

**PROJECT INFORMATION DOCUMENT (PID)  
IDENTIFICATION/CONCEPT STAGE**

Report No.: PIDC34345

<b>Project Name</b>	STRENGTHENING POLICIES AND REGULATIONS TOWARDS PROMOTING RESPONSIBLE FINANCIAL INCLUSION IN EGYPT
<b>Region</b>	MIDDLE EAST AND NORTH AFRICA
<b>Country</b>	Egypt, Arab Republic of
<b>Sector(s)</b>	Banking (50%), General finance sector (50%)
<b>Theme(s)</b>	Financial Consumer Protection and Financial Literacy (30%), Anti-Money Laundering and Combating the Financing of Terrorism (20%), Other Financial Sector Development (50%)
<b>Lending Instrument</b>	Lending Instrument
<b>Project ID</b>	P157526
<b>Borrower Name</b>	Government of Egypt, Ministry of International Cooperation
<b>Implementing Agency</b>	The Central Bank of Egypt
<b>Environment Category</b>	C - Not Required
<b>Date PID Prepared</b>	01-Oct-2015
<b>Estimated Date of Approval</b>	15-Jan-2016
<b>Initiation Note Review Decision</b>	The review did authorize the preparation to continue

**I. Introduction and Context**

**Country Context**

Egypt's economic activity is recovering, after four years of subdued growth. This reflects the gradual improvement in confidence, higher investment spending and favorable base effects. Egypt recorded a growth rate of 4.7 percent during the first nine months of FY15; around triple its pace in the same period last year. However, growth has recently been decelerating gradually. Egypt's public finances are improving slowly, but remain unfavorable. The overall budget deficit to GDP ratio increased to 10.8 percent during the first 11 months of FY15, around 1.3 percentage points higher than its ratio in the same period in FY14; although the underlying "structural" fiscal deficit (excluding exceptional revenues) has actually decreased by 1 percentage point. This improvement in Egypt's underlying fiscal stance was mainly due to the streamlining of energy subsidies since the beginning of FY15, the lower international oil prices, and containing the wage bill growth (after four years of an upsurge), in addition to the other revenue-enhancement measures implemented early in FY15, including the introduction of new taxes, and raising the rates of existing ones. In light of these fiscal consolidation measures, headline inflation has been high, averaging 11 percent during FY15; around one percentage point higher than average inflation in FY14. This also partially reflected the gradual devaluation of the Egyptian pound against the US\$ throughout FY15 by around 6.85 percent. On the other hand, average annual core inflation decreased to 8.1 percent during FY15, from 10.2 percent in FY14; confirming that the headline inflation was primarily driven by the hikes in the prices of administered items; mainly those of energy products.

Egypt's external accounts have been buoyed by; the Gulf deposits held at the Central Bank of Egypt (CBE), the pick-up in net FDI inflows, the recovering tourism (although coming from a low base), as well as the issuance of a Eurobond worth US\$ 1.5 billion towards the end of the year. Egypt's net international reserves increased to US\$ 20.1 billion in end-June 2015, before dropping to US\$ 18.5 billion in end-July 2015, when Egypt made its scheduled payment to the Paris Club, in addition to injecting foreign exchange to meet higher imports of food and other basic commodities during the month of Ramadan. The CBE allowed the official exchange rate (against the US\$) to devalue twice successively in its regular foreign exchange auctions in early July, after holding it steady for over four months. The parallel market rate followed suit, weakening temporarily, before stabilizing with a premium of around 1-1.5 percent above the official rate in mid-July. Shortages in hard currency continue to persist, hampering economic activity and investors' sentiment.

In FY13, the last year for which data are available, more than a quarter of the population lived below the poverty line. Recent developments in correlates of welfare suggest that the poor and bottom 40 would have enjoyed limited gains from the resumption of growth. Sectoral breakdown of growth in FY14 and first half of FY15 shows that most growth occurred in non-extractive industry and services—a growth pattern which would not directly benefit the poor and the bottom 40 percent as they are less likely to be working in these sectors. Agriculture, where most of the poor are employed, grew at less than 1 percent per year in FY14 and first quarter of 2015. Indeed, enduring regional disparities mark Upper Egypt as the region with the highest poverty rates, in particular rural areas where the poverty rate is 50 percent and households have limited options to work outside subsistence agriculture.

