



FINANCIAL INCLUSION  
STRATEGY (FIS) PEER  
LEARNING GROUP



SME FINANCE (SMEF)  
WORKING GROUP

# BRINGING THE INFORMAL SECTOR ONBOARD



TOOLKIT

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# INTRODUCTION

Bringing the informal sector onboard has a crucial role to play in expanding financial inclusion (FI) for the world's two-plus billion people working in the informal economy. FI policymakers' successful engagement with the informal sector supports sustainable development, poverty reduction, decent work and more inclusive societies.

The imperatives and benefits cut in two directions between FI and the informal sector:

## 1. THE INFORMAL SECTOR AS A FOUNDATION FOR INCREASING FINANCIAL INCLUSION



Better engagement with informal sector workers and micro, small and medium-sized enterprises (MSMEs) is integral to increasing overall FI rates, particularly for women, given the immense size of the informal sector in many countries across the globe. Making up much of the world's unbanked, people working in the informal economy and the unique factors of informality must be considered in FI agendas.

## 2. FINANCIAL INCLUSION POLICIES AND PROGRAMS TO TRANSFORM THE INFORMAL SECTOR



Likewise, FI policymakers have an important role to play in improving conditions in the informal sector. Extending financial services enhances conditions for economic growth at the macro-level and for income at the micro-level, which is a key part of eventual formalization and supporting employment and livelihoods for many of the world's working poor.

FI policymakers have a number of tools at their disposal to achieve goals of onboarding the informal sector. The theoretical underpinnings and shared learnings in the development of these tools continue to evolve as FI stakeholders recognize the imperative of bringing the informal sector onboard.

## DEFINING THE INFORMAL SECTOR

The informal sector is defined differently across contexts. The official International Labour Organization's (ILO) definition states that the informal economy is "all economic activities by workers and economic units that are - in law or in practice - not covered or insufficiently covered by formal arrangements."<sup>1</sup>

One of the key tasks for bringing the informal sector onboard is to create a commonly agreed upon definition within a country.<sup>2</sup> This working definition should be coordinated between the central bank and other government departments, such as the ministries of finance, labor and gender, telecommunications, and enterprise registration authority so that all relevant stakeholders understand what the informal sector encompasses and what success looks like. The ILO describes that formalization can be defined along with registration and licensing lines, bookkeeping and maintenance of bank accounts, implementing employment contracts, and measures of social security and protection.

It should be emphasized that bringing the informal sector onboard is not about the formalization of informal enterprises and workers per se. The two ideas are connected, with FI holding promise for formalization, as it can also be considered "gradients" of formalization; the country experience from Nepal shows how informal MSMEs and workers are increasingly using formal microfinance services. While not registered, this can in some ways be considered part of being formalized, with increasing financial transactions, records, and liquidity in the formal system. However, there is an important distinction to make between bringing the informal sector onboard and narrowly defined efforts towards "formalization". Strong drives towards formalization are risky and may often be counterproductive as informal actors bear formalization costs and perhaps not the benefits. "Formalization" may also preclude more nuanced engagement by FI policymakers, who recognize the gradients between informal and formal as in Nepal, and the long-term benefits of working for and with the informal sector using tools outlined in this toolkit.

1 ILO (2002). Resolution and conclusions concerning decent work and the informal economy. 1 June 2002.

2 ILO (2016). Role of Finance in Driving Formalization of Informal Enterprises. ILO Thematic Policy Brief - Enterprise Formalization.

## PURPOSE OF THE TOOLKIT

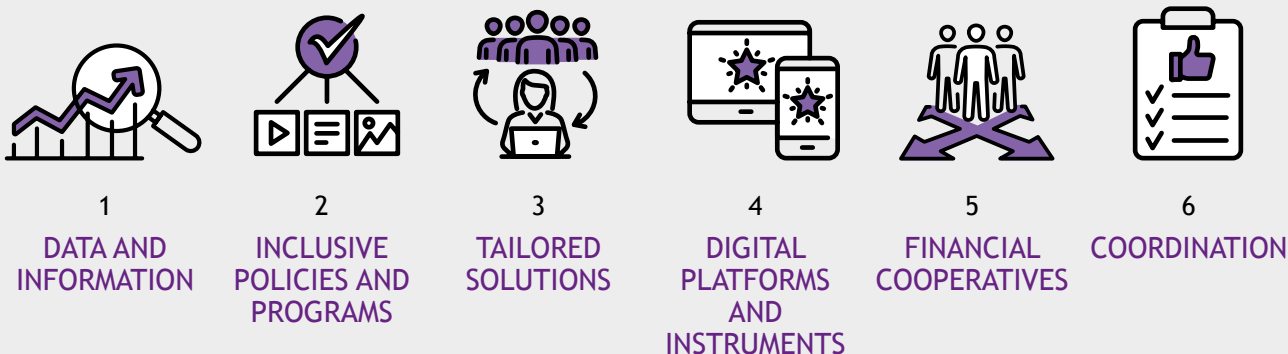
With the dual benefits to the informal sector and FI becoming increasingly apparent, and the key role FI holds regarding the informal sector, the question then is how the informal sector can be better brought onboard. The purpose of this toolkit is to outline different tools that FI policymakers and stakeholders have at their disposal. The tools are explained along with the process of using them systematically.

## WHO IS THE TOOLKIT FOR?

This toolkit is designed for Financial Inclusion policymakers and practitioners. AFI member countries are all working with regards to informal sectors within their countries, whose size and dynamics hold major implications for FI. Further still, FI has transformative potential for those engaged in the informal sector, both directly in terms of their access to finance and what this means for them as informal enterprises and workers, and indirectly when considering the positive changes that can arise from increased earnings, inclusive programs, and coordinated policies. Global FI and informal sector policymakers can also use this toolkit to understand the nexus between the two areas and guide policy and program engagement.

