministry of Finance. As registering as a microfinance organization is not yet mandatory, the risk of quasi-deposit taking remains at least until the Consumer Credit Law will come into force on July 1, 2014. Until this date, the main factors incentivizing registration as MFO are that only MFOs are eligible for government support and that the MFO status provides them with a confirmation of the legality of their microfinance activities.

**Linkage between consumer protection and financial inclusion**

The Microfinance Law includes a number of conduct of business rules:

- It establishes general information disclosure requirements: MFOs have to inform their customers of the rules relevant to microloans, including rules of loan application procedures and review, and rules of loan agreement signing and repayment schedule provision. MFOs have to inform loan applicants about loan agreement conditions, about a possibility to change the agreement at the initiative of either the MFO or the borrower, and about a list of all fees and commissions and their amounts charged in connection with loan disbursement, servicing and repayment, as well as delinquency penalties.
- Several provisions in the Microfinance Law prohibit MFOs from changing loan agreements unilaterally and charging pre-payment penalties as long as clients (natural persons and individual entrepreneurs) give MFOs 10 days’ notice on their intention to prepay.
- The Law requires that MFOs maintain confidentiality of their client data.

At the same time, though the linkage with consumer protection was identified (as increased inclusion was thought to require “creating conditions for consumer protection”, i.e. provide a legal definition for an MFO and its activities), it may not have been sufficiently managed as the law did not specify the details of how MFOs were supposed to implement these consumer protection requirements and left room for various interpretations; it also did not address in detail business practices that could potentially be harmful to consumers (such as penalties and loan collection), and neither did it provide for a dedicated complaint and recourse mechanisms for MFO clients.

**Linkage between financial inclusion and integrity**

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43 The coming into force of the Consumer Credit Law (see Sec. 3.3) as well as upcoming amendments to the Civil Code will lead to a mandatory registration requirement. However, this will apply to entities engaged in consumer lending only; those engaged in enterprise lending can arguably still lend under the general provisions of the Civil Code without registering.

44 MFO clients – natural persons became subject to consumer protection requirements under the general Consumer Protection Law which, however, does not cover legal entities and individual entrepreneurs. This will change in July 2014 with MFOs also being covered under the Consumer Credit Law (see Sec. 3.3).
With regards to **financial integrity**, the Microfinance Law provided a definition of an MFO, which made it possible to include MFOs in the list of institutions covered by the AML/CFT Law.\(^{45}\) However, integrity concerns did not feature prominently when the law was adopted and only later received more attention, as a potential tradeoff between strict AML/CFT rules and inclusion became apparent.

### 3.2.3. What has been the observed effect on the I-SIP objectives?

It is difficult to assess the effect of the law on the I-SIP objectives because of the lack of comprehensive data prior to the law. All statistics on nonbank microlenders prior to the law (collected by the RMC and the MIX) covered entities which identified themselves as "microfinance", but there may have been others which did not do so and were therefore left out. As such, it is not possible to make comparisons to the whole nonbank microlending market before the law, only to a part of it. As noted above, one of the objectives of the law was to better understand the market and measure its size and performance. In addition, in the absence of national definitions of the I-SIP objectives, there is no clear picture of what can be considered a success.

**Inclusion:** After the adoption of the Microfinance Law, the market saw a rapid growth of registered MFOs, the majority of which were newly established entities. According to the CBR, as of 2013, 4,287 MFOs had been registered (with over 300 later excluded from the register), 1,055 of which were companies that had been established before adoption of the Microfinance Law (though it is unclear how many of them had been engaged in microlending). As of November 2013 the total number of active MFOs (i.e., those with a valid MFO certificate) was 3,969 – about 14 times the number of market players that had identified themselves as microlenders prior to the law. It appears that such growth in the number of MFOs was unexpected, and today the MFO sector is still the only one in the financial market with a growing number of players. The total loan portfolio of registered MFOs as of July 2013 is estimated at about RUB 32 billion\(^{46}\) (approx. USD 0.89 billion), which is over 8 times larger than before the law. The total number of active borrowers in June 2013 was about 950 thousand and thus 13 times higher than the reported number of borrowers before the law.\(^{47}\)

The outcome has been significant with regards to increasing financial inclusion for MSMEs, as the number of MSMEs served by MFOs grew five-fold from 10,000 in 2010 to over 55,000 as of June 2013.\(^{48}\) But in addition to increased outreach to MSMEs, the law brought other players into the microlending market as well. The number of government and municipal funds registered as MFOs is about 350,\(^{49}\) or less than 10 percent of the total number of MFOs, accounting for about 29 percent of the sector’s portfolio as of September 2013 (funded by the MED and SME Bank).\(^{50}\) Other MFOs include a variety of players. For example, several MFOs were established by banks as they saw the law as an opportunity to

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47 Data provided to the author by CBR.

48 Ibid.

49 Currently it is not possible to establish the exact number based on public sources as the state register of MFOs does not contain categories of MFOs.

50 November 2013 Interview with Mikhail Mamuta (in his capacity as RMC President).
make this business line cheaper. A number of MFOs, as mentioned above, had existed before the law and only obtained a new status. However, the absolute majority of newly registered MFOs are commercial consumer lending companies, and many of them are so-called “payday lenders” (the latter are the majority of all MFOs in the MFO register). There are also some MFOs that offer several types of microloan products – from loans for entrepreneurial purposes to consumer and payday loans. The Russian Microfinance Center estimates that the total microlending portfolio can be broken down as follows: enterprise loans (provided by government and municipal funds as well as private MFOs) - about 55 percent; consumer loans – 30 percent; payday loans - 15 percent.

51 Expert RA Rating Agency. “Microfinance Organizations in the First Six Months of 2013: In Expectation of Changes.” December 2013. It should be noted that “Expert RA” Rating Agency use their own definition of payday lending as loans to natural persons with a term of up to 30 days.


54 Some of them are owned by foreign companies that have a long experience of payday lending in other markets such as the United States and the United Kingdom.

55 “Expert RA” Rating Agency (2013) estimate that the share on non-performing loans in the portfolios of private MFOs was about 30 percent as of June 2013.

56 Estimates on this vary widely with some observers stating that up to 50 percent of payday lending occurs outside the law.
terms, financial inclusion means more than just growth in numbers. At least part of the growth has been in financial services with questionable qualities and thus with potentially negative effect on the customers. Regardless of whether payday lenders are registered as MFOs or not, the fact that payday lending was recognized as a microfinance activity and became regulated – and “approved” – in the eyes of the public – by the CBR, may have initially propelled the growth of this subsector. At the same time, bringing payday lending into the open may have made it easier for the CBR to limit negative practices at least among MFOs engaged in this type of lending. It is too early to tell whether the resulting effect has been an improvement in the quality of financial inclusion, but it has led to an increase in the number of MFOs being excluded from the state register, the majority of which have probably been payday lenders.\(^5^7\) The coming into force of the Consumer Credit Law in July 2014 is likely to have the more significant effect on the quality of financial inclusion (see Sec. 3.3).

**Consumer Protection:** Though relatively small in terms of the portfolio volume, payday lenders have quickly become the most visible part of the microfinance sector, alerting policy makers to the risk of regulatory arbitrage and the need to manage linkages between the objectives of inclusion and consumer protection and also between protection and stability. As the growth of the payday lending market gathered in speed after the adoption of the Microfinance Law, policy makers initially did not identify these linkages.\(^5^8\) One scandal in particular highlights the need to manage the linkages with consumer protection and stability: in February 2012, a payday lender offered “loans to pensioners” at over 2770 percent p.a. through offices of the Russian Post in several cities. Some Russian Post visitors – most of them low-income people as the Post administers disbursement of social and pension benefits – then may have indeed concluded that the loans were offered by the government. The incident gained so much publicity\(^5^9\) that remarks were made by President Medvedev’s assistant promising to resolve the issue. It seems that at this point policy makers realized that there was a range of players under the same regulatory category for microfinance, creating significant reputational risks for the sector. Furthermore, they recognized that consumers of financial services – especially low-income and financially illiterate ones – were not adequately protected from unethical practices of payday lenders. The Russian Post scandal also gave rise to a discussion on regulating interest rates for all financial institutions offering consumer loans (see Sec. 3.3). Public opinion surveys conducted soon after the Russian Post scandal confirmed that the reputation of the microfinance sector may have been affected, showing that MFOs were the least trusted among financial institutions – only 14 percent of respondents said they trusted MFOs as compared to 65 percent who trusted banks.\(^6^0\) However, it should be noted that MFOs were a new phenomenon then and the lack of trust could also be an indication of a lack of familiarity with MFOs; even in December 2013, 78 percent of people were still not aware of MFOs.\(^6^1\)

Another consumer protection aspect of the payday lending sector has to do with its target market which is primarily lower-income and more vulnerable consumers who cannot access better alternatives (e.g.

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\(^5^7\) According to CBR data, between September 1, 2013, and March 1, 2014, 400 MFOs were deregistered (about half of them voluntarily). In the first half of 2013, only about half this number of MFOs were excluded from the register.

\(^5^8\) And, as noted above, it is hard to say to what extent the growth of the payday lending market has been propelled by the law.

\(^5^9\) See, for example, Газета.Ру. «Страна у нас такая: люди нуждаются в деньгах». 6 February, 2012.

\(^6^0\) NAFI. "Credit and Debt: Russian Consumers’ View." Data as of March 2012.

due to lack of bank branches, absence of credit history or bad credit history, lack of a regular salary, etc.). It also seems that payday lenders, limited in their ability to raise corporate funding due to their low portfolio quality, have been looking for possibilities to get around the RUB 1.5 million floor on loans from natural persons that they are allowed to mobilize. For example, there is evidence of emerging schemes when funds from natural persons are mobilized as member savings through a credit cooperative (CC), which then extends a loan to an MFO as a legal entity (the MFO has to become a member of this CC). Another scheme has been the mobilization of small loans from natural persons by companies not registered as MFOs — i.e. under the Civil Code general provisions (without restrictions on the loan limit), and then either lending themselves or on-lending these to MFOs. From the I-SIP perspective, this regulatory arbitrage raises both stability and consumer protection concerns since such ways of raising money may create risks for unsophisticated consumers. It is not clear how many MFOs have been using this institutional setup.

It can also be argued, however, that the fact that payday lending became more visible as it was now also conducted by regulated entities increased the pressure on the regulator — since September 2013 the CBR — to address consumer protection issues, as evidenced by the recent adoption of the Consumer Credit Law (see Sec. 3.3).

**Stability:** The fact that payday lending MFOs (and other companies providing payday loans) charge extremely high interest rates (1.5 – 2.5 percent daily, or 547 – 912 percent p.a., on average) and even higher delinquency penalties (up to 4.5 percent daily, or over 1640 percent p.a.) may not be just affecting the level of client indebtedness, but in the opinion of industry experts, may also be undermining consumer credit discipline if it leads to increased debt stress or to a general loss of trust in the industry. When surveyed on what would cause them not to pay back their loans, a large proportion of adults mentioned the case where a bank (or other creditor) cheated them. Generally, extreme over-indebtedness and a loss of credit discipline — even if it only affects a small share of the market such as the payday lending sector — expose a linkage between consumer protection and financial stability, if consumer attitude potentially spills over to banks thus putting public deposits at risk or causing a loss of trust in the formal system. The need to manage the tension with consumer protection and stability might have become even more acute since the CBR assumed responsibility for MFOs.

Attempts of some MFOs to get around the restrictions on taking loans from natural persons, as described above, could not be attributed to the Microfinance Law as such (indeed the Microfinance Law tried to curtail them by setting limits); yet these activities exposed a need for policy makers to focus on stability and work on eliminating any possibilities of quasi-deposit taking by unregulated entities.

**Integrity:** In the area of financial integrity, the scope and complexity of procedures provided for in the AML/CFT Law turned out to be difficult and costly for MFOs to comply with the AML/CFT requirements. For example, the AML/CFT law establishes very comprehensive KYC requirements, including the establishment of the end beneficiary of a financial transaction, and requires updating this information at least once a year. MFOs must once in every three months check whether any of their clients are blacklisted by Rosfinmonitoring, the AML/CFT agency, and block any property of these clients or terminate their transactions (it is not entirely clear how this requirement could be implemented since

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62 The only restriction on lending by credit cooperatives is that they cannot lend more than 10 percent of their loan portfolio to a single borrower.

63 On average the portion respondents choosing the answer has been 29 percent in 2009 and 2012, with a peak of 35 percent in 2010. See NAFI. "Press release: Borrowers’ responsibility grows." 7 June, 2012.
MFOs do not take deposits, and any loans taken from individuals or legal entities are legally considered as property of MFOs. MFOs must develop and comply with their AML/CFT internal control rules and maintain written documentation on the implementation of these rules. It should be noted that the AML/CFT law provides for significant fines for non-compliance. According to some observers, it is impossible for MFOs to comply with all legal provisions and some of them lack clarity, which puts MFOs at risk of being penalized for non-compliance. It should be noted, however, that Rosfinmonitoring has issued specific regulations for MFOs that take into consideration the specific risk profile of microfinance operations and are therefore more relaxed than what is required of banks in as far as AML policies are concerned (yet the same rules on CFT apply). While these regulations were drafted in close consultation with the industry and have been more tailored to the specific risk profile of MFO’s activities, some challenges remain. As for the effect of the introduction of AML/CFT rules in the MFO sector, there are currently insufficient data to assess whether integrity risks have decreased as a result.

**Ongoing attempts at managing linkages:** In order to manage the increasing tension between the objectives of financial inclusion and financial consumer protection in the case of certain categories of loans and lenders, the Central Bank jointly with the Ministry of Finance and the Russian State Duma proposed amendments to the Microfinance Law aimed at improved consumer protection and government regulation in the MFO sector, which were adopted in December 2013. In particular, these amendments provide for the detailed disclosure of the full loan cost – in line with requirements of the Consumer Credit Law (see Sec. 3.3). In addition, MFOs will be required to inform their clients of their registration as MFOs under the Microfinance Law. Participation of MFOs in at least one credit bureau will become mandatory in July 2014. Accompanying draft amendments to the Law on Advertisement will no longer allow advertisement of lending services by non-financial organizations (i.e. those lending under the Civil Code and not registered as banks, MFOs or credit cooperatives), something that is expected to have a chilling effect on these types of lenders. In March 2014, the CBR also established a special department for consumer protection – the Bank of Russia Service for Protecting the Rights of Consumers of Financial Services and Minority Shareholders.

3.2.4. What have we learned about managing linkages and optimizing results?

The financial inclusion objectives of the Microfinance Law could be achieved even better with a sharper definition of microfinance in place that clearly distinguishes enterprise lending from consumer lending. The fact that there was no qualitative definition of microfinance in the Microfinance Law brought various players into the microfinance market – ranging from enterprise lenders such as government funds, NGOs, commercial MFOs and MFOs established by banks to commercial consumer lenders and payday lenders – without at the same time introducing necessary legal provisions to address any unethical practices among payday lenders. The entry of the two latter types of lenders was an unintended consequence of the law adoption and highlighted the tension between the financial inclusion and consumer protection objectives. Permitting payday lenders to register as MFOs provides them with a “stamp of approval” – a signal from authorities that their activities are legally recognized

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and regulated; this effect may have been underestimated and now presents distinct consumer protection and reputation risk challenges.