The unemployment rate started declining slowly, yet remains high. Unemployment decreased to 12.7 percent during the third quarter of FY15, compared to 13.3 percent during FY14. However, unemployment continues to be almost four percentage points higher than its level in FY10, with the youth, the educated and the women facing relatively worse labor market conditions.

The dire political and economic situation in Egypt calls for innovative approaches to incentivize economic growth and job creation. One important solution is promoting financial inclusion. An inclusive financial system can play a pivotal role in job creation, poverty reduction and overall sustainable economic growth yet, progress remains slow on financial inclusion in Egypt. According to the most recent Global Findex data, only 14 percent of all Egyptians have a formal bank account, with only 6 percent of the adults in the poorest 40 percent holding an account.

### **Sectoral and Institutional Context**

Financial inclusion in Egypt is low, as of 2014 only 14 percent of the population have formal bank accounts, four percent have formal saving accounts, and six percent have formal borrowing accounts.. This places Egypt with one of the lowest penetration rates in the region, followed only by Yemen and Iraq with 6 and 11 percent respectively, and well below the developing world average of 62 percent. The gap widens even further for women, where only 9.3% of women have a bank account

Access to finance for firms is a key constraint. The 2012 Investment Climate Rapid Assessment Survey reveals that only 13 percent of firms have access to bank credit compared to 29.7 percent in Jordan and 33.4 percent in Morocco. The situation for MSMEs, not surprisingly, is by far the worst. Access to finance is an important constraint for MSMEs. This group of enterprises accounts for more than 98 percent of Egypt's enterprises, more than 85 percent of employment in the non-agriculture private sector, in addition to an overall 40 percent of total employment. The Investment Climate Rapid Assessment Survey reveals that only 11.1 percent of micro enterprises and 17.4 percent of small enterprises have bank loans, as opposed to 38.2 percent of large enterprises (Figure

2). Of these surveyed firms, more than 70 percent raise concerns regarding the surge in the cost of finance post revolution. As a result, they often resort to alternative sources of finance, relying on personal savings (79 percent) or inheritance (15 percent) to raise capital, while only four percent access the formal market (Figure 3).

Moreover, Non-bank financial institutions (NBFIs) play a very limited role. Only 2.5 percent of MSEs tap financing from NBFIs. MSEs face problems obtaining finance from capital market vehicles. Venture capital and angel investors have a limited, yet growing presence in the Egyptian market. Their operations are not easily tracked in terms of magnitude, due to the lack of a comprehensive regulatory and reporting framework governing their operations. Financial leasing and factoring are underdeveloped, and provide limited services to MSEs.

Gender disparities are also prevalent, with women entrepreneurs facing more challenges in accessing finance than men. Traditions, in some cases, give women little control over their own assets. In many cases women are unable to use assets as collateral, being under the guardianship of a male member of the family. In addition, banks impose higher collateral requirements for women, as they are perceived as more risky, particularly due to the traditions that place them as the key family members responsible for taking care of the household, presumably leaving them with little time for work. Moreover, cultural barriers and norms limit women's mobility, constraining their entrepreneurship opportunities. Enhancing women's access to finance and providing them with an equal opportunity is critical as funds should be allocated to their most productive uses with no discrimination by gender.

On the supply side, banks are reluctant to extend financial services to MSMEs or individual with small transaction value as they incur high transaction cost. Among the reasons for the high transaction cost is following the same Know Your Customer (KYC) procedures for every client regardless of the risk exposure to abide with the AML/CFT regulations. Introducing tiered KYC proportional to the risk of clients will lower the transaction cost for banks.