## USING THIS TOOLKIT

This toolkit contains six gender-sensitive “tools” that policymakers can use to bring the informal sector better onboard.



These six tools cover six different - yet overlapping - policy areas. Digital platforms and instruments for bringing the informal sector onboard will require concerted coordination, for example, with actors in the telecommunications sector regarding mobile money. Another example is how inclusive policies and programs for the many women, minorities, and other vulnerable groups in the informal sector requires that these groups are better understood and given a voice in disaggregated data and information efforts. These intersections should be kept in mind when using the different tools to avoid a piecemeal approach that does not match the need for integrated and inclusive FI planning and implementation.

The six tools are structured to be deep dives into the measures taken by different countries working to bring the informal sector onboard. Based on the real-world experiences of AFI members and experts working at the crossroads of FI and the informal sector, the tools detail the experiences, challenges, and actions taken from across the global context. This combines how a tool has been wielded, how it can be replicated across different countries, the actual bumps in the road and how these might be navigated when putting policies into practice.

# 1. DATA AND INFORMATION: UNDERSTANDING THE INFORMAL SECTOR



High-quality (sex) disaggregated data and information on the informal sector is the foundation for well-designed policies and programs.

Research supports more nuanced understandings of the informal sector, including size, composition, characteristics, gender indicators, key sectors, and ongoing trends. Research also builds knowledge on the links between the informal sector and FI - how access to financial services differs between formal and informal areas of the economy, how FI can support better conditions in the informal sector, and pathways to enhanced inclusion for the diversity of informal sector workers and enterprises. Importantly, data helps financial policymakers to formulate appropriate policies that are based on actual dynamics in the informal sector and to create programs that are responsive to informal MSMEs and worker needs.

Both the United Nations 2030 Agenda for Sustainable Development and ILO recommendations on the “*Transition from the Informal to the Formal Economy*” highlight the importance of the collection, analysis, and dissemination of statistical data and indicators on the informal economy, noting they are crucial for policy formulation and monitoring.

## A) DEVELOPING A BROAD LEVEL OF UNDERSTANDING AND APPROACH TO THE INFORMAL SECTOR

The necessary first step to bringing the informal sector onboard is to have a solid conceptual basis for understanding the informal sector. The first working paper by Women in the Informal Economy: Globalizing and Organizing (WIEGO), “The Informal Economy: Definitions, Theories and Policies”, outlines the multi-decade historical debates and theoretical thinking on the informal sector, with different schools of thought matching the heterogeneity and complexity of the informal sector. Since much of the informal sector remains outside of government purview and the opacity of the informal sector is exacerbated by the very nature of informality, policymakers who use conceptual frameworks that misunderstand the informal sector,

especially the gender-specific aspects of it, are at risk of creating misguided policies.

A strong conceptual framework includes understanding the informal sector as a scene of dynamism, providing important economic output, employment, and income for large sections of the population. At the same time, these understandings can identify the many issues in the informal sector, including a lack of legal and social protection, decent work deficits, gender risks and opportunities, low-skill and productivity levels, and financial integrity risks.

Placing people that are part of the informal economy at the center of conceptual thinking will ensure that the dynamics, needs, and potentials of the informal sector guide policies and programs. From domestic workers in San Salvador to fisherfolk along Mozambique’s coast, construction workers in Tunisia, charcoal producers in Nepalese towns and street vendors in the Solomon Islands, this understanding forms a strong basis for research, data, and practice.

## B) LINK WITH EXISTING DATA AND RESEARCH

The informal sector is receiving increased attention globally with renewed interest in its gender dimensions, size, scope, and importance. While major studies into the specific intersection of FI and the informal sector may not be available in individual countries, there is a growing evidence based on informal sector dynamics produced by different stakeholders, including the ILO, the World Bank Group, the GSMA, WIEGO, and more targeted local research within countries.

Even with the absence of specific studies relating to the FI of informal economies, policymakers should harness the power of sex-disaggregated data from diverse sources to understand how the informal sector factors into their country’s FI agenda. Policymakers are already using diagnostic studies, information drawn from financial service providers, and data parsed from FI studies, which provide indicative information relating to the informal sector. Existing and upcoming research should integrate understandings of informality into their research and sex-disaggregated data collection methodologies.

### LEVERAGING DATA FROM FINANCIAL COOPERATIVES IN ECUADOR



Ecuadorian FI authorities draw on sex-disaggregated data from financial cooperatives, which cater to people in the informal sector. This data is used to track trends in FI indicators, including expanding access and usage rates countrywide. The data allows Ecuadorian policymakers to analyze disaggregated breakdowns such as gender. Through the financial cooperatives data, or “Sector Financiero Popular y Solidaria”, the FI unit can analyze that though gender balance was close to equal in account access and usage, men accessed loans at much higher rates than women. This is despite lower default rates amongst females. With this existing data, FI policymakers can devise responses to address gender gaps that would not have been apparent without the hard, quantitative data.