At the same time, the higher visibility of consumer protection challenges under the Microfinance Law might have propelled the government to introduce necessary regulatory changes (such as the recent amendments to the Microfinance Law and the introduction of the Consumer Credit Law, with the latter being discussed in more detail in Sec. 3.3). There are some indications that this has led to the exclusion of an increasing number of payday lenders from the register.

While no direct risks to financial stability exist, there are potential indirect risks through the impact of consumer protection issues. Stability concerns included initially only concerns with respect to unregulated quasi-deposit taking by MFOs (and legitimately so, given the history of financial pyramids in Russia in the 1990s), but did not consider reputational risks to the microfinance sector of payday lending being conducted under the law. Although payday lenders indeed do not usually pose risks to systemic stability (as they do not mobilize public deposits and their share in the total consumer lending portfolio is currently negligible – see Sec. 3.3), their disproportionate visibility can create risks to the reputation of the sector and have a negative effect on the performance of other parts of the sector. At the extreme, consumer protection issues in the payday lending market can therefore have an indirect effect on the stability of the sector. In terms of financial stability as such, there have been no financial pyramids in the form of MFOs, but there is still risk of unregulated financial intermediation since on-lending of loans from the public is not restricted for institutions not registered as MFOs – which can still borrow and lend under the Civil Code (this will change in July 2014 with the Consumer Credit Law coming into force – see Sec. 3.3).

Regulatory arbitrage arising from insufficient analysis of the broader financial sector and how a new law fits within existing legislation presents another stability and consumer protection-related risk. In particular, it is possible for MFOs to take advantage of credit cooperatives by becoming their members (or creating CCs) and then be able to borrow natural persons’ funds invested as savings in these CC and put them at risk by lending them out. MFOs can also mobilize natural persons’ loans through the establishment of separate legal entities that are permitted to do so under the Civil Code (i.e. without restriction on the size of borrowing) and then can either lend themselves, without registering as MFOs, or on-lend to MFOs (this, too, will change with the Consumer Credit Law enactment).

The resolution of consumer protection issues that surfaced as a result of rapid consumer lending growth in the absence of effective consumer protection regulation requires introduction of new legislation and changes to several legal acts (particularly as consumer loans are provided by various financial institutions with MFOs only being one type of provider). Policy makers in Russia have developed a Consumer Credit Law, adopted in December 2013 (see Sec. 3.3) and are currently working on the draft Financial Ombudsman Law, as well as amendments to the Law on Advertisement, Administrative Offence Code and several other laws and regulations.

When specifically tasked with the management of some of the I-SIP objectives, a regulator may be able to better exercise this management. In the case of the CBR, failure to manage the tension with consumer protection could create reputational risks for the regulator. The establishment of the consumer protection issues that surfaced as a result of rapid consumer lending growth in the absence of effective consumer protection regulation requires introduction of new legislation and changes to several legal acts (particularly as consumer loans are provided by various financial institutions with MFOs only being one type of provider). Policy makers in Russia have developed a Consumer Credit Law, adopted in December 2013 (see Sec. 3.3) and are currently working on the draft Financial Ombudsman Law, as well as amendments to the Law on Advertisement, Administrative Offence Code and several other laws and regulations.

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E.g. regional divisions of FFMS (now the Financial Market Service of the CBR) have been regularly publishing lists of organizations “possessing characteristics of financial pyramids” and informing of actions taken against them (e.g., http://nsk.ffms.ru/informaciyadlyainvestora/piramida/, http://www.fcsm.spb.ru/invest/2/5).
The protection department at the CBR (the Bank of Russia Service for Protecting the Rights of Consumers of Financial Services and Minority Shareholders) in March 2014 was an important response to the issue.
3.3. Law on Consumer Credit (ex-ante analysis)

3.3.1. The proposed policy change

The Federal Law 353-FZ on Consumer Credit (Loan) (Consumer Credit Law) was adopted on December 21, 2013 and will come into force on July 1, 2014. The initiative for the law on consumer lending began with a first draft in 2006 in response to a growth in consumer lending by banks that were lending aggressively. There were consumer protection concerns around their high interest rates, opaque lending terms, and forceful collection processes for unsecured loans. One highly publicized incident of lack of transparency and unethical collection processes at a large commercial bank warranted an intervention from the General Prosecutor’s Office. In 2008, after the financial crisis, regulators responded with bank regulations on disclosing the full cost of credit.

Continued growth in consumer lending – both through the banks and a variety of new providers such as MFOs and those lending under the Civil Code – has renewed government interest. At the banks – the largest providers of consumer loans – the consumer lending portfolio has grown more than 116% since 2009 (see Figure 2). Though payday lenders (registered under the Microfinance Law - see Sec. 3.2 for explanation – or lending under the Civil Code) are the most visible and fastest growing in terms of number of providers – their loan volumes are limited as compared to the banks. According to the RMC, such payday lenders only account for about RUB 4.8 billion (approx. USD 137 million) in outstanding loans, which is 0.9 percent of consumer lending by the banks in 2012.

Initially, the draft law was only applicable to credit organizations (banks and NBCOs) but after a series of changes, the law defines “professional consumer lending” as the activities of a legal entity or individual entrepreneur engaged in “consumer lending in monetary form conducted with funds attracted systematically on a returnable and fee basis and/or at least four times in one year”. This broadens the definition of ‘creditor’ significantly to include credit organizations and nonbank financial organizations: microfinance organizations, credit cooperatives (including agricultural credit cooperatives) and other legal entities providing consumer loans at some scale. Notably, it attempts to even cover lenders (natural persons and legal entities) lending under the Civil Code. The law is also applicable to entities that are assigned the consumer credit through succession or by foreclosure of the property right owner.

The Consumer Credit Law has been adopted at a time when the CBR has recently become the consolidated regulator for the financial sector and has begun to oversee the MFOs and CCs through the establishment of 9 new structural units, including a General Directorate for Countering Unfair Practices and Behavior in Financial Markets.

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68 With the exception of the ceiling on the total cost of the loan which will come into effect by 14 November 2014 when the CBR begins to publish the average market values of the total cost of credit.

69 CBR Direction No. 2008-U of 13 May, 2008 “On the Order of Calculation and Informing a Borrower – Natural Person – of the Full Cost of Credit”.


71 Through the newly formed the General Directorate of the Microfinance Market and Financial Inclusion Methodology responsible for MFOs, credit consumer cooperatives, rural credit consumer cooperatives, housing cooperatives, and self-regulatory organizations of credit consumer cooperatives.

The law applies to professional consumer lending to individuals, but not to loans for productive use (corporate or enterprise lending). The law standardizes transparency and disclosure requirements for general terms and conditions to be displayed at the point of service, as well as those specific to the individual loan contracts including guidelines on calculating and presenting the annual total cost of credit, ceilings on the permitted interest rate, presentation of repayment schedules, and limits the size of penalties and fees in case of delinquencies. The law also sets standards for signing the contract for consumer credit, the disbursement/transfer of loans using electronic means, refusal of credit and early repayment. Finally, the law sets minimum requirements for the assignment of rights/claims to third parties, consequences for violation of the loan agreement, and acceptable practices with regards to loan collection.

3.3.2. Which linkages were identified and managed?

The primary objective of the Consumer Credit Law is to protect individuals in the market for unsecured consumer loans regardless of the type of provider serving them. High interest rates, fees, penalties, and aggressive collection practices have persisted and have an undesirable impact on consumers. The law is an attempt to ensure that consumer loans are subject to business conduct rules. By setting transparency and disclosure standards and market conduct rules, the law aims to provide consumers with the information they need to make appropriate decisions about indebtedness and curb the supply of loans that may harm consumer.

The discussions leading to the introduction of the Consumer Credit Law, various changes to the law in the drafting stage, and the final outcome of the law clearly show that policy makers, the industry, and consumer advocates have identified linkages among various policy objectives and have managed some of them.

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73 In an earlier draft of the law, mortgage lending was also subject to the law, but in the final draft, mortgage lending was excluded.
Linkage between consumer protection and financial inclusion

Policy makers recognized that the growth in loan origination through means that are harmful to consumers lead to aggrieved customers and over-indebtedness which can have a negative effect on clients’ intention and ability to repay and erode their trust in lenders, both of which may compromise the quality and longevity of financial inclusion over time. In the short run the provisions of the Consumer Credit Law are expected to lead to a decrease in the demand for loans as clients do not find the available loan products attractive due to increased transparency of loan costs and conditions. While this decrease in lending may look like a setback in financial inclusion, most policy makers are careful not to equate simple growth in lending or outreach with increases in financial inclusion, in spite of the market demand for these loans. A temporary decrease is accepted, because of the anticipated positive impact on inclusion in the long term as clients enter into appropriate loan agreements and access quality loans that encourage them to use financial services on a sustained basis.

A decrease in predatory lending is also aligned with the primary objective of the law: consumer protection. Policy makers expect and want the law to decrease the supply of harmful credit. Despite concerns from short-term lenders (such as payday lenders) and banks offering overdraft facilities wary of disclosing their interest rates in annual terms (as these are the most expensive consumer loan products), these requirements have persisted in the final law. The provisions are aimed at curbing lending by restricting lenders’ income streams from high rates of interest, excessive penalties over time, and forceful collection. However, a strong lobby has developed against these requirements. This is not surprising, as some providers’ business models depend on these harmful practices; e.g. there is evidence of consumer and payday lenders’ business models in the market that are based on charging high penalties rather than loan interest.

Linkage between consumer protection and stability

One reason for policy makers’ renewed interest in the Consumer Credit Law was that they recognized the potential negative impact of rapid growth in consumer lending on financial sector stability and larger macroeconomic concerns such as inflation and economic growth. The rapid growth in consumer credit is a suspected cause of the increase in the consumer debt burden and over-indebtedness. A recent IMF report highlights these concerns: banks have faced high growth in retail and unsecured consumer lending segments of 40 and 55 percent respectively in 2011 and 2012. Though household debt to GDP in 2012 is still quite low (approx. 12 percent), according to the IMF, debt service ratios are high (approx. 20 percent), reflecting short maturities and high interest rate costs. In turn, there is concern that this level of growth will lead to clients’ inability to repay their debt and cause a deterioration of provider balance sheets where consumer loans have accumulated.

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76 International Monetary Fund (2013). According to the IMF: “The NPL ratio has been declining due to rapid credit growth, with NPLs growing in nominal terms. The FICO Credit Health Index has been declining since 2012 as a result of the rapid growth in the highest-risk sectors of the credit market (notably unsecured consumer loan and credit cards) and rising delinquencies in these segments. There are indications that overall asset quality has deteriorated in 2013, and NPLs may increase quickly once credit growth slows.”
As such, debt stress and over-indebtedness are not only consumer protection challenges, but can also have implications for the financial health (solvency) of providers if they lead to a deterioration of the quality of their loan portfolios. This can potentially also cause systemic risk if it leads to a general slump in repayment discipline and thus negatively affects the stability of the banking sector. According to an October 2013 report by the IMF, with the rapid growth in consumer lending there are signs that the quality of the uncollateralized retail loan portfolio has started to deteriorate: NPLs have grown in nominal terms as ratios decrease because of the growth in the loan portfolio.\textsuperscript{77}

The potential risks to systemic stability will differ based on type of provider and whether the lenders are deposit taking institutions. Some policy makers have expressed a fear that high levels of indebtedness even at non deposit taking institutions (for example, payday lenders) could impact credit discipline and depositor trust in the financial sector more broadly, thus heightening stability concerns (see also Sec. 3.2). Sustainability concerns may be more acute for lenders that focus on unsecured lending and may not have adequate buffers to absorb losses. For the banks, these concerns have been met with changes in the prudential requirements (provisioning and risk weighting) to rein in uncollateralized lending.\textsuperscript{78} It should be noted that prudential requirements to curb uncollateralized lending are likely to have a faster and more significant effect on consumer loan growth. The Consumer Credit Law appears to be another avenue to address these concerns by improving the quality of consumer loan portfolios and ensure lender soundness as these issues are certainly of concern for the CBR.\textsuperscript{79}

From a macroeconomic perspective, the IMF and CBR are concerned that the high growth in unsecured retail loans, in tandem with stagnating GDP growth, will drive inflation.\textsuperscript{80} The threat of inflationary pressure has also been a driving force behind the CBR’s interest in curbing the growth in consumer lending. This potential threat to the critical macroeconomic objective of low inflation is likely to supersede the potential threat to stability, and as such may be the driving force behind the policy.

While policy makers have identified and leveraged the synergy between consumer protection and stability in this case, it is important to note that it was not the only measure to mitigate stability risks caused by a rapid expansion in lending: as noted above, banks faced new prudential requirements to rein in lending, because of the size and value of the consumer loan portfolios. Thus the stability risk was identified and managed.

3.3.3. What is the expected effect on the I-SIP objectives?

As this is an \textit{ex ante} case, no effects can be observed to date. Instead, this section discusses expected effects on I-SIP objectives once the Consumer Credit Law comes into force in July 2014. It is based on an analysis of the provisions of the law. The new law is a product of the legislative process, and the story of the deliberations offer some indication of where we may see additional linkages that have not been

\textsuperscript{77} Ibid.

\textsuperscript{78} Directives No. 2920-U, No. 2947-U and 2948-U of December 2012. Amending its Regulation No. 254-P “On the Formation of Provisions by Lending Organizations to Cover Potential Losses in Loans, Loan Indebtedness and Other Similar Indebtedness.”


\textsuperscript{80} Ibid. The growth in consumer loans is giving rise to inflationary pressures since they are not used to contribute to labor productivity and growth, as enterprise loans might more reasonably be expected to do.
considered as part of the deliberations of the law, but may still require careful management to observe a positive effect on the I-SIP objectives.

**Consumer protection**

**Transparency and disclosure mechanisms provided for in the law have not been comprehensively tested.** To curb harmful lending, the transparency and disclosure practices adopted under the new law must be appropriate for the consumers they target and address lenders’ harmful but lucrative practices. There have been many questions raised on whether the means of transparency and disclosure suggested in the Consumer Credit Law are better than the existing requirements across providers and whether they provide the appropriate type and amount of information for consumers to have the desired reduction in harmful borrowing. Regulators should define the change they expect to see in the market (consumer loan origination, indebtedness, non-performing loans, etc.) and monitor progress towards this goal to support recalibration of the law as necessary.

**A cap on penalties was subject to many changes during the drafting of the law.** The penalty limit which comes into effect offers two options for the upper limit on the penalty, with one option allowing lenders to charge both interest and penalties. A clause to curb inappropriate collection practices was also re-introduced in the final version of the law, strengthening consumers’ position by setting limits on what type of direct action creditors may take with the borrowers when trying to collect from borrowers. For example, the law sets limits on the time of day during which borrowers can be contacted via telephone and text message. Efforts should be made to monitor consumer complaints with regards to collection practices to better understand if the law is having the desired effect.