Banks are reluctant to lend to MSMEs, especially young and new ones, due to the perceived associated risk. Furthermore, banks continue to lend based on collateral as opposed to cash-flow, narrowing the opportunities for MSMEs which often do not have sufficient collateral. The value of collateral needed for a loan compared to the total loan size is 88 percent for small enterprises, which significantly hampers their ability to have access to bank loans. Effectively, banks in Egypt are serving large, well established enterprises.

A key challenge to Financial inclusion is the lack of proper outreach channels. In March 2010, the CBE had issued regulations governing the provision of Payment Orders through Mobile Phones. Moreover, CBE had recently issued an Internet Banking regulation that defines control objectives as well as specific controls/requirements for banks providing internet banking services in Egypt. However, to date there are no regulations/guidelines for the rest of electronic banking channels including Mobile banking, ATM, and POS. Meanwhile mobile penetration in Egypt exceeds 100 percent, thus making internet and mobile banking framework and regulations integral for the expansion of the outreach of financial services in Egypt. Developing regulations and improving the framework of delivery channels are essential in reaching out to the poor and underserved segments of the society where, evidently the mobile penetration rates are very high.

On the demand side, the weak financial intermediation of MSEs is attributed to various institutional factors. One of the main challenges is enterprises' lack of transparency, their inability to hold regular bookkeeping records, and their inadequate capacity to issue audited financial statements. Financial institutions are unwilling to lend to enterprises that do not have audited financial statements or well-prepared business plans. This problem is directly related to the lack of awareness of MSEs on the importance of having proper documentation and business planning in order to ensure the success of their projects. MSEs usually complete business planning processes by

themselves and do not use the services of the professional providers (audit firms and business consultants). In addition, there is often lack of physical access in poor villages, as it is not cost-effective. The lack of a comprehensive market analysis and diagnosis for the suppliers and consumers of financial services is a key obstacle preventing regulators and policymakers from taking measures that could enhance financial inclusion. The importance of data and information as a premise to any financial inclusion strategy cannot be overemphasized. Data gathering and analysis will inform policy makers about the current status of financial inclusion, and will enable them to accurately diagnose the state of financial inclusion, set targets and identify existing barriers. In addition it will allow for the monitoring and evaluation of regarding the achievement of these goals. The existing data in Egypt are from scattered surveys that are not focusing on financial inclusion. In the best case scenario, this dataset will only touch upon certain aspects of inclusion, such as accessibility. As such, a comprehensive fully-fledged dataset covering the supply and demand for financial services and consumers is a necessary step to develop a comprehensive financial inclusion strategy or advocate policies and measures to promote inclusion.

On the regulatory side, Consumer Protection is considered an integral component for enhancing Financial Inclusion. Absent or weak consumer protection framework can hurt financial inclusion. It is an integral market component to level the playing field, disseminate information to consumer and assist in regulating the financial markets. It is important that existing customers and customers with new services can make well-informed decisions and that proper consumer protection frameworks are in place as new providers and delivery mechanisms open up scope for consumer fraud and abuse. Currently, there is no central financial consumer protection body that caters specifically to the financial services industry in Egypt. Various regulators are left to cater to their respective sectors. Currently, on the level of CBE, the function of financial consumer protection is performed by the “Legal and Foreign Exchange Cases and Complaints Department” under the Banking Supervision sector within CBE. Therefore, there is a need to introduce measures to strengthen consumer protection frameworks and raise financial consumer awareness.

In response to these challenges, efforts have been made to both improve the enabling environment for financial intermediation, and to strengthen the financial infrastructure. The first private credit bureau was established, significantly improving the information on clients’ credit worthiness. The payments system was modernized, in terms of operations, policies, and regulations, creating a more supportive institutional framework. Moreover, the CBE issued the Code of Corporate Governance, enhancing transparency and governance of the banking sector. All this has contributed to attaining a more enabling business environment, making it more conducive to MSE lending.

At the same time, at the broad country level, there have been a number of very positive developments for financial inclusion, an example of this is the recent passage of the microfinance law, which was ratified by the President on November 12, 2014, in order to address key regulatory gaps, allowing commercial companies to engage in microfinance and opening a window for non-governmental organizations (NGO) to establish and own shares in microfinance companies.