### C) SET OUT CORE RESEARCH OBJECTIVES

Policymakers should map out the key data gaps and information areas of interest, including regulations and initiatives targeted at the informal sector. These will be highly contextualized to each country. Examples of informal sector areas of keen interest to FI policymakers can include:

- > **A high-level understanding** of the informal sector, FI, and the intersections between the two. This can include the size, composition, gender-disaggregated and key characteristics of the informal sector and a broad overview of their current access to finance.
- > **Targeted studies** that focus on particular demographics, sectors, and topics that comprise the informal sector.
- > **Identification of barriers** to FI for informal sector actors. In some countries, the lack of identification documentation (ID) might be the major hurdle for informal workers to access finances, while in others, the lack of gender-sensitive financial products offering low-cost, high-volume, low-balance transactions may preclude informal MSMEs from financial access.
- > **Stakeholder mapping** of key actors in the informal sector and FI space is essential for coordination.
- > **Market research and demand studies** that inform the design of financial solutions tailored to the informal sector, including studies that identify what informal clients need and want in financial services.

### THE PHILIPPINES’ RESEARCH ON HURDLES TO MSMEs FORMALIZATION AND ACCESS TO FINANCE

The Bangko Sentral ng Pilipinas, in coordination with the Asian Development Bank (ADB), will roll out a comprehensive disaggregated demand-side survey for MSMEs. The survey is envisioned to augment the limited information currently available for MSMEs and generate new insights and a more granular data on MSMEs’ access to finance. This survey results could support gender-sensitive evidence-based policymaking and provide a more in-depth market insight for financial service providers to help them broaden their products and services available in the market.

### D) FORGE PARTNERSHIPS FOR RESEARCH

FI policymakers should explore partnerships to further the research agenda of informal sector dynamics. A range of donors and stakeholders are increasingly funding research on the informal sector. FI policymakers should monitor where FI can be included in this research agenda, given its importance in bringing the informal sector onboard. Policymakers can also seek partnerships to expand their information and data agenda, whether it is on large-scale studies or smaller, targeted research. Partnerships can include seeking support from donors and funding bodies, linking with research institutes and universities, as well as coordinating with national statistics organizations and other government ministries collecting data on the informal economy.

### A FRUITFUL PARTNERSHIP BETWEEN FI AND NATIONAL STATISTICS

The Banco de Moçambique maintains a bilateral coordination mechanism with the Mozambique National Institute of Statistics. The Institute of Statistics conducts a number of studies with other research institute and NGOs, including on savings and loan groups. The agreement allows the Bank to access data shared on FI, including intersections with the country’s large informal sector.

**GSMA RESEARCH  
ON MOBILE MONEY**



GSMA are expanding their research agenda by using mobile data in order to understand how the informal sector uses digital financial tools and mobile money. This is part of the drive towards understanding the linkages between mobile financial services and the informal sector. Better data on markets and customers will lead to better mobile money policies. GSMA, who represent the interest of mobile operators worldwide, published a paper “Mobile Money: Driving formalization and building the resilience of MSMEs”, which outlined how mobile money is being used in the informal sector and its beneficial results.<sup>4</sup> The research includes the role of policymakers and actions they can take to encourage the use of digital financial services (DFS) among both formal and informal MSMEs.

**E) USING DATA - INFORMATION IN ACTION**

Disaggregated data from the informal sector can drive gender-sensitive policy and program design, and lead to adjustments in implementation. Research on barriers shows how FI stakeholders can recognize, address, and overcome hurdles faced by informal sector actors. Similarly, data from FI interventions can shape and fine-tune ongoing programs, such as financial literacy or dedicated financial product uptake. Findings can be shared across governance bodies and between different FI and informal sector stakeholders, in order to leverage the power of information to create positive change.

**UNDERSTANDING BARRIERS TO INFORMAL SECTOR  
FI IN ANGOLA**

In Angola, the FI Unit at the Banco Nacional de Angola used data from the simplified accounts program called Bankita. Specifically targeted at the working poor, who are almost always working in the informal sector, growing data from Bankita is being used to understand informal sector dynamics, which is useful for more comprehensive policies and programs. Gender-sensitive data analysis demonstrated barriers to usage, such as distance from branches, proving the need for expanded coverage and mobile money options, which are then featured in subsequent FI policies and regulations relating to digital finance. High ATM usage rates compared to low in-branch banking rates showed a potential social barrier for those in the informal sector, particularly women, to both feel comfortable in traditional banking spaces and to be able to access branches during opening hours. This clearly demonstrated that informal sector customers

used banking services, especially for low transaction amounts, and the importance of ATM coverage across Angola. Finally, authorities could detect irregular account behavior relating to unauthorized intra-family usage, which led to increased coordination between the FI Unit and the ministry in Angola responsible for families and youth.

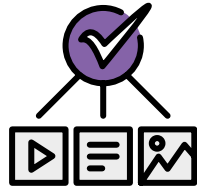
**F) REGULARIZED RESEARCH PROCESSES FOR  
UPDATED UNDERSTANDINGS**

Research and disaggregated data collection are not an “end destination”. The informal sector is dynamic and changing, as are links to the FI agenda such as informal sector financial preferences and needs. A learning agenda where consistent information will update understandings among key stakeholders, will reflect new trends and changes. This can include information necessary to adjustments to policies and programs, where prior successful research methods and evolving practice from other contexts can inform ongoing efforts to bridge data gaps and ensure evidence-driven policies and programs.

<sup>4</sup> GSMA (2020). Mobile Money, Driving Formalization and Building the Resilience of MSMEs



## 2. INCLUSIVE POLICIES AND PROGRAMS



The informal sector is characterized by its diversity. In more than half of the world's countries, women make up the majority of those working in the informal sector. This includes 92 percent of all women in developing countries who work as part of the informal economy.<sup>5</sup>

Ethnic, linguistic, and religious minorities work as part of the informal sector, and migrants and displaced groups are often overrepresented in it. These populations have diverse experiences within the informal sector and varied needs, desires, aspirations relating to financial services. Policymakers cannot achieve their FI goals without including these different groups that make-up so much of the informal sector.