**Inclusion**

**If set too low, the ceiling on interest rates may prohibit providers from reaching traditionally excluded client segments.** There is a risk that clients who are more difficult – and thus higher-cost – to serve, particularly in remote areas, will not be served. The law implements a ceiling on total cost of credit (Article 6) set at one-third above the market average for the specific loan type (based on loan amount, duration, collateral, type of lender and other criteria set by the CBR).

The discussion on interest rate ceilings to date has been somewhat nuanced: lawmakers considered that different market segments and products require different limits on interest rates, and the CBR is charged with determining these rates and providing more guidance in forthcoming regulations. To date, there has been no assessment of the expected implication of interest rate ceilings on the market. However, it appears that there will be further industry research and consultation with regards to the regulation. The CBR has until November 2014 to implement this provision, providing them the opportunity to better understand which type of loans may not be able to be offered on a profitable basis under the adopted interest rate cap. This may require adjustments to the cap to ensure that providers can sustainably lend to clients who have no other options for credit.

**The increased cost of compliance may adversely impact small providers supporting inclusion.** While policy makers appear comfortable with the decrease in lending driven by a decrease in harmful lending practices, it must be noted that no systematic assessment has been done to quantify lenders’ cost of compliance with the new law, which can negatively affect financial inclusion. Some policy makers expressed caution not to raise the barriers to consumer lending “too high” for fear that providers are

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81 The new provision on the penalty limits restricts the penalty size to either 1) 20% in addition to the interest accrued; or 2) 0.1% per day, if no interest is accrued.
pushed to lend in the unregulated “gray market”, which may have negative impacts on integrity (as flows in the informal sector are less traceable) and consumer protection issues (which would not be supervised). Even lenders that do not pose consumer protection concerns may find compliance costs unsustainable, causing them to curb or stop lending. For example, some smaller microfinance providers have indicated that the calculation of the total cost of credit using the required formula poses significant challenges for their current management information systems. A high cost of compliance may push these providers to stop lending. Though they would still technically be subject to the law, there is still a lack of clarity of how this would be enforced. The potential negative impact of the cost of compliance on inclusion of this and other provisions could be significant, but it has not been identified as one of the potential tradeoffs between protection and inclusion and this linkage has not been managed.

**Stability**

Despite identified synergies between increased consumer protection in the market for consumer loans and increased stability, some policy makers/regulators perceive a conflict between the mandates of defending consumer protection and financial stability and advocate for a division of these responsibilities. The Service for Protecting the Rights of Consumers of Financial Services and Minority Shareholders was established at the CBR in March 2014, with responsibility for executing the law for non-bank lenders while Rospotrebnadzor, the consumer protection agency, will maintain its general responsibility for consumers with a special focus on banking clients (except for enterprise lending and credit cooperatives). To some policy makers, consumer protection or the rights of consumers are considered to be at odds with the primary mandate of the CBR (which is to ensure financial stability): consumer protection is perceived as costly and affecting banks’ profitability. However, it is more likely that banks’ solvency would be at risk because of undesirable and unsustainable lending practices in the face of this law than because of unsustainable compliance costs. Since there is a long term vision for integration of consumer protection oversight into a single regulator, it is expected that, by law, the CBR will need to develop a special policy aimed at the management of the conflict.

3.3.4. What have we learned about managing linkages and optimizing results?

The exact shape of a regulatory measure can determine whether there is a tradeoff or synergistic outcome between protection and inclusion. The realization of the potential positive linkages between consumer protection and both financial inclusion and stability discussed above are highly dependent on the efficacy – on both the demand and supply sides of the market – of the consumer protection approach adopted. The Consumer Credit Law relies heavily on transparency and disclosure of interest rates and charges to prevent client debt stress or over-indebtedness. This shifts the onus to the client to make appropriate decisions about debt. In such a regime, it is essential that the format and information is communicated to clients in a way that they can understand and absorb. This may vary for client segments and product types. As such, it is important that transparency and disclosure rules be tested

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82 Since the law is not applicable to enterprise loans – there may still be an opportunity to circumvent the law’s consumer protection requirements by providing business loans.

83 Federal Service on Customers’ Rights Protection and Human Well-Being Surveillance.
with real consumers of different types, to ensure they are effective\(^{84}\) and better than the status quo for all providers.

The provision on the interest rate cap is a good example of where careful design is necessary to avoid a tradeoff. This decision and specifics of the interest rate cap should be carefully supported by targeted research, drawing on credible compliance cost projections from industry, to understand which loan types, customer segments, and lenders the proposed interest rate ceilings would affect. The risks to inclusion of setting the ceiling too low must be identified. Though responsible lenders are less likely to be affected by the provision on penalties and the limitations on collections processes, further analysis would help to provide a better understanding of different providers’ business models and the client segments they serve, to determine whether there are potential tradeoffs with inclusion.

*It is necessary to collect data that adequately diagnose the challenge and reflect progress towards the policy objective with appropriate segmentation.* When attempting to understand the current status of the consumer protection challenges to be overcome by the Consumer Credit Law, current indicators do not paint an adequate picture of the status quo or support tracking progress towards the objective. Current data on debt stress and overindebtedness such as household debt/GDP and average debt as a percentage of household income are largely only available for the banking sector (not other lenders) and only at the economy-wide level, which does not capture the distribution of indebtedness.\(^ {85}\) It is critical to be able to look at both the aggregate figures (economy and sector wide) as well as break them down by provider type to determine whether potential linkages are material by provider type. There is utility to disaggregating statistics by segments — e.g., income groups, regions, and employment types — to detect localized or segment-specific stress.\(^ {86}\) In particular, measuring the extent of the client debt burden and using these measures to understand the market and to adopt policy is a challenge, as traditional indicators for measuring debt stress and overindebtedness have limitations.\(^ {87}\) For example, at the institutional level, using a low level of arrears as an indicator of debt stress can obscure the true level of arrears in a market characterized by rapid growth in lending, competition and high liquidity (since borrowers can more easily take out a new loan to repay an old one). Arrears are a lagging indicator. At the macro level, the relevance of the debt to income ratio for understanding consumer or household debt stress is driven by the type of debt included in the measure. Furthermore, this indicator only provides an estimate of the overall amount of debt rather than the burden of debt servicing for consumers.\(^ {88}\)

**Inter-agency cooperation to harmonize standards and determine implementation and enforcement responsibilities is critical to ensure a level playing field.** Inconsistent implementation across providers may open the door to arbitrage. In the short term, the newly created Service for Consumer Protection at the CBR and Rospotrebnadzor will be responsible for financial consumer protection of different

\(^{84}\) Effectiveness will also be influenced by consumers’ formidable behavioral biases that militate against consumers reinig in their tendency to borrow too much or unwisely (e.g., temptation, overconfidence in future earnings, etc.).

\(^{85}\) Some initiatives like the Forbes Debt map are able to segment bank data on indebtedness geographically/geographically. However it is unclear if these tools are being used by policy makers.


\(^{87}\) Ibid.

\(^{88}\) Ibid.
providers serving the market for consumer loans and will need to ensure consistency in their approach to oversight. There is a need to look at negative and positive linkages arising in the consumer lending market, which includes multiple providers that may compete for clients. As such, statistics should be both comprehensive and easy to disaggregate. To date, very limited data are available regarding the volume of consumer loans outside the banking sector and require a cooperative effort and common purpose to provide the full picture.

*Enforcement and feedback into the Consumer Credit Law will be critical to its success in this relatively new objective for the CBR: consumer protection.* The newly established Service for Consumer Protection must surmount concerns about the tensions between stability and consumer protection by highlighting the synergies. Enforcement and supervision of the new law via this new Service for Consumer Protection will be critical for its success. This type of market conduct department should have a degree of separation from the prudential supervisors to avoid any conflicts of interest. However, it should also recognize the need to communicate around material issues of market conduct that need to be addressed by prudential supervisors responsible for stability, and vice versa. The expected split between the market conduct function of the CBR and Rospotrebnadzor should evolve to maintain a level playing field and ensure the appropriate authority on prevention and tools for enforcement that are consistently applied across providers.

*High visibility of a potential linkage does not necessarily imply a material linkage.* Payday lenders, for example, have received significant attention for the rapid growth in number of providers and loan origination and high interest rates and fees for short term loans. However, the size of their lending is limited as a percentage of the total consumer loan portfolio, the growth of which has been driven primarily by the banks. As such, the relevance of the payday lending sector for the direct stability linkages mentioned above (growth in bad debts), is limited. High visibility, such as in the case of the payday lending sector, may put pressure on policy makers to take action to address threats to stability that may not warrant action. However, when it comes to consumer protection, visibility may in fact be a factor that is material to consumers feeling of trust in the system.
3.4. Electronic Money Operators under the National Payment System Law

3.4.1. The policy change

For a long time, the Banking Act\(^89\) and the Russian Civil Code\(^90\) were the only laws regulating payment services in Russia. It was generally argued that payment services were the exclusive domain of banks and the Russian Post (which is subject to a separate law).\(^91\) This gradually changed with the introduction of special laws in 2009 that permitted any legal entity or individual entrepreneur to act as a (nonbank) payment agent or bank payment agent.\(^92\) By 2010, new retail players had emerged such as e-money operators (e-money and e-money operators were terms not defined under Russian law at that time) offering e-money services mostly on the internet and without requiring a bank account and mobile network operators (see Sec. 3.5) offering mobile financial services. Although there were no specific legal provisions that governed these providers or their operations, e-money operators in particular were signing up increasing numbers of customers and claimed to have huge and growing transaction volumes.\(^93\)

There was a convergence of interests in establishing an explicit legal framework for e-money operations among policy makers and industry players. At the same time that the government was pondering the regulation of e-money, banks started lobbying for stricter rules on nonbanks’ involvement in the provision of payment services on the grounds that it was unfair competition. At the same time, existing web-based e-money issuers such as Yandex.Money and WebMoney (which collectively controlled 90 percent of the market)\(^94\) were interested in more legal certainty regarding their operations. However, there was less of an agreement on the approach to regulation.

In 2009, nonbank e-money operators formed the “Electronic Money Association” to represent their interests and also because of their disappointment with the speed of legislative progress.\(^95\) They suggested a model along the lines of the European Union’s E-Money Directive, which would have allowed them to apply for a specialized nonbank e-money issuer license and offer e-money accounts without having to be licensed as a credit organization. This model, however, was not favored by the CBR and did not receive sufficient political support within the Russian legislature (which at the time was preoccupied with the discussions about the National Payment System Law, but without yet considering the integration of e-money under this law).\(^96\) The Central Bank was concerned that under this model, there was a risk of creating a parallel settlement system outside the CBR’s direct control and with high AML/CFT risks. Following the nonbank e-money issuer model would also have required a change in the

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\(^92\) CGAP. Update on Regulation of Branchless Banking in Russia. Washington, DC: CGAP, 2010.

\(^93\) Ibid.

\(^94\) Ibid.


\(^96\) Ibid.
Civil Code (i.e., to include a definition of e-money) at an inopportune time as amendments to the Civil Code had just been finalized.

For some time, the Russian Government worked in parallel on two separate draft laws – one on e-money and one on payment systems more generally – but eventually decided to treat e-money as part of the payment system and integrate relevant rules under the same law, which is in line with the current practice of many recent payment system laws. The Explanatory Note to the draft law mentions, among others, as reasons for the introduction of the Payments Systems Law:

- The introduction of international standards set by the Committee on Payments and Settlement Systems;
- The development of modern information and communication technologies;
- The entry of new players into the payment services market; and
- The need to introduce a modern, integrated, and balanced regulatory framework.97

In June 2011, the National Payment System Law98 was adopted and was gradually implemented over a period of 18 months (with the exception of parts of Article 9 on Procedures for the Use of Electronic Means of Payment – more on this below). The National Payment System Law includes specific provisions for electronic money operators (EMOs), but also covers many other players in the payment system, among them money transfer operators, mobile network operators (see Sec. 3.5 below), and bank payment agents, which had previously been regulated under a different law.

The National Payment System Law defines e-money as a non-cash transfer without the opening of a bank account. This definition of e-money is a unique Russian concept. The law does not use the terms e-money accounts or electronic wallets, as this would have been perceived as being too similar to traditional deposit accounts requiring a full banking license. The law requires an EMO to be registered as a credit organization: either a bank, which must notify the Central Bank about the launch of electronic fund transfers, or a special type of “E-Money NBCO”. This type of NBCO is subject to a minimum capital requirement of RUB 18 million (approx. USD 514,000), a capital adequacy ratio of 2 percent, a liquidity ratio of 100 percent (ratio of cash and assets maturing within 30 days over short-term liabilities), and is – as all NBCOs – prudentially regulated and supervised by the CBR. The proceeds from e-money issued by EMOs are stored in a pooled account. Customers open ‘electronic wallets’ that can be ‘personalized’ and held by natural or legal persons (max. balance of RUB 100,000 or USD 2,800) or ‘non-personalized’ and only held by natural persons (max. balance of RUB 15,000/USD 430 and monthly transfer limit of RUB 40,000/USD 1,100). Non-personalized e-wallets are exempted from identification requirements specified in the AML/CFT Law.

3.4.2. Which linkages were identified and managed?

According to our interviews, the government and regulator were primarily concerned about the stability risk caused by a growing industry outside the reach of the regulator and wanted to bring the sector under its direct control.99 E-money was perceived as being highly dependent on the trust in the system and sudden massive withdrawals could, in their opinion, lead to the bankruptcy of the issuers as they were not subject to any restrictions on where to hold the funds received in exchange for e-

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97 Explanatory Note to Draft Law “On the National Payment System”.


99 An alternative would have been to close it down.
Another concern within government was integrity issues, as EMOs did not fall under the AML/CFT Law and as most of the customers were not identified. Finally, CBR saw the need to improve customer protection, as there were no specific requirements for the contracts between customers and EMOs. Policy makers identified all three objectives – stability, integrity, and protection – and saw them as complementary because they regarded the introduction of a special legal framework for EMOs as having a positive effect on each of them.

The policy change was not framed as a financial inclusion intervention despite the potentially significant effect the provision of e-money services can have on financial inclusion. Instead, the main objective was to formalize the sector and thereby create more space for its growth, which can be regarded as a necessary, but not sufficient condition for advancing financial inclusion.

**Linkage between financial inclusion and stability**

There can potentially be both tensions between stability and inclusion (i.e., through the imposition of strict safeguards which could limit the number of players) and synergies (i.e., assuming that a regulated sector is more attractive to investors, resulting in bigger and/or more numerous providers). Policy makers identified the potential tradeoff and managed it cautiously by only allowing credit organizations to provide e-money services and not creating a separate category of less strictly regulated nonbank e-money issuers. As credit organizations, EMOs are subject to prudential regulation by the Central Bank including applicable AML/CFT rules. However, the fact that EMOs can be registered as NBCOs with more limited prudential requirements is evidence that policy makers acknowledged that they pose lower stability risks than banks intermediating public deposits. They recognized the importance of the liquidity and safety of the pooled account, which is catered for by the 100 percent liquidity ratio.