With the objective of attaining a more inclusive financial system, this proposed Project comes at a particularly opportune time. The CBE became a principal member to the AFI Network in July 2013. Since this time, the CBE has put financial inclusion squarely on its agenda. This has involved CBE’s active participation in the AFI Working Group on financial inclusion strategies; taking an active role in the task force for financial inclusion, a subcommittee of the Arab Committee on Banking Supervision formed by a decree of the Board of Arab Central Bank Governors and Arab Monetary fund; and the establishment of a working group led by the Egyptian Banking Institute- CBE’s training arm-on developing national strategy for Financial Literacy.

In addition, the proposed project will promote financial inclusion through developing the regulatory framework necessary to promote financial inclusion and via creating an evidence base that will feed

into the broader process of stakeholder engagement underway thus establishing the necessary foundation for informing the design and reforms needed. This proposed project financed by the Transition Fund will be supported by the World Bank Group (IFC and the Bank), in collaboration with GIZ, and will complement other efforts in the microfinance sector in Egypt, and attaining broader outreach with better risk management.

### **Relationship to CAS/CPS/CPF**

The World Bank Group (WBG) has recently launched the public consultations which will help develop the Country Partnership Framework (CPF) for its partnership with the Arab Republic of Egypt during the period of 2015-2019. This is part of a larger exercise that includes a Systematic Country Diagnostic (SCD), which constitutes the analytical basis for the formulation of the CPF. The consultation process started with a kick-off event with the World Bank Group's Government counterparts on March 5, 2014. It was followed by a series of consultation meetings with different stakeholders in various governorates (Cairo, Alexandria, and Aswan) in June 2014.

The proposed operation is closely linked to the SCD, and the outcomes of the CPF consultations. The SCD assessed low levels of financial inclusion in Egypt and need to ensure broader financial access for disadvantaged segments of the population—women and youth, as well as lagging geographical regions. Furthermore, financial inclusion was identified under social inclusion focus area during the CPF consultations. The proposed operation, through mapping out supply and demand barriers for access to financial services will support ongoing regulatory reform to address broader access issues and will provide insights into market obstacles to growth and opportunities for innovation in product development and delivery. In addition, it will support the development of interventions/programs that aim at increasing financial inclusion in specific market segments (i.e. regions or population groups). At the same time, the consumer protection initiative under the project will ensure better and fairer access to information and accountability to financial clients, especially the marginalized and small clients who lack financial knowledge and expertise.

The proposed project is also directly in line with the global initiative recently announced by the World Bank Group (WBG) President Jim Kim to provide universal financial access around the world by 2020. The WBG has identified 25 focus countries (including Egypt) for the Universal Financial Access 2020 goal, together representing 73 percent of the world's unbanked adult population, for more targeted and comprehensive interventions, including through the design and implementation of National Financial Inclusion Strategies (NFIS). This project will contribute by conducting a thorough market diagnostic to map out the supply and demand barriers to achieving greater financial inclusion in the country, and establishing a comprehensive evidence base needed to inform policy development for greater financial access, as proving quality, up to date data about the levels and trends of financial inclusion are essential first steps for the design and implementation of an effective National Financial Inclusion Strategy (NFIS), that helps achieve the financial inclusion goals.

The Project's objective is also aligned with the Bank and IFC's regional framework and strategy for the Middle East and North Africa (MNA) region, which has evolved to respond to the events of the Arab Spring, and focuses engagement on inclusion, job creation and sustainable private sector-led growth. Through designing AML/CFT measures that meet the national goal of financial inclusion, this project will contribute to promoting financial inclusion in Egypt by including important segments of the population that are currently excluded from formal financial services, by

“operating” in the informal economy due to the application of an overly cautious approach to AML/CFT safeguards, which consequently leads to excluding legitimate businesses and consumers from the financial system, thereby compelling them to use services that are not subject to the regulatory and supervisory oversight. As such, the project is also aligned with the 2012 Interim Strategy Note (ISN) for Egypt (2012-2014), discussed by the World Bank’s Board of Executive Directors in June 2012, which entails a different way of doing business. The ISN envisions fostering inclusion and ensuring broader financial access for disadvantaged segments of the population.