### A) INCLUDE DIVERSE POPULATION SUB-GROUPS AND WOMEN IN FI, INFORMAL SECTOR POLICIES AND PROGRAMS

Diversity considerations should be included in all FI policies targeted at the informal sector. This is with the recognition that many previous policies and programs that are gender-neutral tend to be more beneficial for men than women. Furthermore, they often do not account for the diverse needs of people from different backgrounds. Policies and programs must consider specific vulnerabilities and barriers to financial access that are experienced by socioeconomically disadvantaged groups in order for these to be overcome. Planning and implementation that address gender, minority status, and disability, among others, will lead to better outcomes and long-term results.

Policymakers should also pay attention to intersectionality. Different social categorizations combine to amplify discrimination or privilege. A woman working in the informal sector may face barriers to financial access due to her gender. If the woman is also a migrant or has been forcibly displaced, these barriers may be compounded further because of the intersection of her social identities. This may mean she is even more likely to not hold the requisite ID and financial transaction history to open formal financial accounts, as well as face linguistic and social barriers

while wanting to do so. Understanding intersectionality will allow for policymakers to identify the multiple and interrelated factors that must be addressed when bringing the informal sector onboard.

### FEMALE BANKING AGENTS IN INDIA



In India, the Rural Financial Institutions Program (RFIP) found that when female members of a local self-help group received training and started to work as banking agents, the rates of first-time women financial customers increased. This included elderly and illiterate women, as female banking agents were perceived to be more relatable and reliable.<sup>6</sup>

### B) PROMOTE MEANINGFUL ENGAGEMENT

Women and sub-groups, such as minorities, migrants, and people living with a disability should be meaningfully engaged at different policy levels. These diverse groups should have a seat at the table as participatory policymaking and programming are much more likely to be responsive to their needs, and therefore, to succeed. The inclusion of diverse groups in research, public consultation, and coordination mechanisms supports the formulation and implementation of gender-sensitive and vulnerability-sensitive policies and programs. A transformative approach to policymaking should be adopted to enhance these groups' decision-making power, strengthen positive norms, and aim to change the underlying structures that perpetuate social inequalities in informality and financial access.

Relevant government ministries and non-government stakeholders should be included in FI platforms. This can be included in national financial inclusion strategies (NFIS) (as described in Tool 6 - Coordination) or through targeted bilateral partnerships with organizations working on, with, or are part of the informal sector. This is particularly the case for organizations working on specific social issues tied to inclusive policies and programs, such as women's and youth's rights, legal economic rights, and labor rights.

5 Bonnet, Florence, Joann Vanek, and Martha Alter Chen. Women and Men in the Informal Economy: A Statistical Brief. WIEGO and ILO.

6 Arora, A; Krishnaswamy, K. (2015). Why Women Self-Help Group Members Make for Good Bank Agents.



## INCLUSIVE PARTNERSHIPS IN ECUADOR



The Ecuadorian FI unit has a memorandum of understanding with an NGO named “*Mujeres*” - or “Women” - to support Ecuadorian policymakers in their review of the National Financial Education Strategy. The education strategy includes emphases on women in the informal economy, with *Mujeres* providing technical support. The partnership also includes a financial education programs for women living in poverty-affected areas.

## 3. TAILORED SOLUTIONS



FI policymakers globally are finding success in regulating and designing financial products and programs tailored to informal MSMEs and workers.

In the Solomon Islands, the micro pension program YouSave was targeted at the informal sector and particularly women in the informal sector. It quickly brought financial access to many of the country’s unbanked. Elsewhere, a number of countries are accelerating simplified account programs and tiered-know your customer (KYC) regulations. One prominent example is the *Bankita* simplified accounts program in Angola. Many of these solutions cater directly to those in the informal sector, expanding FI and further bringing the informal sector onboard.

### A) MARKET RESEARCH AND IDENTIFYING NEEDS

Those designing or regulating financial products require information on what informal sector workers and MSMEs need. Additionally, information on what those in the informal sector actually want and desire out of their financial services is essential for financial product success. While many informal MSMEs may need credit facilities to expand their operations, the modalities and type of loan services may vary markedly from country to country and sector to sector. In some Islamic countries, informal MSMEs may desire *Sharia*-compliant financial instruments, such as *Murabaha*, a cost-plus-profit arrangement, and *Ijarah*, a leasing-based contract. In other countries, informal MSMEs rely on seasonality-dependent cash flows, which has implications for repayments and sustainability if financial products are not designed for these specificities.

Similarly, informal sector workers may have different consumer preferences than traditional bank clients. In Angola, *Bankita* data revealed that account users engaged in high-volume, low-balance transactions. Informal sector workers may want access to low-cost mobile money, digital payments for informal sector vendors and market stalls, or micro pension products where funds can be withdrawn for emergencies.

### DIARIES TO UNDERSTAND SMALLHOLDER DEMAND FOR FINANCIAL SERVICES



In 2015/16, CGAP conducted innovative research into smallholder financing.<sup>7</sup> The research included a financial diary tool that studied smallholder families' financial habits in Mozambique, Tanzania, and Pakistan. The research revealed the integral role "arthis" or agricultural agents played in the financial lives of smallholder families in Pakistan, the non-agricultural income that families draw on in addition to their farming, new microfinance options being used, and FI imperatives for the hundreds of millions of smallholders who lack access to finance.