**Linkage between financial inclusion and integrity**

As credit organizations, EMOs are subject to the AML/CFT Law and its implementing regulations. Yet the potential for financial inclusion (in the sense of market growth) was clearly regarded as being dependent on the complexity of the KYC rules imposed on EMOs. Therefore, the law exempted from the KYC requirements small value accounts with clearly defined transaction limits – a maximum balance of RUB 15,000 (USD 430) and maximum transfers of RUB 40,000 (USD 1,100) per month – and consequent lower money laundering risks, reducing the obstacles to reaching more remote locations and lower income clients.

**Linkage between financial inclusion and consumer protection**

One of the objectives of the law was to define clear rules for the legal relationship between EMOs and their customers. Customers are now served by credit organizations that are subject to the consumer protection rules specified by the CBR. A few provisions of the law have been subject to debate. One such issue is specific consumer protection rules in Article 9 of the law, which exemplify a potential tradeoff...
between inclusion and protection and are therefore of particular relevance from an I-SIP perspective. The article prescribes a ‘zero liability rule’: the provider is obligated to reimburse a client immediately in the case of a dispute unless the provider can prove that the client has violated operational procedures. Furthermore, the law requires providers to notify clients about each transaction, a condition necessary to implement the zero liability rule. The implementation of these provisions was delayed until 1st January 2014, as credit organizations were concerned about both the cost of implementation (which depends on what kind of notification is accepted) and the potential for high incidences of fraud as customers could easily reverse transactions even if they were genuine. While both measures – the zero liability rule and the transaction notifications – have been described as the most significant consumer protection measures in the National Payment System Law and the Central Bank believes are likely to increase confidence of consumers in e-money transactions, the industry has expressed concerns that their implementation might have a serious negative impact on the growth of the industry (tension between protection and inclusion).

3.4.3. What has been the observed effect on the I-SIP objectives?

There are signs for a positive effect of the law on all three of its main objectives – stability, protection, and integrity, even though the limited availability of data does not allow for an exact assessment of its impact.

**Stability:** The regulated e-money sector has been expanding rapidly since the introduction of the National Payment System Law. The number of credit organizations with e-money authorization was 82 as of 1 February 2014, with the majority of them (43) having been authorized in 2013. These include traditional retail banks, regional banks, companies specialized on international remittances, banks closely cooperating with or having common ownership with MNOs, and previously existing EMOS. Of the 82 EMOS, 64 are banks and 18 NBCOs. The effect the launch of e-money services had on existing banks is difficult to determine unless one would be able to isolate it from other factors influencing the stability of these institutions. However, as the CBR is regarded as an effective and rigorous regulator and as the regulatory standards for NBCOs (and even more so for banks) are thorough, it can be assumed that bringing the e-money operations of these institutions under direct Central Bank supervision has had a positive impact on the stability of EMOS.

**Integrity:** EMOS are now subject to the AML/CFT regime for credit organizations – a positive development for integrity that has also been acknowledged in the October 2013 FATF Mutual Evaluation Report. Reflecting a risk-based approach, non-personalized accounts with maximum value and

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103 Another contentious issue is the treatment of prepaid cards, of which more than 48 million have been issued (see http://blog.danielgusev.com/2013/06/prepaid-business-is-much-more-than-just.html). They now fall under the e-money rules, yet some of the provisions create operational challenges and banks are interested in the reintroduction of special rules for prepaid cards (which used to exist before the adoption of the National Payment System Law).


105 The analysis of this section is based on CBR data available on its website: http://bit.ly/1gKQhCS.

106 In addition to capital and liquidity requirements they include, among others, minimum requirements for the senior management and standards for the risk management of NBCOs.

transactions limits (and therefore lower money laundering risks) can be offered without any customer identification although cashing out of such an account requires further KYC. By far the majority of e-money accounts – 96.9 percent in terms of number of transactions in 2013\textsuperscript{108} – are non-personalized accounts. However, conducting transactions electronically rather than in cash increases their traceability and allows for monitoring of suspicious transactions. The fact that EMOs have to report to Rosfinmonitoring in the same way as any other reporting entity can lead to additional compliance cost (see 3.2.3 for details).

**Protection:** The National Payment System Law has had a positive impact on consumer protection by bringing e-money under a specialized legal framework. Article 9 of this law includes consumer protection rules, which are targeted at increasing the confidence in the use of e-money services. The long delay in implementing Article 9 was a sign of policy makers and providers discussing the potential linkages between protection and inclusion. It is too early to tell what the effect of this will be on protection and inclusion. In addition to the rules under the National Payment System Law, the Consumer Protection Authority, Rospotrebnadzor, supervises EMOs’ conduct of business under the general authority of the Consumer Protection Law.

**Inclusion:** Keeping in mind that inclusion was not an explicit objective of this policy initiative, the most important effect of the law on inclusion has probably been the creation of more legal certainty by introducing a special legal framework for EMOs, which provided the basis for growth of the sector (as a necessary condition for improving financial inclusion). While banks and mobile operators were previously wary of the lack of a clear legal basis for e-money operations, they have now entered the market in much greater numbers than before the law. It might be too early to see the effect in the data, but this has certainly increased the potential for high growth rates in the future and is therefore a necessary, even if not sufficient condition for making progress on financial inclusion.\textsuperscript{109}

Direct supervision by the Central Bank has apparently not slowed down the growth of the sector. According to interviews with EMOs now being registered as NBCOs, they had to change their operations to comply with capital adequacy, liquidity, and KYC rules, but the changes were expected and are regarded as reasonable, even though they somewhat complicated their operations.\textsuperscript{110} This is also reflected in the limited data available on the sector. The exponential growth of the e-money sector preceded the adoption of the law, but has continued at a similar rate since (see Figure 3). According to the Electronic Money Association, the number of active e-wallets was estimated as 70 million in 2012 (up from 30 million in 2010 and 45 million in 2011), while the volume of top ups of e-money accounts had reached RUB 125 billion (USD 3.57 billion) in 2011 (up from 40 billion in 2009 and 70 billion in

\textsuperscript{108} Data provided by CBR.

\textsuperscript{109} A case in point is Sberbank, the largest retail bank in Russia, which terminated its cooperation with the e-money and payment terminal provider Qiwi to launch its own e-money operations in 2012 and later that year bought a majority stake in Yandex.Money. This is a sign that mainstream banks are now more interested in launching their own electronic wallets than just co-operating with other e-money operators. See also http://blog.danielpusev.com/2012/12/sberbank-buys-yandex-money-as-part-of.html?q=yandex.

Due to difficulties in accurately defining which transactions to count as e-money transactions, the E-Money Association has not published more recent estimates of the size of the market.\footnote{Dostov, Victor. "E-Money 2011 (&1q 2012): New Stage and New Opportunities." \textit{Presentation at Press Conference, Russian Electronic Money Association}. 2012. 2012 data from Dostov, Victor. "Remittance in Russia: Trends and Lessons." \textit{Presentation at GPFI Forum in St Petersburg}. 21 October 2013.} According to data by the CBR, the number of active wallets was 55 million at the beginning of 2014, and in year 2013 the number of e-money transactions was 338 million and its volume RUB 428.6 billion (USD 12.25 billion).\footnote{Source: Preliminary data provided by CBR.}

\textit{Figure 3: J’son & Partners data on e-money turnover in billion Rubles}\footnote{Source: J’son & Partners. \textit{Russian Market of Remote Financial Services}, 2013}

Whereas the number of users and volume of transactions have continued to grow since the adoption of the law, it still remains to be seen whether e-money services just add convenience for customers that already have a bank account in serving their financial needs or are \textit{transformational} in the sense of providing essential financial services to customers that are otherwise excluded from the formal financial sector. Unfortunately, no recent data are publicly available on this. In 2011 (see Figure 4), i.e. a year when the law was not yet fully operational, by far the largest share of payments was for games, entertainment, lotteries, and the like, and for telecommunication services (mobile top-up and internet bill payments).\footnote{Source: Correspondence with Victor Dostov, President of the “E-Money Association”, December 2013.} Reportedly the composition of payments has not changed much in year 2012.\footnote{A different estimate is that the volume of e-money payments increased from RUB 163 billion in 2011 to RUB 281 billion in 2012, with the three biggest providers, Qiwi Wallet, Yandex.Money, and WebMoney covering 90 percent of the market. This is still much lower than the volume of payments made over the internet, which stood at RUB 591 billion in 2012. Data from: J’son & Partners (2013), \textit{Russian Market of Remote Financial Services}.

According to this, at least until 2012, few customers used e-money services for their basic financial needs. While it is possible to also use e-money for purchases of consumer goods, payments of taxes, financial instruments (defined as payment for financial services that do not imply the purchase of goods and services and also include person-to-person transfers) come on top as these tend to be larger transactions.
fines, state, municipal, housing, and insurance services, and for loan repayments, no recent data are available on how widespread these payments are.

One explanation for a possibly limited success in reaching the unbanked is the potentially negative impact of the law on smaller operators, who might have the highest potential for innovation and for reaching poorer customer segments with tailored products and services. The minimum capital of RUB 18 million can be prohibitively high for new innovative providers.\(^{117}\) Very few innovations in payments system could be observed in recent years, and this might have to do with the lack of a waiver from the regulatory provisions for small players (as it exists, for example, in the European Union).\(^{118}\)

**Figure 4: E-Money Association data on number and volume of e-money transactions in 2011\(^{119}\)**

Customer surveys show the increasing awareness about and usage of e-money services, but also confirm that it is mostly young, internet-savvy, well-educated people who know and use them (see Box 3).

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\(^{117}\) Dostov and Shoust (2013), "Electronic Payment Services in Russia: The Impact of New Regulations on a Mature and Innovative Market."

\(^{118}\) Even large players like Yandex.Money started with initial investments that were much lower than the required minimum capital for E-Money NBCOs.

\(^{119}\) Data from Dostov (2012). Financial instruments includes virtual prepaid cards; transfers to the other e-money systems; loan repayments; money transfer services; and other transfers that do not imply purchasing goods or services.
Box 3: Awareness and usage of e-money services

According to nationwide surveys conducted by the National Agency for Financial Studies (NAFI), the overall usage of e-money services on a regular basis has increased. While in April 2011, the share of the population using e-money for regular payments stood at 1 percent, in August 2012 it had already increased to 3 percent. Overall, in 2012, 10 percent of Russians said they have used e-money services by companies such as Yandex, WebMoney and PayPal. The most active users of these services were young people between 18 and 24 years, active internet users, people with medium and higher income, as well as residents of Moscow and Saint Petersburg. However, bank cards are still by far the preferred means of payment with respect to convenience, reliability, safety of personal data, and even cost. Another survey in August 2013 found that 34 percent of respondents are well aware of e-wallets, and for respondents between 18 and 24 years this figure even stood at 58 percent.

It can be concluded that the National Payment System Law has laid the ground for future growth of e-money services with a high potential to advance financial inclusion. Industry experts believe that e-money services are well positioned to reach customers in smaller cities with populations below 100,000 that are not served (any longer) by traditional bank branches. For example, the number of branches and offices of credit organizations in March 2014 was about 43,000, yet for Yandex.Money alone there are 170,000 locations in Russia that can be used for replenishing the account.

3.4.4. What have we learned about managing linkages and optimizing results?

The National Payment System Law has been successful in nurturing an e-money sector with overall positive observed effects on stability, integrity, and protection. Financial inclusion was not one of the objectives of the law and did not feature prominently in the discussions about the law, not least because none of the authorities involved had a clear mandate to promote financial inclusion. Yet policy makers were very much aware of the potential tradeoffs between inclusion (if narrowly defined as increase in outreach numbers) and stability and between inclusion and integrity. Allowing only credit organizations to be authorized as EMOs ensures clear oversight responsibilities by the Central Bank and Rosfinmonitoring, while permitting E-Money NBCOs as one possible structure avoids confining the market of e-money to banks. The exemption from identification requirements for low value/low volume transactions has created space for easily signing up new customers without a negative impact on overall integrity risks.

The delay in implementing major consumer protection rules for e-money operations is a sign for the tension between consumer protection and market growth. There was a real concern from the industry that the provisions of Article 9 (zero liability and customer notification requirements) will be too costly.

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120 This is based on a survey of 1,600 respondents at 140 locations in 42 regions of Russia. See NAFI. "Press Release: More payments, but the same payment methods." 14 September, 2012.


123 According to CBR, see http://bit.ly/1mfXtyu.

124 According to its website: money.yandex.ru.
to implement and increase the number of fraud cases, which can lead to a slowdown in the growth of
the sector. It is too early to tell whether this will be the case.

A possible drawback of the policy intervention not having been regarded as an explicit financial inclusion
policy is that it was not guided by a clear understanding about its potential to have an impact on overall
financial inclusion in Russia. While the creation of more legal certainty and the clear legal recognition of
EMOs was a necessary condition for the growth of the sector and thus for making progress on financial
inclusion, it is not sufficient for providing transformational financial services to previously excluded
customers. Only very limited data are available about the type of customers served, the potential of e-
money products to meet customer needs, challenges in customer adoption, and also consumer
protection issues in the delivery of e-money services. The design of the regulatory framework for EMOs
has not been guided by financial inclusion concerns beyond the general understanding that the growth
of the sector should not be curtailed and new players be encouraged to enter. The lack of such guidance
makes it likely that the impact on financial inclusion remains below its potential. There is some
indication that this is currently the case in Russia (the current composition of e-money transactions and
the profile of users).
3.5. Mobile Network Operators under the National Payment System Law

3.5.1. The policy change

As payment services were the exclusive domain of credit organizations until the adoption of the National Payment System Law in 2011, prior to this mobile network operators (MNOs) could only play a very limited role in the provision of financial services: MNOs had to partner with banks and link their prepaid airtime account to a bank account in the customer’s name. In 2008/9 the major MNOs were actively lobbying the Central Bank for changes in regulation that would allow them to also process payments to third parties. Initially there were also some discussions about amending the Communication Law. However, this did not bear fruit as the Ministry of Telecommunications, which used to be a strong advocate for mobile financial services, changed its priorities in 2009 to focus on communications services of MNOs.