## II. Project Development Objective(s)

### Proposed Development Objective(s)

The proposed project development objective (PDO) to strengthen policies and regulations towards promoting responsible financial inclusion in Egypt

### Key Results

Progress towards achieving the project’s objectives will be measured by a series of quantitative and qualitative indicators at the PDO level and at the intermediate level. Key results and indicators at the PDO level, are: (i) a financial inclusion study for Egypt that combines the supply and demand side data to take a holistic look at the financial sector, identifying market opportunities, policy imperatives as well as potential market and regulatory barriers to exploit these opportunities; (ii) the issuance of the consumer protection Regulations by CBE; and (iii) a diagnostic and a set of recommendations for a more conducive KYC regulation.

Key results and indicators at the intermediate level are: (i) the establishment of a credible, data set for measuring the levels of financial inclusion in Egypt, drawing from existing supply side data available in the market; (ii) initiating an empirical, nationally representative demand side study that identifies the drivers of and barriers to the usage of financial products and services within the context of existing supply and regulatory frameworks; (iii) establishment of a National Steering Committee of relevant stakeholders to help coordinate the market diagnostic process; (iv) the number of staff and clients trained—workshops, study tours, and capacity building events; and (v) the number of consumer protection initiatives launched and implemented by CBE.

## III. Preliminary Description

### Concept Description

The proposed project comprises of three main components: (i) conducting a financial inclusion Market Diagnostic for Egypt; (ii) promoting financial consumer protection; and (iii) developing a Risk Based Approach to KYC processes for cheaper and more accessible banking products to enhance access to finance. The total cost of the project is US\$ 3 million.

Component I: Conducting a Financial Inclusion Market Diagnostic for Egypt (US\$ 1.5 million). The key objectives of the market diagnostic exercise are to (i) provide policy makers with an accurate picture of the current status of financial inclusion in the country, including information on the supply, access, demand and quality of both formal and informal financial services in the country; (ii) help inform a national dialogue around the definition and vision for financial inclusion in Egypt, (i. e. identifying policy priorities around access, usage, quality or impact) and (iii) provide a baseline on access and usage of financial services for poor and low income people in Egypt, against which to set time-bound action plans and targets. This component comprises of the following sub-components:

(i) Providing TA to establish a National Steering Committee. The committee will be chaired by the CBE to help coordinate the market diagnostic process; determine data needs based on existing

sources of supply side data (CBE, EFSE, ENPO, MoF, SFD, MoA) as well as individual and household data including national household and income surveys, SME census data, financial capability survey, etc; and provide guidance and oversight of data mapping efforts. The Steering Committee will include all key stakeholders including commercial banks, NGOs, Microfinance Institutions (MFIs), government agencies and regulators, National Statistics Bureau, and research houses, to ensure buy in for the process and that results are useful and provide maximum impact.

(ii) Advisory services to develop the scope of work for Data Mapping. The members of the Steering Committee will work together with the GIZ facilitated process to identify the key policy questions to be examined (e.g. willingness and ability of clients to use internet, mobile or agent banking); assess existing data in the country which can be built on or drawn from to reduce costs and avoid duplication of efforts, particularly the supply side data noted above; determine areas of specific interest to be measured (access, usage, quality, impact) and market segments to be included (e.g. geographic breakdowns, women, youth, small holder farmers, etc.) through a nationally representative demand survey. The project will work in partnership with the Central Agency for Public Mobilization and Statistics (CAPMAS). Given that this will be the first financial inclusion mapping exercise done in the Egypt, the project will draw on the expertise of qualified external research firms (such as FinMark, Microfinance Center of Poland, Bankable Frontiers, Gallup, IFMR trust etc.) that have an established methodology in place, which can be adapted to the local context to ensure local ownership of data and data processes, as well as the replicability of data collection in the future.