Market research is also important in identifying the unique and frequently gender-specific challenges that informal sector actors face when accessing financial services. Informal workers often lack IDs, find mismatches between their hours of work and financial service provider opening hours, face access issues, and may encounter less-tangible issues such as feelings of social marginalization and exclusion in formal financial service providers' physical branches.

To understand these specific market demands and barriers, conducting market research is an essential initial step - covered in *Tool 1 - Data and Information* - as product and regulation design need to be anchored in the real-world consumer preferences and responsive to informal sector dynamics.

### FEASIBILITY STUDIES FOR THE SOLOMON ISLANDS YOUSAVE MICROPENSION PRODUCT



The Solomon Islands YouSave Micro Pension product commenced with a feasibility study, which was carried out in order to establish whether there was a demand for pension and long-term savings for retirement in the informal sector. The feasibility study also provided potential product contours and specifications before the design phase.

## B) DESIGN, TEST, REITERATE

The design phase of tailored financial services should draw heavily from earlier market research and demand studies. Products should integrate consumer preferences and address any challenges facing informal sector customers that were revealed in the research phase. This care during design should be well-worth the effort; a core lesson from the YouSave program was that a well-designed and gender-sensitive product accelerates uptake.

YouSave accounts are easy to open, with simple KYC requirements that can include a birth certificate, driver's license, voter card, or letter from a church leader or village elder. This addresses one of the major barriers to informal sector workers. The cost hurdle was also factored into product design, with the YouSave account being free of charge and only requires an initial deposit of SBD 50 (approximately USD 6 in 2020). Deposits were simplified, with options between traditional channels, a network of authorized agents, and airtime deposits through mobile phones. Finally, the design also included emergency saving withdrawals, with a general account that may be accessed at any point four times per year. All these features were designed specifically to address the barriers, needs, and preferences of informal sector clients in the Solomon Islands.

Tailored informal sector product design can also benefit from shared learning across different contexts. In the increasing rollout of tiered-KYC regulations, low-risk, low-balance accounts for informal sector clients who cannot fulfill more stringent ID requirements are drawing on experiences in other countries that are further along in implementation. These shared learnings support FI policymakers and program experts to configure their own tiered-KYC and simplified account mechanisms while staying aligned with requisite anti-money laundering (AML) and anti-terrorist financing (ATF) regimes.<sup>8</sup>

### DESIGNING SIMPLIFICATION: THE ANGOLAN BANKITA PROGRAM



The Banco Nacional de Angola developed a simplified accounts program in 2009 called Bankita. The financial accounts were designed to expand financial access for low-income earners, many of whom were women who worked in the informal sector. With differentiated ID requirements for account opening, low deposit amounts, and no bank fees, the program has been successful in bringing more people into the formal financial system.

7 CGAP (2014-2016). Diaries: A Tool for Understanding Smallholder Families. Blog Series. Accessed at: <https://www.cgap.org/blog/series/diaries-tool-understanding-smallholder-families?page=1>

8 AFI (2020). Inclusive Financial Integrity: A Toolkit for Policymakers.

Testing and reformulating the tailored solutions are the next essential step in the process. The testing and reiteration phase presents a low-cost, low-risk means to identify financial product design features that can be changed and enhanced. In the Solomon Islands, YouSave was piloted and tested against established business case thresholds. Data insights from the YouSave pilot phase then informed the next iterations of the micro pension program.

### C) ROLLOUT, CONTINUED LEARNING, AND EXPANSION

As tailored financial solutions move from theory to practice and from the lab to the streets, tailored solutions continue to generate learning that can be useful to FI policymakers. The Bankita program has provided information to the Banco Nacional de Angola that has proved useful in the development of tiered-KYC, mobile money, and microfinance regulations. Similarly, learning generated from tailored products can also be shared across contexts, such as the experience from the Solomon Islands, which has seen the important role of women market vendors in communicating information on the service to others.

#### SPREADING THE WORD ON SIMPLIFIED ACCOUNT PROCEDURES IN THE PHILIPPINES

The Bangko Sentral ng Pilipinas promotes the use of basic transaction accounts with simplified requirements and low maintenance costs. The simplified accounts were designed in the context of a widespread lack of ID, which is especially prevalent given the pending of the full implementation of national ID in the country. In support of the rollout of the new procedures, the Philippines Bank's Advocacy Group plays an important role in outreach and advocacy, spreading awareness of the simplified procedures to the unbanked population.

Successful tailored products have the potential to expand across countries and even between contexts. After meeting and exceeding initial use targets, including the number of account openings and usage rates disaggregated by gender, YouSave is now being scaled across all nine provinces of the Solomon Islands over five years. This has significantly expanded financial access for the informal sector, increasing formal liquidity and savings but also providing safe, convenient, and needed financial services for people working in the informal sector. The Solomon Islands and partners to the YouSave program are communicating the findings and learning from the product after seeing the galvanizing effect of the micro pension program, designed specifically for people working in the informal sector.

## 4. DIGITAL PLATFORMS AND INSTRUMENTS



Digital financial platforms, pathways, and tools have the potential to create far-reaching and transformative change potential for the FI of the informal sector.

The digital agenda can support informal workers and MSMEs to lower transaction costs, increase income, and lead to business and economic expansion. There are also more practical considerations cited by AFI members, including the potential for digital finances to circumvent the need to purchase foreign-printed cash. For some people in the informal sector, digital financial tools are their best means to save, transfer, and make or receive payments. For instance, female market vendors in Angola find it difficult to leave their stalls, where they would lose income by not selling for long stretches of time to visit physical bank branches that are long distances from the market. With mobile operators common in the market themselves, mobile money can present an excellent vehicle to access and use formal finances, with the ability to receive payments instead of handling cash. It is also important to note that without effective digital literacy capability, DFS can pose a risk to consumers, particularly women who generally have lower levels of opportunity needed to gain the necessary digital skills. They are also less likely to own and use a mobile phone or use the internet. Expanding DSF without understanding the gendered risks can actually increase the gender divide and leave women even more excluded than before.