This changed with the passage of the National Payment System Law. MNOs successfully argued for an integration of mobile financial services under this law. They were not interested in the option of applying for an authorization as an e-money operator as this would have required them to operate e-money services through a separate legal entity licensed as a credit organization (Sec. 3.4.1). Instead they argued for special legal treatment under the law, which would not require them to be under direct Central Bank control. As a result, a special article (Article 13) was included in the law defining a different operational model for MNOs – described as ‘communications service providers independently authorized to render mobile communications services’. Any MNO that wants to offer mobile financial services must operate in partnership with an electronic money operator (which must be a credit organization: either a bank or E-Money NBCO – see Section 3.4.1). The MNO cannot directly make payments from the prepaid balance, but has to transfer the money from the prepaid balance of the client to an e-wallet held by the same client with an e-money operator, from where it is immediately

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125 For a summary, see CGAP. "Update on Regulation of Branchless Banking in Russia." Washington, DC: CGAP, 2010.
126 Previously the main way for clients to pay from a mobile phone was the “premium SMS model”, where customers would send a premium SMS to the MNO, which would share the revenue with the service provider (e.g., a mobile commerce platform). See Dostov and Shoust (2013), "Russian Anti-Money Laundering Legislation in Electronic Payments: A Case of Regulation Catching up with Business Practices."
128 CGAP (2010), Update on Regulation of Branchless Banking in Russia.
129 MNOs still have the option to set up a subsidiary for their e-money operations and apply for an authorization as an e-money operator under the law. However, none of the MNOs offering mobile financial services has opted for this.
130 Article 13 talks about a communication service provider (such as an MNO) sending instructions to an e-money operator to increase the e-money balance of a client and at the same time reducing the amount of funds paid in advance by the individual subscriber for communications services. As this is functionally equivalent to an MNO providing financial services, it is here referred to as mobile financial services.
transferred to the end beneficiary in line with the rules for e-money operators (used for payments or transferred to a bank account).\textsuperscript{131}

3.5.2. Which linkages were identified and managed?

The primary objective of Article 13 of the National Payment System Law was to provide MNOs with legal permission to offer mobile financial services. Policymakers did not regard this as an explicit financial inclusion initiative – even though mobile financial services have the potential of having a significant positive effect on inclusion – but as an initiative to facilitate the emergence of a mobile financial services sector.

The treatment of MNOs is particularly interesting when comparing it to the treatment of e-money organizations under the law. The main impetus for regulatory change came from large MNOs, which could not take on the risk of launching mobile financial services without a sufficiently clear legal framework. In comparison to the case of e-money issuers, the regulators (the CBR and Rosfinmonitoring) were much less concerned about stability and integrity risks because MNOs’ involvement in the provision of financial services was minimal prior to the adoption of the law.

\textit{Linkage between financial inclusion and stability}

Policymakers were concerned that the authorization of MNOs to directly provide payment services without at the same time bringing them under the CBR regulation might lead to stability risks. Yet they also acknowledged concerns by the MNOs that such regulation might stifle their growth. They managed this linkage between inclusion and stability by only allowing those MNOs to provide mobile financial services (in partnership with an electronic money operator) that are represented in more than 30 (out of currently 85) regions of the Russian Federation – which most observers regard as strong companies with very low risk of failure – and not the thousands of smaller communication service providers with many of them being considered as less stable. By limiting the number of providers of mobile financial services, but at the same time not imposing the same rules on MNOs as apply to e-money operators – in particular not requiring them to get a license as credit organization – the policymakers have actively managed the tradeoff between stability and inclusion.

Another potential risk to stability is caused by the fact the prepaid funds held by MNOs are not subject to specific rules where to keep funds received in exchange for airtime. As MNO clients in Russia do not hold a separate mobile wallet for mobile financial services, but use their prepaid airtime balance, the sum of prepaid airtime becomes functionally equivalent to electronic money held with the MNO, yet without subjecting the MNOs to specific rules on where to place these funds to keep them safe and liquid. Such \textit{fund safeguarding} and \textit{fund isolation} (to shield them from claims by third parties) rules are commonly used in countries with a special regulatory window for nonbank e-money issuers.\textsuperscript{132}

\textsuperscript{131} For more details see Lyman et al. (2013). In practice, the balance of the e-wallets is always zero, as the funds are immediately used for the payment/transfer.

\textsuperscript{132} In many nonbank e-money schemes around the world, the e-money float – i.e. the equivalent of customers’ funds held in electronic accounts – is subject to fund safeguarding and fund isolation rules to ensure that it is safe and not compromised by the failure of the nonbanks or the financial institutions that hold the funds. See Tarazi, Michael and Paul Breloff. "Nonbank E-Money Issuers: Regulatory Approaches to Protecting Customer Funds." Focus Note 63. Washington, D.C.: CGAP, 2010.
The overall risk of the Russian approach depends on the customers’ perception about the nature of the funds held in the prepaid airtime account. The risk is not high if most customers primarily use these accounts for communication services and do not regard or use them as prepaid funds to be used for mobile financial services (including the option to redeem them through the banking sector). This potential stability risk will increase in proportion to the growth of the sector and will only be significant once a substantial share of the prepaid airtime balance is used for mobile financial services. Until now this risk has not been subject to much debate yet.

**Linkage between financial inclusion and integrity**

The operational model of Article 13 does not require any balance and transaction limits for the prepaid airtime accounts held by customers, as they are still primarily regarded as prepaid airtime accounts, and not as mobile wallets to be used for mobile financial services. However, as all mobile financial transactions are channeled through e-money operators (which are subject to the full AML/CFT regime applicable to credit organizations – see Sec. 3.4), they are monitored for suspicious transactions and are subject to transaction limits applying to e-wallets. As long as transactions do not exceed the transaction limits for non-personalized accounts, they are not subject to any KYC requirements. The linkage between inclusion (in the sense of growth) and integrity has therefore been well managed.

Furthermore, since August 2013 MNOs have also been included in the list of reporting entities under the AML/CFT Law, which means they are now subject to the full force of this law (see Sec. 3.1.3 for details). However, this change was not triggered by integrity concerns in using mobile financial services, but introduced for other reasons.  

**Linkage between financial inclusion and protection**

No linkages have been identified between inclusion and protection with regard to the provision of mobile financial services.

### 3.5.3. What has been the observed effect on the I-SIP objectives?

**Inclusion:** MNOs have substantially scaled up their engagement in mobile financial services since the introduction of the National Payment System Law, but it is unclear how much of a positive effect this has on financial inclusion (which is more than just growth of transactions volumes and values). The three largest MNOs – Beeline, MTS, and Megafon – are all closely cooperating with banks in this as they cannot offer the services on their own.  

There is an increasing convergence between mobile financial services and e-money services with customers easily switching between the internet and mobile phone to transact and increasing numbers of mobile phones offering internet capability. To date, the four largest MNOs (with Tele2 as the fourth largest MNO) that together control 92% of the Russian market already offer a facility to pay from the prepaid airtime account. Only very limited data are available on the market size. One estimate is that the market for mobile financial services stood at RUB 9.4 billion (USD 269 million) in 2012 (up from RUB 1.8 billion or USD 51 million in 2008) and was expected to reach RUB 13.1 billion (USD 374 million) in 2013.  

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133 It was driven by concerns about terrorists using anonymous SIM cards.

134 For details, see Lyman et al. (2013).

135 Dostov and Shoust (2013), "Electronic Payment Services in Russia: The Impact of New Regulations on a Mature and Innovative Market."

services in 2013 at RUB 40 billion (USD 1.14 billion) and the growth rate from 2011 to 2012 at 280 percent and from 2012 to 2013 at 100 percent.\textsuperscript{137}

Considering the high mobile phone penetration in Russia of 227.6 million,\textsuperscript{138} which translates into a total mobile penetration of 164\% or unique subscriber penetration estimated at 73\%,\textsuperscript{139} mobile financial services should have the potential to reach much further than traditional bank channels such as branches or ATMs. However, very little data are available about the profile of current users and to our knowledge no research has been conducted about customer adoption of mobile financial services among poorer people. It does not seem to be an explicit strategy of any of the MNOs to reach unbanked customers. For example, currently MNOs are lobbying for changes to the law that would allow them to also serve corporate clients and postpaid customers (which do not have a prepaid balance as a source of funds for payment transactions). Both these changes are certainly not targeted at the lower end of the market, but would increase the convenience of payments for already banked customers. As the trust of customers in banks is much higher than in MNOs, operators see their main role in the provision of payment services, but not in directly competing with banks and offering fund storage facilities.\textsuperscript{140}

The general structure of the model, which does not allow MNOs to offer mobile financial services on their own, but only in partnership with credit organizations, has been mentioned as creating operational challenges, which might have a negative effect on the growth of such services and thus on its inclusion potential.\textsuperscript{141} At the same time, this burden should be much lower than the alternative of an MNO having to set up a credit organization to offer mobile financial services.

Positive for the likely uptake and utility of mobile financial services is the fact that customers do not have to fund a separate wallet before they can start transacting, but can simply use their existing prepaid airtime account, and that different systems are interoperable in the sense that customers can send airtime between prepaid accounts at different operators. The fact that regulation did not prescribe the separation of funds used as airtime and for mobile financial services can be seen as positive for the inclusion objective, but also changes the analysis of stability risks.

Stability: Most industry experts believe that today there is limited potential stability risk related to mobile financial services, even though (i) prepaid balances are functionally very similar to e-money accounts, (ii) MNOs are not subject to direct regulation by the financial regulator, and (iii) MNOs are not

\textsuperscript{137} Correspondence with Victor Dostov, President of the “E-Money Association”, December 2013. This translates into a turnover of RUB 5.3 billion in 2011 and RUB 20 billion in 2012.

\textsuperscript{138} See Advanced communications & Media. “Mobile Penetration in Russia is above 156\% as of 2011.” 8 February, 2011.


\textsuperscript{140} According to a 2012 poll by NAFI, 38 percent of adults believe that branchless banking channels (which include mobile financial services) are safe, and 46 percent believe they are not safe (and the latter group tends to be lower-income people and non-internet users). See NAFI. “Branchless Banking Services: A Russian Consumer View.” 2012.

\textsuperscript{141} Under the current model, the customer first requests the payment transaction, then the MNO replies with full details about the transaction, and then the customer confirms to the MNO that she indeed wants the transaction to go ahead.
subject to fund safeguarding and fund isolation rules. One reason is that only the four largest MNOs, which are all strong and well-capitalized, have been permitted to offer the services. Furthermore, while no data on this are publicly available, the share of the aggregate prepaid balance held by customers and being used for payments is probably still very small, which means that most customers use their prepaid balance only for services provided by the operator rather than for payments and do not expect the funds to be redeemable (even though de facto all the prepaid funds are redeemable). However, this might change in the future if mobile financial services continue to grow quickly. Even now MNOs state that the average balances on prepaid accounts have been increasing in particular for those clients that actively use their accounts for mobile payments. As soon as customers start perceiving prepaid funds as redeemable e-money (and not just as an advance payment for communication services as described in Article 13 of the National Payment System Law), the issues of liquidity and safety of funds becomes paramount and the balance between the inclusion and stability objective will shift.

Positive for stability is that only MNOs (and not the thousands of other communication service providers) can offer mobile financial services and that all transactions are channeled through the banking sector (either through banks or NBCOs) and therefore do not occur outside the supervision of the financial sector regulator. The Central Bank has not permitted direct payments from the prepaid account to third parties, as these transactions would not be subject to the same oversight.

**Integrity:** No specific data are available on integrity risks with regard to mobile financial services. However, the fact that in August 2013 MNOs have been brought under the AML/CFT Law should have a positive impact on integrity. This is a development going beyond the specific changes brought about by the National Payment System Law with wider implications for the integrity – inclusion linkage (see Sec. 3.2 for a description of challenges in complying with AML/CFT rules).

Even before MNOs were brought under the AML Law, all e-money transactions were channeled through e-money accounts and thus subject to the same identification requirements, transaction limits and suspicious transaction monitoring applied to e-money transactions. Furthermore, the owner of the SIM card is identified at SIM registration under rules, which have been strengthened at the beginning of 2014. While this change is outside the scope of the National Payment System Law, it still has implications for the overall integrity risk. As the KYC rules at SIM card registration apply to all accounts irrespective of the overall amount held on the account or its transaction volume, customer identification rules for mobile financial services are stricter than for non-personalized electronic wallets. All mobile financial services transactions have to be monitored for suspicious transactions as they are channeled through e-money accounts held with banks or NBCOs.

**Protection:** Finally, the National Payment System Law includes basic requirements on disclosure in the case of MNOs conducting e-money transactions, which should be positive for protection. Customers, however, do not enjoy the same protection as customers of e-money operators as they are neither covered under the general consumer protection rules applying to credit organizations nor the specific rules of Article 9 of the National Payment System Law (see Sec. 3.4). The risk to the safety of funds kept in the prepaid accounts is still low, but will be increasing with wider usage of the service.

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142 According to one estimate the average balance is below USD 7; see Lyman et al. (2013).

3.5.4. What have we learned about managing linkages and optimizing results?

Financial inclusion was clearly not the primary objective of the rules on mobile financial services in the National Payment System Law, yet they have substantially increased the potential for increasing financial inclusion. In this regard the MNO case is similar to the e-money operator case. The process seems to have been mostly driven by the commercial interests of MNOs, which wanted to participate in the dynamic retail payment market. The same observation as in the e-money case applies: the creation of a legal framework that allows new nonbank entrants into the market does not automatically have a positive impact on reaching out to new, underserved market segments. Similarly, mobile financial services (in the same way as e-money) seem to have a high potential for a positive impact on inclusion especially in areas with low population density and without bank branches. Financial inclusion appears to have been more of a welcome side effect than a deliberate policy objective of this specific policy intervention.

Stability and consumer protection risks are not material at this point, but have to be closely monitored moving forward. The fact that MNOs are not subject to specific rules about the investment of the proceeds from selling airtime seems not to be a major issue to date, as the overall share of prepaid airtime used for payments is still small. The policy decision to only allow MNOs (and not other communication service providers such as internet service providers) to offer mobile financial services has mitigated the potential risk of this model as long as it does not grow beyond a size where sudden withdrawals by customers could cause liquidity problems. At the same time, the decision not to bring MNOs under direct Central Bank supervision has facilitated the operations of the four largest MNOs in mobile financial services. Moving forward, it will be important to monitor the changes in payment behavior among mobile financial services customers, as the overall stability and protection risks will invariably increase with the growth of the mobile financial services market.
### 3.6. Summary of linkages in policy interventions

#### Table 3: Summary of linkages in policy interventions

<table>
<thead>
<tr>
<th>Policy intervention</th>
<th>Policy change</th>
<th>Primary motivation</th>
<th>Tradeoff policymakers were concerned about</th>
<th>Observed effects to date</th>
</tr>
</thead>
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<tr>
<td><strong>Law on Credit Cooperatives</strong></td>
<td>Adoption of the Law on Credit Cooperatives to bring all deposit taking CCs under one legal framework.</td>
<td>To provide the legal certainty and standards for the growth and development of a stable credit cooperative sector.</td>
<td>Consumer protection challenges would negatively impact consumer trust, in turn harming stability and sustained use of financial services.</td>
<td>It is difficult to ascertain the increase in CCs and their members without a baseline from before the law. A large number of CCs are supervised by SROs and meet new prudential standards. This bodes well for both consumer protection and stability, but conclusive evidence is limited.</td>
</tr>
<tr>
<td><strong>Law on Microfinance</strong></td>
<td>Adoption of the Law on Microfinance Activity and Microfinance Organizations.</td>
<td>To create a legal basis for activities of MFOs and thus enable increased financial inclusion (primarily for MSMEs), as well as better monitoring and understanding of the sector.</td>
<td>Policy makers limited MFO opportunities for raising funds from natural persons as they were concerned about stability. Consumer protection concerns appeared later, with the growth of payday lending market.</td>
<td>Inclusion increased in quantitative terms, but the diversity of the MFO sector begs the question about the qualities of financial inclusion achieved.</td>
</tr>
<tr>
<td><strong>Consumer Credit Law</strong></td>
<td>Adoption of the Consumer Credit Law.</td>
<td>To protect individuals in the market for unsecured consumer loans through business conduct rules.</td>
<td>Consumer protection issues in lending negatively impact soundness of lenders and stability.</td>
<td>Ex-ante: Yet to be seen whether transparency and disclosure mechanisms are well-suited to the market. Interest rate ceiling may curb outreach if not carefully managed through forthcoming regulations.</td>
</tr>
<tr>
<td><strong>Electronic Money Operators</strong></td>
<td>Adoption of the National Payment System Law providing rules for e-money operators.</td>
<td>Stability concerns regarding unregulated e-money issuance, but also concern regarding integrity and protection.</td>
<td>Stifling market growth (being different from financial inclusion).</td>
<td>Laid foundation for future market growth, but unclear what the effect on inclusion will be. Positive effect on stability, integrity, and protection can be assumed, but no supporting data on this.</td>
</tr>
<tr>
<td><strong>Mobile Network Operators</strong></td>
<td>Adoption of the National Payment System Law providing rules for MNOs offering mobile financial services.</td>
<td>Facilitate the emergence of mobile financial services sector.</td>
<td>Stability and integrity.</td>
<td>Scaled up operations, but effect on inclusion unclear. No data on stability/integrity/protection.</td>
</tr>
</tbody>
</table>
4. Proposals for further development and refinement of the I-SIP Methodology

Russia is the third country (after South Africa and Pakistan) to undergo a rapid research exercise on I-SIP linkages in financial sector policy making. It adds another five cases to the growing “I-SIP library” of policy interventions studied, with some similarities to cases analyzed in the previous two rapid research exercises (e.g., the legal frameworks for Microfinance Banks and for Branchless Banking in Pakistan, and the Cooperative Banks Act in South Africa), and some cases considering completely new areas of relevant policymaking (the *ex ante* case of the Consumer Credit Law). The following section summarizes some observations from the cases analyzed, Sec. 4.2 outlines lessons for the development and refinement of the I-SIP Methodology coming out of the Russian research, and Sec. 4.3 revisits the I-SIP Propositions, building on the previous two I-SIP rapid research exercises in South Africa and Pakistan.