(iii) Improving quality of supply side data. There are a number of bodies currently collecting financial inclusion relevant data in Egypt from financial service providers as part of their supervisory function, most notably CBE as part of its offsite activities for the banking sector and EFSA for non-bank financial institutions. However, the scope and quality of this data is relatively limited and does not include information on accounts held at the ENPO or PBDAC, significantly understating access figures. At the same time, much of this data is aggregated and does not provide information on client demographics (geographic distribution, age, gender) or active use/dormancy, which is useful for private as well as public sector actors. The project will provide technical assistance to the CBE on improving the scope, quality and use of supply side financial inclusion data by addressing the technological and human capacity constraints to collecting this data, so that future financial inclusion data collected reflects the broader set of financial inclusion priorities identified by the national steering committee.

(iv) Designing and conducting demand survey. An external research team will be selected through an international competitive process to work with the Steering Committee on developing a survey to fit the policy objectives and needs of the Egyptian context, ensuring that the survey is appropriately tailored to the domestic environment and the priorities identified by stakeholders. The external research team will work with CAPMAS and/or a local research house to pilot test a sample survey and train local enumerators for conducting field work, ensuring local capacity exists to update and repeat the survey in the future, as part of the national monitoring and evaluation plan.

(v) Analyzing data and dissemination of findings. Once the field work has been complete, the external research firm will work with a local partner to write up findings from both the supply and demand side data collection efforts and make evidence based policy recommendations that can stimulate debate and lead to effective public and private sector interventions. The survey results will be discussed in and utilized in a series of workshops and conferences to identify opportunities for greater financial inclusion in the country.

Component II: Promoting Financial Consumer Protection (US\$750,000). This component will support CBE in developing a robust consumer protection capacity within the banking sector, and in

developing financial literacy amongst target population groups. The tasks related to consumer protection will be handled by CBE's Complaints Unit through expanding the unit's mandate in line with international practice in Consumer Protection regulation and supervision with the support of the project. This component comprises of five sub-components: (i) developing and finalizing a consumer protection regulation in harmony with EFSA; (ii) providing advisory services on consumer protection specific supervisory tools; (iii) conducting study tours and on the job training in countries which have well developed systems for financial consumer protection; and (iv) building the capacity of the Complaints Unit to cater for the consumer protection regulation through training seminars and workshops.

Component III: Developing a Risk Based Approach to KYC processes for cheaper and more accessible banking products to enhance access to finance (US\$750,000). This component will support CBE and financial institutions in designing KYC processes that meet the national goal of financial inclusion, without compromising the measures that exist for the purpose of combating crime. It will also provide technical assistance to help CBE comply with the latest technology in the field of document scanning, and thus enable them to maintain document integrity, and mitigate document loss risks. Specifically, this component will support CBE through six main sub-components by: (i) defining high level existing or prospected product list, covering payment, deposit and credit services; (ii) defining categorized services list, based on different risk factors, including but not limited to; non-face-to-face relationships and anonymity, geographical reach, methods of funding, and access to cash; (iii) developing a risk matrix for the list of services; (iv) developing possible risk-based exemption from KYC processes for some of the services; (v) developing risk mitigation measures including customer due diligence; loading, value and geographical limits; source of funding; and record keeping, transaction monitoring and reporting; and (vi) developing level of KYC processes proportional to the level of risks.

#### IV. Safeguard Policies that Might Apply

Safeguard Policies Triggered by the Project	Yes	No	TBD
Environmental Assessment OP/BP 4.01		x	
Natural Habitats OP/BP 4.04		x	
Forests OP/BP 4.36		x	
Pest Management OP 4.09		x	
Physical Cultural Resources OP/BP 4.11		x	
Indigenous Peoples OP/BP 4.10		x	
Involuntary Resettlement OP/BP 4.12		x	
Safety of Dams OP/BP 4.37		x	
Projects on International Waterways OP/BP 7.50		x	
Projects in Disputed Areas OP/BP 7.60		x	

#### V. Financing (in USD Million)

Total Project Cost:	3	Total Bank Financing:	0
Financing Gap:	0		
<b>Financing Source</b>			<b>Amount</b>
MENA Transition Fund - IBRD as Implementing Agency			3

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