The digital agenda relevant to FI policymakers regarding the informal sector includes mobile money and e-wallets, digital KYC processes, digital transaction histories for alternative credit scoring, cross-border remittances, and regulatory technology (RegTech). AFI shares lessons on digital finance and Financial Technology (FinTech), including experiences from global leaders and case studies of best practice.<sup>9</sup>

<sup>9</sup> AFI (2019) FinTech for Financial Inclusion and Policy framework for women's financial inclusion using Digital Financial Services

## A) DEVELOP INTELLIGENT REGULATORY FRAMEWORKS AND INFRASTRUCTURE

Policymakers should prioritize well-designed gender-sensitive regulatory frameworks that support digital finance and foster their uptake. This should keep in mind the multiple components required in regulations and seek out best-practice examples from regimes that have encouraged FinTech and innovation. Major policy papers relating to digital finance and the informal sector map out the different areas where policymaking and regulation can create high impact.<sup>10</sup> These include (1) identity frameworks and structures; (2) digital payments infrastructure; (3) alternative data for credit reporting; and (4) financial consumer protection, financial literacy, and data protection.

For identity frameworks, several AFI members are progressing with changes in regulation for simplified accounts, tiered-KYC, and e-KYC (see *Tool 3 - Tailored Solutions* for further details), especially pertinent for the informal sector where there is a prevalent lack of ID in many countries. Low-risk, low-balance digital accounts that comply with AML/ATF requirements on the one hand, while also allowing people in the informal sector to access and use financial services such as mobile money savings and transfers, are being facilitated in many countries.

To reach the unbanked informal sector population, agency banking serves as a pivotal example that manages to reach individuals where formal banking has failed - but it needs clear regulatory frameworks to ensure compliance. The agency banking model refers to branchless banking, where traditional banks use authorized agents to extend their outreach without having to set up branches. Kenya is at the forefront of this model and has specific regulations in place with its *Guideline on Agent Banking CBK/PG/15* prepared by the Central Bank of Kenya in 2010.

Regulatory approaches should stay consumer-centric based on the importance of building consumer trust and protection regarding DFS. At the same time, regulations should be supportive of digital growth to harness its power to help informal sector workers and MSMEs gain access to needed financial services. Burdensome regulations, including taxes on mobile money circulation, may inhibit growth that precludes digital services scaling to meet informal sector actors' needs.

## B) KEEP INFORMAL SECTOR DYNAMICS, FINANCIAL LITERACY, AND CONSUMER PROTECTION IN MIND

The fact that digital platforms and instruments have vast potential to financially include both informal

workers and MSMEs is well-acknowledged, but the gendered risks of these opportunities must not be overlooked. Digital regulations, policies, and programs must keep informal sector conditions at the center of any engagement strategies (as can be seen in *Tool 1 - Data and Information* and *Tool 3 - Tailored Solutions*).

While mobile phone penetration is high and quickly expanding in many developing countries, many people, particularly women, working in the informal sector do not have access to a smartphone, precluding usage of some of the more advanced mobile money services. This highlights why pushing DFS can risk increasing the gender divide if the reasons behind women's lower use of digital technology are not addressed in tandem. Likewise, internet-based services and platforms may not be that useful in many contexts. Digital financial efforts should be differentiated and tailored depending on the context, with much heterogeneity within informal sectors in individual countries that need to be considered.

Digital finance should usually be accompanied by (1) consumer protections, including robust oversight arrangements and data protection, as well as (2) financial and digital literacy programs, particularly aimed at vulnerable population segments. Trust in the service and the platform is essential to uptake and usage, linked to social norms, which are an important driver of behavior. In Nepal, the Nepal Rastra Bank emphasizes that digital and financial literacy should accompany the introduction of DFS.

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Sometimes people are illiterate and are not able to use digital services even if facilities are available. We push for FinTech and online banking, but it may still be difficult for many even if they have access because of a lack of capacities.”

Prakash Shrestha, Nepal Rastra Bank

## C) CROSS-CUTTING DIGITAL REFORMS

Digital platforms outside of financial services can also prove to be an important area at the nexus between the informal sector, digitalization, and FI. The Gambia expanded their e-Government systems as part of

<sup>10</sup> G20 and G20 (2018). Digitisation and informality: Harnessing digital financial inclusion for individuals and MSMEs in the informal economy - G20 Policy Guide. Leora Klapper, Margaret Miller and Jake Hess (2019). Leveraging Digital Financial Solutions to Promote Formal Business Participation. The World Bank Group



their administrative reforms in order to reduce the cost of doing business and increase the benefits of formalization. To do so, the Gambian government established an Online Company Registry across the country to improve documentation and to increase transparency. The Gambian government instituted digitized, automated, and integrated post-registration procedures for businesses, with a focus on start-ups, and the registration of staff engaged directly with the informal sector. The e-Government systems also facilitate access to digital banking, a key component in the lead-up to the country's NFIS. FI policymakers should map where they can best insert into digital platforms for the informal sector and what experiences can be shared from digital finances outwards to other government arms.

#### D) PURSUE INTEROPERABILITY

Financial regulators should set up interoperability standards, with the view towards enhancing the usage and function of digital finance and, therefore, its usage, including amongst the informal sector.