4.1. Observations from the Russian I-SIP rapid research exercise

The analysis of the five cases has led to a number of case-specific observations, summarized below, that might not only be of relevance for Russia, but also for similar policy interventions in other countries. They differ from the lessons for the I-SIP Methodology discussed in Sec. 4.2 below in as far as they cannot necessarily be generalized, but are likely to apply only in those cases that share some of the characteristics with one or more of the five policy interventions analyzed in Russia.

In Russia, where it has been possible to provide financial services under a legal basis other than the main financial sector laws (such as the Civil Code), special legal frameworks have still been introduced to encourage new players and facilitate growth by adding legal certainty. Several of the legal changes analyzed in this report were primarily motivated by the need to provide an explicit permission both to important existing providers and to potential market entrants by introducing a well-defined legal framework for the specific type of institution or activity. While numerous providers, some of them substantial in aggregate transaction value, numbers of transactions, asset value or number of customers, had been offering their services under the provisions of the Civil Code or some other legal basis outside the main financial sector laws prior to the enactment of the new law in question (e.g., MFOs, credit cooperatives, and EMOs), they were constrained by ambiguity as to how their operations fit within the existing legal system. In particular, large corporations with diversified operations (and thus potential negative spill-over effects to other business lines) were hesitant to experiment unless they had a clear legal basis for their operations. While Russia’s Civil Code provides the general rules for business relationships, it does not have the specificity of laws designed to cover the offering of financial services.

The increase in MNOs’ and banks’ involvement with e-money operations after the adoption of the National Payment System Law suggests the importance of increased legal certainty for increasing outreach, however, it is unclear to what extent this increase has benefitted the previously un- or underserved. Additionally, the stability, integrity, and protection objectives were served where the new frameworks increased transparency of the providers’ operations and brought hitherto unsupervised providers under supervision.

**Russian policy makers have at times adopted a “test and learn” strategy, using light regulation to first understand the size and characteristics of the market before gradually tightening regulation as needed.** Both the Microfinance and Credit Cooperation Laws were introduced at a time when very little information was available about the respective markets beyond their potential to reach excluded or underserved population segments.

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144 The Pakistan I-SIP Report discusses the “test and learn” approach in more detail.
In the case of the Microfinance Law, policy makers deliberately chose an approach that did not prescribe detailed regulatory provisions from the start, but was seen as a first step in regulating the market by understanding its dimensions and dynamics.\footnote{As discussed in Sec. 3.2, the new law also made it easier for MFOs to receive government funding, as it created a specific legal type that could be referred to in regulation governing funding eligibility.} The idea was to begin with low entry barriers in order first to understand the market by collecting relevant data, and then to tighten regulation over time as needed based on market development. Policy makers were also aware that setting entry barriers too high without at the same time restricting unregulated lending under the Civil Code would have likely resulted in many lenders continuing to operate outside the law.\footnote{Even now very little is known about the size of the entire market, as professional lending has continued under the Civil Code (which will only change with the enforcement of the Consumer Credit Law on 1\textsuperscript{st} July 2014). The objective to understand the dimensions of the market has therefore only been partly achieved.} There were minimal attempts to use alternative sources of data, such as surveys, to better understand the scale and potential of the unregulated market.\footnote{Depending on the specific case, an alternative strategy to gather policy-relevant data could be to analyze data reported to other authorities or to undertake primary research. Once the market is better understood, regulatory provisions can be tailored to its specific needs and the likely market response with regard to the I-SIP objectives could be more accurately predicted.}

The idea was to begin with low entry barriers in order first to understand the market by collecting relevant data, and then to tighten regulation over time as needed based on market development. Policy makers were also aware that setting entry barriers too high without at the same time restricting unregulated lending under the Civil Code would have likely resulted in many lenders continuing to operate outside the law.\footnote{The difficulty of establishing whether these consumer protection challenges “outweigh” the harm to consumers from informal lending outside the purview of registered MFOs that would otherwise have taken place typifies the measurement challenges inherent in I-SIP analysis.} There were minimal attempts to use alternative sources of data, such as surveys, to better understand the scale and potential of the unregulated market.\footnote{As discussed in Sec. 3.2, the new law also made it easier for MFOs to receive government funding, as it created a specific legal type that could be referred to in regulation governing funding eligibility.} The Microfinance Law, however, also illustrates that the creation of a new inclusion-linked legal window without strict licensing requirements can open the door to rapid proliferation of new players entering the market, some of which lack entirely the social mission initially envisaged by the lawmakers and others serving the demand of the underserved part of the population for better access to credit. The growth of the payday lending market has created reputational risk for the sector as a whole and for the regulatory authority, as well as also consumer protection challenges.\footnote{The difficulty of establishing whether these consumer protection challenges “outweigh” the harm to consumers from informal lending outside the purview of registered MFOs that would otherwise have taken place typifies the measurement challenges inherent in I-SIP analysis.} If it leads to a general loss of trust in MFOs, it will affect responsible and irresponsible lenders alike and can have negative effects on stability and inclusion. One could say that a positive effect of the highly visible consumer protection challenges has been increased pressure to change the Microfinance Law and introduce the Consumer Credit Law, as both laws have been fast-tracked as a response to this. Such a test and learn approach exemplifies the importance of monitoring and managing I-SIP linkages over time.

The high visibility of consumer protection challenges has influenced the perceptions of the materiality of linkages among the I-SIP objectives and the appropriate nature of the response. Consumer protection issues in the cooperative sector (with financial pyramids having been set up as credit cooperatives prior to the adoption of the Credit Cooperation Law) or in the microfinance sector (with the emergence of the payday lending market) have been highly visible in the public media. This, and the fact that mostly disadvantaged segments of the population have been adversely affected, has created an interest among policy makers which seems out of proportion with the apparent systemic significance of the markets in question. At the same time, the visibility of consumer protection challenges can create reputation risk for the sector even if only a small part of the sector is affected. In the extreme case, a loss of trust can even spill over into the broader financial sector and thus cause broader stability concerns. This means that stability risks might be higher than the size of a market alone might suggest
because of the linkage between (highly visible) protection issues and stability. The size of the payday lending market in Russia is, for example, small when compared to the total volume of consumer lending, yet the high visibility of predatory lending by some of them can still lead to a loss of trust in lending institutions generally and thus have a potential adverse effect on stability. An analysis of linkages between protection and stability in such a case might lead to the conclusion that conduct of business regulation targeted at reducing consumer protection risks and preserving or increasing trust may be as – or even more – important than prudential regulation focused explicitly on stability risks. The draft law ‘On self-regulated organizations in the sphere of financial markets’ is expected to introduce new conduct of business and consumer protection standards via the self-regulatory organizations.\(^\text{149}\)

A piecemeal approach to financial inclusion without an analysis of sector-wide effects of each policy intervention has led to challenges in optimizing the I-SIP linkages. Current financial sector regulation provides ample room for regulatory arbitrage as some of the specific policy interventions such as the adoption of the Microfinance and Credit Cooperation Laws and the Consumer Credit Law kept loopholes open for preferential treatment outside the law or for undermining the intention of the law. The scope of a policy intervention can have effects that stretch beyond the specific case and trigger unintended consequences that undermine the effectiveness of the policy and challenge the management of I-SIP linkages. Examples from the Russian cases that could lead to unintended stability and protection risks include: the omission of agricultural cooperatives from the Credit Cooperation Law (leaving an important part of the sector outside the regulator’s purview);\(^\text{150}\) the permissibility under the Civil Code of borrowing even small amounts by lenders that could lead to quasi-deposit taking or mobilization of member savings through credit cooperatives that are then on-lent to MFOs; and the fact that market conduct rules similar to those enshrined in the Consumer Credit Law do not exist for enterprise loans (though the borrowers in question may be unsophisticated individual entrepreneurs). The identification of a policy champion in charge of financial inclusion (such as the new Directorate General on Financial Inclusion and Microfinance within CBR), the adoption of a national financial inclusion strategy, and definition of financial inclusion in the Russian context (as well as indicators to measure it) might be helpful in following a more comprehensive approach in the future (see also I-SIP Proposition 1).

Russian policy interventions not primarily framed as financial inclusion interventions still laid the foundation for financial inclusion, though greater inclusion might have been achieved through an explicit and structured approach to identifying the linkages between inclusion and the “SIP” objectives: The adoption of the National Payment System Law with rules for EMOs and MNOs was not explicitly targeted at financial inclusion and there was no strong financial inclusion voice at the table when the law was designed. Yet it opened the door for the growth of an industry with a strong potential to reach unserved markets in difficult to reach areas through innovative delivery channels. A more explicit and structured approach to I-SIP analysis, however, might have led to a greater financial inclusion effect by, for example, clearly spelling out who is intended to be reached, with what type of products and services, and which types of providers are most likely to have the highest potential to reach new customer segments (i.e., smaller, innovative EMOs, which are currently excluded by the minimum capital requirement for NBCOs). Additionally, potential tradeoffs and synergies between inclusion and the other I-SIP objectives are most likely to be identified and effectively managed if one


\(^{150}\) Since July 2013 agricultural credit cooperatives are regulated by the CBR per amendments to the Law on Agricultural Cooperation.
agency involved with the policy change has a clear mandate to consider financial inclusion effects and advocates for necessary policy changes.

4.2. Lessons for the I-SIP Methodology

Building on previous I-SIP rapid research exercises in South Africa and Pakistan, the Russia I-SIP provides several general lessons for the I-SIP Methodology.

**The role of proportionality in linkage management:** A fundamental goal underlying the I-SIP Methodology is to facilitate a proportionate approach with regard to potential linkages among I-SIP objectives.\(^{151}\) With regard to linkage management, this triggers the complex challenge of weighing the costs against the benefits of pursuing all four I-SIP objectives at the same time: the success of a given policy intervention cannot be determined by looking at a single objective (e.g., financial inclusion), but has to consider potential tradeoffs and synergies with the other I-SIP objectives, as well as higher-level policy objectives such as employment generation, poverty reduction, inequality reduction, or faster economic growth as determined by the country context.

The I-SIP research in Russia confirms the importance of taking a proportionate approach while also highlighting the difficulties of doing so in practice when the costs and benefits potentially vary substantially across not only the I-SIP objectives, but also higher-level policy objectives likely to be in play. In several instances manifested in studied cases, policy makers have applied the principle of proportionality, if it is defined simply as balancing the benefits of the policy intervention against its costs as measured by the achievement of I-SIP objectives.\(^{152}\) One such example is the Law on Credit Cooperation, which defines prudential requirements that are gradually tightened with increasing scope of operations (in terms of number of members, volume of sales, and value of assets). This approach promotes the development and sustainable operation of smaller credit cooperatives with less sophisticated systems. These smaller cooperatives trigger little or no risk to stability and are thus subject to simpler and less costly rules. Similarly, MFOs are only subject to prudential standards on capital adequacy and liquidity if they take loans from natural or legal persons as this type of financing is viewed as introducing greater stability and consumer protection risks than only self-financing.\(^{153}\) Another example of a proportionate approach is the setting of a high bar for offering mobile financial services.

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\(^{151}\) The South African I-SIP Report concludes with a “tentative proposal of a methodology for policy makers to optimize the I-SIP linkages through the principle of proportionality” (emphasis added).

\(^{152}\) The GPF white paper *Global Standard-Setting Bodies and Financial Inclusion for the Poor: Toward Proportionate Standards and Guidance* observes that risks and benefits are often perceived and measured differently by different stakeholders, and the complexity of the risk and benefit assessment multiplies when applied across the different products, services, and providers that a broad financial inclusion agenda involves. Also, the proportionality calculus requires attention to the contribution that achieving the I-SIP objectives can make to the previously mentioned higher-level policy objective underlying financial sector policy generally. See GPF. "Global Standard-Setting Bodies and Financial Inclusion for the Poor: Toward Proportionate Standards and Guidance." Washington, D.C.: CGAP, 2011.

\(^{153}\) In both cases it is still too early to tell whether the approach has actually had the intended effect as only limited data is available on the risk profile of MFOs and credit cooperatives.
(allowing only MNOs and not all kinds of communication service providers), but then subjecting them to only limited regulatory provisions.\textsuperscript{154}

At the same time, the Russian cases evidence instances where the approach taken regarding consumer protection and AML/CFT appears not to have been proportionate, creating potentially unnecessary tradeoffs with the inclusion objective. One example is the implementation of consumer protection measures for EMOs (specifically the zero liability rule), which has met strong resistance by the industry as it is expected to have a negative effect on the viability of the sector and thus on inclusion. As this intervention was only introduced recently (at the beginning of 2014), it is too early to tell whether the industry’s concerns will prove to have been justified. Another example is the AML/CFT regime, which provides an exemption from identification requirements for small value payments not involving the opening of a bank account, while subjecting EMOs to the same rules as other credit organizations with respect to such matters as internal control and written documentation of AML/CFT policies.

**Challenges in measuring effects of policy interventions:** A recurring challenge in conducting I-SIP research – and an inherent challenge in managing the I-SIP linkages practice – lies in defining relevant indicators to assess the effects of policies and the availability of data to determine whether targets have been met. Quantitative data are needed not only for the period after the introduction of a policy change, but also for a certain period preceding it, as this can be used as a benchmark in the analysis.

The Russia research offers several insights:

- Sometimes policy interventions with the greatest potential to contribute to financial inclusion are not put forward with this objective in mind, with the result that no relevant indicators are defined – or even thought about. The EMO and MNO cases illustrate how important it is to identify the potential linkage with financial inclusion and define indicators that can determine their financial inclusion potential. In both cases, indicators are needed that go beyond just the value and volume of transactions, but also show who is using the service and what for. Moreover, to manage all I-SIP linkages, indicators as to such things as the quality of EMO and MNO services are needed, as well as data to assess whether the benchmarks are being met.

- The I-SIP rapid research approach posits that, in the absence of hard data to assess achievement of the I-SIP objectives and linkages among them, the use of “soft data” is preferable to ignoring the interdependence of the I-SIP objectives and effects of a given policy intervention upon them. Soft data include, for example, the types of interviews with policy makers, regulators, providers, and other market stakeholders conducted in the three I-SIP rapid research exercises, who often have the best available insights into how a specific policy change has affected the achievement of the I-SIP objective and the linkages among them, but also interviews with users of financial services. Soft data should be used both ex-ante to estimate the potential effect of a policy as well as ex-post to assess its observable effect. In Russia, soft data could have, for instance, better informed policy makers about the utility of mobile financial services and e-money services and about consumer protection challenges in consumer lending.

- Even where suitable indicators for a given policy intervention are defined across the I-SIP objectives and data sources exist to assess whether they are being met, the effects of the intervention may often not be immediately evident in the data. For example, EMOs and MNOs

\textsuperscript{154} As explained in Sec. 3.5, it is important to monitor the sector closely as stability and protection risks will increase with the growth of the sector.
may introduce new risks to consumer protection that will only become apparent as the services become widely used and consumer expectations change. The delayed observability of this effect may also be driven by the paucity of indicators available to measure some of these concepts. For example, negative effects on stability caused by the introduction of new providers may not have an observable effect on indicators of financial sector stability unless the impact is significant and leads to a systemic crisis. As I-SIP linkage management calls for continual monitoring, even when an intervention has been recently implemented, the timeframe might simply be too short for effects to be observable. It is therefore also important to look at changes in institutional structures, supervisory processes, regulatory provisions, etc. and infer from these the likely effect on the I-SIP objectives.

“Good” vs. “bad” financial inclusion: While Russia does not have a widely accepted definition of financial inclusion, internationally, financial inclusion is commonly defined as having three dimensions: access, usage, and quality of financial services, with different indicators needed to measure each dimension. The quality dimension reflects the inherent and essential objective of financial inclusion efforts: that the excluded can access and use financial products and services that improve their lives. This is highly dependent on having an effective consumer protection regime. Financial inclusion measured by increases in access and usage statistics alone – such as numbers of clients or accounts, or the number and value of transactions of various types – without consideration of the quality of the specific financial products and services may overstate the extent and benefits of inclusion. This challenge is illustrated when counting the recent rapid growth in the Russian payday lending market as financial inclusion, even if such growth is found to come with substantial costs to financial consumer protection.

Identifying and managing the linkages between inclusion and protection is fundamental to the very notion of I-SIP methodology. Thus, increased access and usage by the formerly excluded of products and services that involve the pervasive use by providers of unethical collection practices or significant increases in debt stress among vulnerable population segments (i.e., what might be thought of as “bad” inclusion) would be recognized in the I-SIP analysis as having a negative effect (or at least a lower positive effect) on financial inclusion and a negative effect on the protection objective (and potentially also the stability objective, to the extent they erode consumer trust in the financial sector as a whole). However, appropriate indicators to measure the effects of a policy intervention on consumer protection and the quality dimension of financial inclusion have not been proposed. We are even further from an approach that could determine the extent of challenges to consumer protection or quality that warrant discounting the positive effect on financial inclusion. For example, what quantum of increased predatory lending by payday lenders (once both these terms have been defined) should negate counting the increased lending involved as “financial inclusion.” This is a debate that goes beyond the scope of this

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155 The G20 Financial Inclusion Indicators include indicators of access, usage and service quality. See http://datatopics.worldbank.org/g20fidata.

156 Researchers have suggested the components of a ‘basic consumer protection package’ that lower income countries and countries with higher levels of financial exclusion can realistically adopt, with the aim of achieving a minimum level of quality in formal financial services in order for them to be considered to be in customers’ best interest. Brix, Laura and Kate Mckee. “Consumer Protection Regulation in Low-Access Environments: Opportunities to Promote Responsible Finance.” Focus Note 60. Washington, D.C.: CGAP, 2010.
For purposes of this rapid research exercise – and to simplify the I-SIP analysis and understanding of expected effects – the quality dimension of financial inclusion is integrated into the consideration of the consumer protection objective while also noting, where relevant, that some of the progress on financial inclusion has only been achieved at the expense of the quality of financial inclusion.

4.3. Revisiting the I-SIP Propositions

The essential elements of the developing I-SIP Methodology have been distilled into a set of high-level I-SIP Propositions intended to support policy makers that are designing and implementing new policy interventions to identify, manage, and optimize linkages among the four I-SIP objectives. Each I-SIP rapid research exercise has added more empirical evidence about the relevance of each of the propositions. In South Africa I-SIP Report they were described as “Guidance Statements” collectively making up a “tentative proposal of a methodology for policy makers to optimize the I-SIP linkages through the principle of proportionality.” The Pakistan I-SIP rapid research exercise confirmed their relevance with evidence from a second, very different, market, but proposed use of the term “I-SIP Propositions” in lieu of “Guidance Statements,” to reflect better the state of knowledge on the subject, as well as openness to their further development and refinement with evidence from additional countries (while also adding nuance based on the cases studied in Pakistan). The Russian I-SIP rapid research exercise offers further evidence to develop and refine the I-SIP Propositions, testing their validity and relevance in a third, and also very different, market context.

This section revisits the I-SIP Propositions as developed and refined based on the South African and Pakistan I-SIP rapid research exercise, discussing each Proposition with reference to the Russian cases studied.

I-SIP Proposition 1: Clear definitions for each of the I-SIP objectives at the national level and at the level of specific policy interventions are needed to guide policy makers in policy design. The definitions on the policy intervention level should be detailed enough to allow for measuring the effects of the intervention with regard to I-SIP objectives.

In Russia, none of the I-SIP objectives has been specifically defined at the national and policy intervention level. As regards the definition of “financial inclusion,” the Ministry of Economic Development has been working on this since 2010 (Sec. 2.3) yet so far no definitional framework has been officially adopted by the authorities charged with developing the framework (the Ministries of Economic Development and Finance and the Central Bank). Indeed, despite longstanding high-level political support (see Sec. 2.1), financial inclusion has not found at the national level a “champion” within Government charged with the responsibility for financial inclusion and capable of bringing all

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157 The G20’s quality indicators are extremely high level, and would not offer a basis on which to draw the line between “good” and “bad” inclusion even with respect to an entire class of financial service within a given country (e.g., credit) – let alone allow to decide whether increases in access or usage resulting from a given policy intervention should count positively or negatively for purposes of I-SIP analysis.

158 As the drafting of the Pakistan and Russia I-SIP Reports took place simultaneously, the revised I-SIP Propositions are similar in both reports and reflect the experience from both countries. At the time of writing this report, the Pakistan I-SIP Report was at the stage of an advanced draft, awaiting further input from the State Bank of Pakistan and other advisors. The I-SIP Propositions in the Pakistan I-SIP Report are therefore subject to change.
public bodies relevant to I-SIP analysis to consensus (see I-SIP Proposition 3). Even at the policy intervention level, in most of the studied cases, policy makers have not accorded the objective of advancing financial inclusion a clear definition. This, and the lack of a comprehensive financial inclusion strategy adopted by the Government, have likely contributed to the lack of a coordinated and comprehensive approach in implementing policy initiatives with relevance to financial inclusion (see the challenge of following a piecemeal approach discussed in Sec. 4.1).\(^\text{159}\) For example, in the case of EMOs and MNOs under the National Payment System Law, their significant potential to advance financial inclusion was hardly considered in the discussion about the law. With the creation of a new integrated regulator and a specific directorate with a focus on financial inclusion and microfinance, the CBR is well-placed to emerge as the champion for financial inclusion.

**I-SIP Proposition 2: A structured approach to identifying material linkages amongst I-SIP objectives that may arise in the implementation of a specific policy intervention helps to manage and optimize linkages, thereby avoiding false or unnecessary tradeoffs between objectives and maximizing synergies among them.**

An explicit, structured approach to linkages among the I-SIP objectives is at the core of the I-SIP Methodology. It entails the *ex ante identification* of the most material potential linkages among I-SIP objectives and their *management* over time, striving toward their *optimization* (that means minimization of tradeoffs and other negative outcomes and maximization of synergies). There are numerous examples in the studied cases of Russian policy makers both identifying and consciously managing some of the linkages among the I-SIP objectives. These include the special treatment of MNOs under the National Payment System Law, which does not require MNOs to come under CBR regulation, but restricts the eligibility to large MNOs, and the adoption of lighter regulation for EMOs as a special type of NBCO given the lower level of stability risk presented by this type of provider.

Yet in none of the studied cases was an explicit, structured approach taken to identifying and managing all four I-SIP objectives.\(^\text{160}\) As a result, for example, financial integrity policies – under the jurisdiction of a separate authority (an issue of relevance to I-SIP Proposition 3 as well) – have at times not sufficiently considered positive linkages with inclusion (as more transactions move from the untraceable world of cash to the more traceable world of electronic funds transfer). Furthermore, potential tradeoffs between inclusion and protection (with potential linkages to stability as well) have only recently been explicitly addressed with the passage of the Consumer Credit Law.

The complexity of managing linkages among all four policy objectives (and likely also higher-level policy objectives as well) requires policy makers to focus on actively managing those that are most material. The high visibility of a particular I-SIP objective can lead to an overestimation of its materiality in a given context, as may be the case with respect to consumer protection linkages in Russia (see Sec. 4.1). Part of

\(^{159}\) There is a strategy for increasing access to retail financial services and microfinance for 2012-2016, developed by the National Partnership of Microfinance Market Stakeholders (NAMMS). However, this has not been formally adopted by the Government. See NAMMS. “Concept of Increasing Access to Retail Financial Services and Microfinance Development in the Russian Federation for 2012-2016”. 2011.

\(^{160}\) Russia is of course not exceptional in this regard: both the previous two I-SIP rapid research exercises noted the absence of an explicit, structured approach to identifying, managing and optimizing the I-SIP linkages, even though considerable attention was given to various linkages in policy making practice. Nor is this basic fact surprising in any of the three countries, given that the concept of I-SIP linkage optimization has only been introduced into global discussion in the past two years.
the structured approach should therefore be clear criteria how to assess the materiality of linkages (such as considering value and number of transactions or the consequences of a risk materializing). In both the identification of I-SIP linkages and their management, hypotheses as to the linkages that a given type of policy intervention may trigger are a useful device to stimulate thinking and reduce the likelihood that a potentially material linkage may be missed. As explained in Section 1 and Annex A, the research team developed such linkage hypotheses for each of the studied cases, an example of which – with respect to the Microfinance Law – appears in Annex A.

I-SIP Proposition 3: Inter- and intra-agency collaboration is critical to design, monitor, and adapt policy interventions to optimize the linkages among I-SIP objectives, as well as linkages with national objectives beyond the I-SIP objectives.

Given that in any country interest and responsibility for each of the I-SIP objectives will inevitably fall within various public agencies – or departments within a given public agency – the very notion of identifying, managing, and seeking to optimize the linkages among them calls for inter- and intra-agency collaboration. In Russia, a process for inter- and intra-agency consultation is considered a standard part of the legislative ‘order of actions.’ Examples include the Consumer Credit Law (on which Rospotrebnadzor and CBR collaborated), the MNO provisions under the National Payment System Law (on which the Ministry of Communication and CBR collaborated), and AML/CFT aspects of all of the cases (on which Rosfinmonitoring previously collaborated with FFMS and the Ministry of Finance and now collaborates with the CBR).

The creation of a mega-regulator in Russia has turned some of the inter-agency collaboration into intra-agency collaboration, which is typically easier to achieve (and indeed this is a motivation for establishing the mega-regulator). An inter-government commission has been set up for regular consultations between Rosfinmonitoring and the CBR. Such structural changes mitigate, but do not eliminate, the risk of insufficient inter- or intra-agency collaboration. One such risk is that new policy interventions are introduced, or material changes made, without simultaneous amendment of all relevant existing legislation or regulation. For example, EMOs, MNOs, and credit cooperatives were brought under the AML/CFT regime of Rosfinmonitoring without any change of the law to accommodate their specific attributes, although Rosfinmonitoring has been working closely with the industry to adapt implementing regulations. A similar problem affects EMOs, which have to comply with the full set of regulatory provisions applicable to NBCOs (as these were not amended at the time the relevant provisions of the National Payments Law took effect).

I-SIP Proposition 4: Regularly collected and analyzed data based on indicators and targets specific to a given policy intervention enable the monitoring of its effects on the I-SIP objectives and the management of linkages over time.

As in the case of the previous I-SIP rapid research exercises, the Russian cases show a general lack of data specific to the policy interventions to measure their effect on I-SIP objectives and to manage the linkages among them over time. Measuring effects also calls for agreed indicators and targets, as highlighted in I-SIP Proposition 1. As indicated above, policy makers appear largely reliant on their own data, which is frequently lacking in advance of the law or regulation. Regarding MFOs and credit cooperatives, the regulatory authorities (FFMS, now CBR) have only recently started collecting relevant data. In both cases, very little data were available prior to the adoption of the laws (in fact, the collection of relevant data was one of the reasons for regulating the market – see Sec. 4.1). At that time, the RMC – which collects data from its partners as part of its market monitoring initiative – was the main repository of data on MFOs and credit cooperatives. Policy makers have also occasionally made use of these data, but not in a systematic way. Overall, the limited use of available data – including soft data (see Sec. 4.2) – has made it difficult to understand the expected effect of policy interventions on
inclusion with regards to the specific client segments to be reached (currently served with formal financial services, within reach of these services, outside the reach of formal financial services, or ‘self-excluded’), and in turn the nature of the potential linkages with the other three objectives.

Recently CBR has commissioned NAFI to conduct a survey on payments usage in Russia to understand the market, yet generally policy makers have not made extensive use of demand side data despite the fact that this could have been very useful in determining the effect of policy interventions in particular on the inclusion and protection objectives (e.g. answering questions such as who is reached by e-money and mobile financial services; and which consumer protection challenges exist in consumer lending).