- > **Mobile money** - Banco de Moçambique is working with the telecommunications regulator and digital finance stakeholders to increase the interoperability of mobile money. With issues identified in sending money between different mobile money operating systems, the issue of interoperability is important to ensure that the population, much of which is employed informally, can send mobile money to others easily and thereby, ensure continued formal finance usage.
- > **Digital commerce** - Digital commerce and marketplaces are expanding at a rapid rate. Trends towards online selling have been accelerated during the COVID-19 global health pandemic. This requires consistently updated regulatory approaches to match the fast-growing and fast-changing sector. The Philippines offers an example of best practice regarding digital commercial space. Bangko Sentral ng Pilipinas coordinates with the Ministry of Trade and Industry, who is responsible for the small business sector. With increasing amounts of small, informal businesses selling goods and services online, Bangko Sentral ng Pilipinas regulates the digital payments and transfer systems. This includes working towards interoperability in order to mitigate against online platforms being partnered only with specific partner banks, preventing withdrawal by informal businesses without an account at that bank. Being responsive to monitoring and action will ensure a healthy digital finance ecosystem.

## 5. FINANCIAL COOPERATIVES



**Savings and credit cooperatives (SACCOs), also known as financial cooperatives, are an alternative to formal financial service providers.**

They play a critical role in bringing the informal sector onboard as they serve as a bridge between the arena of FI and informal sector actors. Indeed, financial cooperatives often cater explicitly to the informal sector and the financially deprived, generally the majority of their members are women. The backbone of their mandate is to offer services such as savings and different types of credit and loans to small economic operators and disadvantaged populations that are excluded from the customer base of formal banking institutions. Today, SACCOs have gained ground in a number of developing and emerging economies. They have become particularly widespread in **Latin America** and **Asia**, such as **Nepal** where savings and credit cooperatives have a capital mobilization of over USD 6 billion.

#### A) FINANCIAL COOPERATIVES, A COST-EFFICIENT POLICY INSTRUMENT

##### SOLIDARITY-BASED FINANCING:

Financial cooperatives are membership-based organizations and succeed in appealing to financially excluded groups, which coincide to a large extent with informal workers or small economic units operating informally. Due to their cooperative structure, financial cooperatives present themselves as a viable alternative to private sector-led formal financing and manage to gain the trust of local communities. The absence of sole profit motivations helps reassure members, who are in a better position to tailor the financial services cooperatives offer to their own needs and exercise their full potential as cash depositors and borrowers.

##### RESILIENCE IN THE FACE OF EXTERNAL ECONOMIC SHOCKS AND A SAFETY NET AGAINST VULNERABILITY:

Insights from various countries have shown the resilience of financial cooperatives in times of economic recession, and their higher propensity to support informal economic units, which are hit the hardest. Financial cooperatives, together with microfinance institutions, often act as a lender of last resort to informal sector workers and small-scale enterprises during crises; this is particularly beneficial for women

who are less like to be able to access formal lines of credit. This enables informal sector actors to overcome liquidity shortages and ensure business and livelihoods continuity. A case study from the Philippines exemplifies the role of financial cooperatives in channeling financial support during the COVID-19 crisis. Several savings and credit associations in the country changed their loan repayment conditions and even paid out members' dividends before their due dates. At the same time, the Philippines' regulatory body for cooperatives pressed them to tap into community development funds to assist community members.

#### THE CASE OF ECUADOR: A SUCCESSFUL JOURNEY TOWARDS THE LEGAL RECOGNITION OF FINANCIAL COOPERATIVES



Ecuador has facilitated the success of financial cooperatives and the associated FI of informal sector workers and MSMEs. Since the early 2000s, the Ecuadorian government embarked on a journey to recognize Social and Solidarity Economy (SSE) actors, including financial cooperatives, as part of the country's economic landscape. A regulatory agency, the Superintendencia de Economía Popular y Solidaria (SEPS), was created with a specific mandate to oversee SSE entities, including financial cooperatives.

The creation of this agency, together with the enactment of the Ley Orgánica de la Economía Popular y Solidaria (informal sector) and the Sector Financiero Popular y Solidario (financial cooperatives sector) demonstrated the government's political commitment to FI.

They also contributed to placing up to 95 percent of the country's popular and solidarity-based organizations under the purview of the SEPS. Recent figures on FI in Ecuador show the growth of financial cooperatives: between 2012 and 2020, SACCOs have registered significant growth as assets grew by 142 percent, from US\$6 million to US\$14 million; deposits increased 161 percent to US\$11 million, while membership grew by 51 percent to more than 7 million members. Considering Ecuador's population of 17 million, this level of membership reflects a high number of people in financial cooperatives.



What makes the success of financial cooperatives is that they are working with and for the people. People feel that they are part of this institution, whereas you are only considered a client when you go to a traditional bank. It's two different ways of doing business."

Jorge Moncayo, Superintendencia de la Economía Popular y Solidaria de Ecuador

## B) OVERCOMING LEGISLATIVE AND REGULATORY CHALLENGES

The biggest challenge AFI members claimed to face in developing the financial cooperatives sector is the absence of a sound and comprehensive gender-sensitive legislative framework. Some members stressed their government's reluctance to adopt an overarching law that defines social economy actors, including financial cooperatives, and regulates their economic and/or financial activities. In El Salvador, 95 percent of cooperatives are not regulated. Yet, an institutionalized legal framework that recognizes the role of financial (and non-financial) cooperatives, complemented by strong regulations, can prove extremely useful in curbing a country's informal sector and spurring economic recovery in the wake of the COVID-19 crisis. Key conditions must be satisfied for the expansion and institutionalization of financial cooperatives.