Data collected through oversight may also require some adjustments to better monitor the risks and benefits to the I-SIP objectives. For example, CBR is collecting basic information on e-money transactions as part of its oversight procedure and is in the process of developing more detailed reporting formats. However, it does not have access to data on customers’ funds held in prepaid airtime accounts (an indicator for potential stability risks), as these are considered only as prepayment for communication services and therefore not under CBR’s purview. Once the Consumer Credit Law comes into force, it will be important to collect relevant data about the effect of the law on the protection objective, such as consumers being able to make informed choices and lenders following appropriate lending and collection practices. These data should be appropriately segmented according to different customer groups: currently served with formal financial services, within reach of these services, outside the reach of formal financial services, or ‘self-excluded’.

I-SIP Proposition 5: Periodic structured consultation with providers in proportion to the scale of the proposed changes helps to identify and manage linkages as the market develops.

In Russia, all legislative initiatives are subject to a structured approach of consultation with the public and industry experts (such as the RMC and E-Money Association). Since 2010, the MED has also been conducting basic regulatory impact assessments on new laws, and since 2012 publishing the conclusions on its website. All new draft laws have to go through the Commission of the Government of the Russian Federation on Legal Drafting Activity, which is composed of representatives from Government authorities and members of the business community, as needed. In some of the cases, specific task forces were even set up to discuss the development of the law (e.g., for the Microfinance Law and the Credit Cooperation Law).

Given these formal requirements, of course each of the studied cases involved consultation with the industry, although in some instances additional consultation could have been beneficial for identifying I-SIP linkages. For example, further consultation regarding the envisaged introduction of interest rate

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161 In the South Africa I-SIP report, market segmentation was included as a separate I-SIP proposition. In the Pakistan report and also here it has now been subsumed under this proposition.

162 Before the first reading of the law, the lead agency (a Ministry or the Central Bank) has to discuss the draft with the professional community, which is often done through professional associations. The MED makes any draft law available for public review for 30 days. Regulations (normative acts) issues by the Central Bank are subject to a simplified consultation process.


ceilings in the Consumer Credit Law would be beneficial, as very little is known about the expected effect of such ceilings on different types of lenders and in turn, the expected effect on inclusion. The discussion about implementing Article 9 of the National Payment System Law ( specifying consumer protection measures for EMOs) is an example where consultation uncovered a potential trade-off between inclusion and protection. However, the tension could not be resolved and Article 9 has recently been enforced without any amendments after the negotiated grace period came to a close.

I-SIP Proposition 6: Optimization of I-SIP linkages requires a commitment by policy makers to manage the I-SIP linkages by adapting policy and regulation as necessary in light of the data and other evidence collected and effects observed.

In the five cases studied, laws and regulations have been adapted on a regular basis. Policy makers have responded to newly arising issues (such as the emergence of the payday lending market, or the exponentially growing scale of e-money) by either suggesting amendments to existing laws and regulations (such as changes to the Microfinance Law or the AML/CFT regulations) or introducing new legislation (as with the adoption of the EMO provisions in the National Payment Systems Law and the Consumer Credit Law). However, as systematic data collection on the effect of policy interventions on I-SIP objectives is still lacking (see I-SIP Proposition 4), revisions are not necessarily based on the results of continuous and comprehensive market monitoring. In short, there is room for further progress in Russia on the management of I-SIP linkages.
Annex A: Linkage Hypotheses

Linkage Hypotheses: Linkages hypotheses are a useful tool of the I-SIP rapid research approach that has been developed in conducting the South Africa and Pakistan study and also been used in Russia. As a preparation for the field visits, the team developed hypotheses for each case regarding potential linkages among the four I-SIP objectives triggered by the direct effect(s) of the policy intervention in question. These hypotheses are not focusing on the particular case examined in a specific country, but discuss a policy intervention on a more generic level (e.g., ‘the introduction of a special microfinance law’ or ‘the issuance of agent regulations for banks’). The purpose of these hypothetical linkages is to understand the universe of linkages that might be triggered by a specific policy intervention and to allow for more strategic questioning during the interviews about which of these linkages were considered at the time the policy intervention was designed or revised. A useful by-product of developing linkage hypotheses for each case is a growing library of potential linkages among the four I-SIP objectives that can be considered in the analysis of similar policy interventions in other countries.

The following are some of the important characteristics of linkage hypotheses:

- Linkages between objectives can be positive (synergies) or negative (tradeoffs) or even both at the same time;
- The overall net-effect on any one objective can be indeterminate as each single objective can be subject to positive and negative effects at the same time;
- The analysis focuses on any changes in policy and the benchmark is the comparison with what applied before the change;\(^{167}\)
- Strictly speaking, all policy interventions will affect all four I-SIP objectives even though to a different degree, as all I-SIP objectives are linked (for practical reasons, it might still be useful to focus on those linkages that are material).\(^ {168}\)

In the following, we present the hypothetical linkages for the case of introducing a special law for credit-only microfinance organizations (MFOs) as an example how this tool has been used in the Russia research.

Hypothetical linkages: Law on Microfinance Organizations

The creation of a new category of microlending organizations can result in increased financial inclusion if new organizations are registered and grow or existing organizations grow faster than they otherwise would have.

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\(^{165}\) This section draws on CGAP (forthcoming), Inclusion, Stability, Integrity and Protection: Observations and Lessons for the I-SIP Methodology from Pakistan.

\(^{166}\) For this reason, there is value in keeping the linkage hypotheses relatively generic (e.g., considering potential linkages of introducing a special microfinance law in country X rather than the linkages of the specific law introduced in Pakistan).

\(^{167}\) This is important as it makes a big difference whether, for example, a new microfinance law forces all MFIs to apply for a license or is optional in the sense that MFIs can apply for a license if they want to go into deposit-taking, but can also remain unregulated.

\(^{168}\) The reason for this is that a policy intervention changes the market equilibrium with a defined value for each of the I-SIP objectives. It is, for example, impossible to have a policy intervention only having an impact on inclusion, and not affecting the SIP objectives via the linkages among the objectives.
Stability → Inclusion:
- Effective financial regulation improves the operations of the MFOs that get licensed, which can build the confidence of banks and other investors in MFOs (i.e., attracting more funding), making it possible for the MFOs to extend more loans to more people (+)
- Predatory lending practices of consumer lenders and payday lenders operating under the law (as a result of weak consumer protection measures that don’t prohibit predatory lending practices) can taint the reputation of the sector and undermine consumer trust in and usage of the financial system (-)
- Additional regulatory responsibilities with respect to a new type of financial institution can put pressure on supervisory capacity, distracting from managing potentially bigger risks (-)

Inclusion → Integrity:
- An increase in the numbers of people served by the MFOs (versus by informal providers not subject to AML/CFT requirements) should have a positive impact on integrity (+)

Integrity → Inclusion
- Compliance with the AML/CFT requirements may be burdensome and costly for MFOs (-)

Protection → Inclusion
- The definition of MFO as a new institutional type makes it possible to apply consumer protection rules (+)
- Consumer protection provisions in the Microfinance Law – if they are appropriate – can have a positive effect on inclusion if customers gain trust in the sector (+)
- Conversely, the lack of appropriate consumer protection standards despite being regulated by the Central Bank can undermine the trust in the sector and have a negative effect on inclusion (-)
Annex B: Interview list

<table>
<thead>
<tr>
<th>MONDAY, 11 NOVEMBER</th>
<th>Interviewee</th>
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<tbody>
<tr>
<td>Meeting 1</td>
<td>Anatoly Aksakov, President of the Association of Regional Banks, First Deputy Chairman of the State Duma Committee on Financial Markets</td>
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<tr>
<td>Meeting 2</td>
<td>Anna Baitenova, Lawyer of the National Partnership of Microfinance Market Stakeholders</td>
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<tr>
<td>Meeting 3</td>
<td>Andrey Paranich, Director of SRO NP “MiR”</td>
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<thead>
<tr>
<th>TUESDAY, 12 NOVEMBER</th>
<th>Interviewee</th>
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<tbody>
<tr>
<td>Meeting 1</td>
<td>Guzel Imaeva, General Director, National Agency for Financial Studies</td>
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<tr>
<td>Meeting 2</td>
<td>Rasim Ismailov, Deputy Director of MFO “Money for Rent”</td>
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<tr>
<td>Meeting 3</td>
<td>Alexander Bolshuhin, Executive Director of the Moscow Regional Foundation for the Development of Microfinance</td>
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<tr>
<td>Meeting 4</td>
<td>Alexey Savatyugin, President of the National Payment Council</td>
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<tr>
<td>Meeting 5</td>
<td>Peter Darakhvelidze, Director of External Relations of WebMoney Transfer</td>
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<thead>
<tr>
<th>WEDNESDAY, 13 NOVEMBER</th>
<th>Interviewee</th>
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<tbody>
<tr>
<td>Meeting 1</td>
<td>Andrey Marulev, Director of Foundation for Development of Microfinance</td>
</tr>
<tr>
<td>Meeting 2</td>
<td>Dmitry Yanin, Chairman of the International Confederation of Consumer Societies</td>
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<tr>
<td>Meeting 3</td>
<td>Julia Bondareva, Deputy Head of the Federal Financial Markets Service (FFMS), Liquidator of FFMS</td>
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<thead>
<tr>
<th>THURSDAY, 14 NOVEMBER</th>
<th>Interviewee</th>
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</thead>
<tbody>
<tr>
<td>Meeting 1</td>
<td>Alexei Belov, Head of Legal Department, State Corporation &quot;Deposit Insurance Agency&quot;</td>
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<tr>
<td>Meeting 2</td>
<td>Oleg Prusakov, Head of the Consumer Protection Department of Rospotrebnadzor</td>
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<tr>
<td>Meeting 3</td>
<td>Andrey Shamraev, Deputy Head of Settlements Regulation Department, CBR</td>
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<tr>
<td>Meeting 4</td>
<td>Victoria Tagirova, Chairman of the Board of the Public NGO “Opportunity”</td>
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<tr>
<td>Meeting 5</td>
<td>Alexandr Solomkin, General Director, SRO &quot;Cooperative Finances&quot;</td>
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<tr>
<td>Meeting 6</td>
<td>Mikhail Mamuta, RMC President</td>
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<tr>
<th>FRIDAY, 15 NOVEMBER</th>
<th>Interviewee</th>
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<tbody>
<tr>
<td>Meeting 1</td>
<td><strong>Andrey Rego</strong>, Director of Department of Regulatory Risks, MTS mobile network operator</td>
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<tr>
<td>Meeting 2</td>
<td><strong>Tatiana Alexeeva</strong>, Director for Legal Issues of NGO “Yandex.Money”</td>
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<tr>
<td>Meeting 3</td>
<td><strong>Andrey Emelin</strong>, Chair of the National Payment Council</td>
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<tr>
<td>Meeting 4</td>
<td><strong>Guznov Aleksey</strong>, Deputy Head of Legal Department of the CBR</td>
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<tr>
<td>Meeting 5</td>
<td><strong>Vyacheslav Kuzhyushkin</strong>, Deputy Head of the Financial Policy Department of the Russian Ministry of Finance</td>
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<tr>
<td>Meeting 6</td>
<td><strong>Project Team Wrap-Up Meeting</strong></td>
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</tbody>
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**TUESDAY, 21 JANUARY, 2014**

| Meeting 1 | **Natalia Larionova**, Director of the Department for Small and Medium-Sized Entrepreneurship, Development of the Ministry of Economic Development of the Russian Federation |
Annex C: Ministry of Economic Development: Proposed financial inclusion indicators

In June 2012 MED shared its suggestions for the first stage of the implementation of the financial inclusion measurement system with the Ministry of Finance, the Central Bank, and the Federal Financial Market Service (now integrated in the Central Bank) for their feedback.

In this initial stage, MED suggested using indicators of physical access and use of financial services - credit, deposits, payments, and insurance. MED noted that the dimension of quality is more difficult to measure, and will be addressed at a later stage. These indicators would be calculated by settlement (taking into account the population size), by subject of the Russian Federation, by Federal District, and at the national level.

<table>
<thead>
<tr>
<th>Services</th>
<th>Physical Access</th>
<th>Use of Financial Services</th>
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<tbody>
<tr>
<td>Credits</td>
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<tr>
<td></td>
<td>- Number of credit organizations’ branches per 100 sq. km</td>
<td>- Number of depositors (number of deposit agreements)</td>
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<td></td>
<td>- Number of credit organizations’ branches per 100,000 people</td>
<td>- Average deposit size per capita</td>
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<td></td>
<td>- Number of credit organizations’ branches in settlement/ Number of residents in settlement</td>
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<td></td>
<td>- Number of ATMs per 100 sq. km</td>
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<td>- Number of ATMs in settlement/ Number of residents in settlement</td>
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<td>- Number of CC branches per 100 sq. km</td>
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<td>- Number of CC branches in settlement/ Number of residents in settlement</td>
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<td>- Number of MFO branches per 100 sq. km</td>
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<td>- Number of MFO branches per 100,000 people</td>
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<td>- Number of MFO branches in settlement/ Number of residents in settlement</td>
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<td>- Number of post offices per 100 sq. km</td>
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<td>- Number of post offices per 100,000 people</td>
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<td>- Number of post offices in settlement/ Number of residents in settlement</td>
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<tr>
<td>Deposits</td>
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<td></td>
<td>- Number of credit organizations’ branches per 100 sq. km</td>
<td>- Number of loan recipients (number of loan agreements)</td>
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<td></td>
<td>- Number of credit organizations’ branches per 100,000 people</td>
<td>- Average loan size per capita</td>
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<td>- Number of credit organizations’ branches in settlement/ Number of residents in settlement</td>
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<td>- Number of ATMs per 100 sq. km</td>
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<td>- Number of ATMs per 100,000 people</td>
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<td>- Number of ATMs in settlement/ Number of residents in settlement</td>
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<tr>
<td>Settlement</td>
<td>Payments</td>
<td>Insurance</td>
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  - Number of post offices per 100,000 people  
  - Number of post offices in settlement/ Number of residents in settlement | - Number of credit organizations’ branches per 100 sq. km  
  - Number of credit organizations’ branches per 100,000 people  
  - Number of credit organizations’ branches in settlement/ Number of residents in settlement | - Number of users of payment services  
  - Volume of payments per capita  
  - Number of ATMs per 100 sq. km  
  - Number of ATMs per 100,000 people  
  - Number of ATMs in settlement/ Number of residents in settlement | - Number of users of payment services  
  - Volume of payments per capita  
  - Number of banking agents per 100 sq. km  
  - Number of banking agents per 100,000 people  
  - Number of banking agents in settlement/ Number of residents in settlement | - Number of accounts with remote access (internet, mobile)  
  - Number of post offices per 100 sq. km  
  - Number of post offices per 100,000 people  
  - Number of post offices in settlement/ Number of residents in settlement | - Number of users of payment services  
  - Volume of payments per capita |

| - Number of insurance companies’ branches per 100 sq. km  
  - Number of insurance companies’ branches per 100,000 people  
  - Number of insurance companies’ branches in settlement/ Number of residents in settlement | - Number of users of payment services  
  - Volume of payments per capita  
  - Number of users of payment services  
  - Volume of payments per capita | - Number of insurance agreements  
  - Average insurance premium per capita  
  - Number of users of payment services  
  - Volume of payments per capita  
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  - Volume of payments per capita |
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