### POLITICAL COMMITMENT AND WILLINGNESS:

The adoption of a robust gender-sensitive legislative framework that legally recognizes financial cooperatives and grants them similar rights and prerogatives as formal financial institutions must be backed by strong political commitment. Central banks and other financial regulators can play the role of a catalyst by pushing for the enactment of a robust piece of legislation that encompasses financial cooperatives (among other social economy actors). In Ecuador, a gradual reform process ensued in the 2000s, paving the way for the progressive codification of the financial cooperatives sector:

- > **2008:** A new Constitution defined the financial system in broader terms, acknowledging cooperatives, along with credit unions, community banks, and savings banks, as critical for the country's sustainable and inclusive development. This Constitution laid the groundwork for future policy measures and laws that would further anchor financial cooperatives as part of the country's formally recognized institutions.
- > **2011:** The Law on the Social and Solidarity Economy was passed, providing a legal benchmark for the regulation and supervision of financial cooperatives.
- > **2012:** The popular and solidarity-based economy, which covers financial cooperatives, was placed under the purview of a targeted regulatory body, the SEPS.

### A COORDINATED APPROACH:

Given that financial cooperatives cut across various policymaking sectors, such as finance, social affairs, but also agriculture, as many cooperatives in developing countries are destined for smallholder farmers, a

coordinated approach is needed to overcome policy silos. Consultations around the enactment of a National Strategy for FI bring together policy actors that do not generally interact and can serve as a platform for bringing the topic of financial cooperatives to the discussion table.

#### **MONITORING, OVERSIGHT, AND FINANCIAL PUSH:**

Public institutions were set up in Ecuador to ensure monitoring and oversight of the financial cooperatives sectors. SEPS was created to regulate and supervise financial cooperatives, with a public policy to act as a robust supervisory entity. It ensures that financial cooperatives are aligned with international financial standards, including Basel 1 & 2, leading to professional, competitive, and sustainable SACCOs. The National Corporation for Popular and Solidarity-based Finance (CONAFIPS), an independently administered and funded public institution, was established to support the solidarity-based financial sector and help further the country's efforts towards FI. It operates as a "second-tier bank" with the sole purpose of financially supporting cooperatives, among other solidarity-based institutions, by offering them lower interest rates (four-five percent) and boosting their capacity to offer affordable loans to the financially excluded, especially women in the informal sector.

The Banco Central del Ecuador (BCE) had a key role in mainstreaming financial cooperatives. Within its mandate is the objective of developing an integrated payment system to ensure the free flow of capital and facilitate transactions. To further its FI program, the BCE made a strategic move to incorporate regulated and unregulated cooperatives and credit unions in its national payment platform. The multiplication of payment points in remote, rural areas provided access to financial services to those excluded from formal banks. The national payments systems performed a double function: it catered to disadvantaged groups while bolstering the BCE's governance capacity.

#### **C) FINAL CONSIDERATIONS: RISK MANAGEMENT AND THE COST OF REGULATION**

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Structuring the financial cooperatives sector through legislation can be perceived as a double-edged sword. On the one hand, regulating means that the creation of new financial cooperatives, and the survival of old ones is contingent upon the respect of certain conditions. This means that the financing entities that do not meet specific requirements will be forced to shut down. This was one of the outcomes of the institutionalization of financial cooperatives in Ecuador: the number of cooperatives dropped by half, going from 1000 in 2012,

the year of the creation of the *Superintendencia*, to 400 today. On the other hand, setting up specific prerequisites for financial services provision constitutes a robust risk management instrument. The adoption of a solid regulatory framework entails the prevention of money laundering and the alignment with international banking standards such as Basel I and Basel II, among others. It enhances consumer confidence and sends potential users a strong signal on the viability of financial cooperatives.

## 6. COORDINATION AND COLLABORATION



Coordination and collaboration are essential policymaking tools, given that FI policymakers cannot bring the informal sector onboard alone.

Working in coalition with important informal sector stakeholders across a wide range of government and non-government actors, amplifies the impact of policies and programs. It ensures that the large and diverse informal sector areas are accounted for in these policies and programs, such as the sub-groups important to inclusive policies (Tool 2). The Central Bank of El Salvador described coordination as a puzzle with pieces that include the Ministry of Finance, the Regulatory Agency for the Financial System (*Superintendencia del Sistema Financiero*), and the legislature (Congress).

### A) MAPPING KEY STAKEHOLDERS

A high priority should be placed on building bridges between FI and the informal sector. AFI members note that it is often difficult to create and implement end-to-end coverage in terms of regulations with other government bodies. Coordination deficits also arise with relevant actors outside of government. For effective policies and programs, FI policymakers should map specific actors who can support FI aims to bring the informal sector onboard. This includes groups that represent the diversity of the informal sector, including women, youth, and those from minority backgrounds. Key stakeholders to consider include women's advancement organizations, youth groups, unions, businesses, and informal sector associations. This is alongside the relevant ministries, governance bodies, and regulatory authorities, whose work is related to the informal sector.



We need to involve all stakeholders: governments, banks, but also cooperatives and the private sector. At our Central Bank, we have made great progress by forming these links.”

Otto Boris Rodriguez, Banco Central de Reserva de El Salvador

### B) LEVERAGE NFIS COORDINATION MECHANISMS

The informal sector coordination tool does not need to be built from scratch. It can build off existing coordination frameworks and bilateral partnerships that relate to the informal sector. NFIS coordination structures can play a key role in integrating stakeholders from the informal sector. Many of these stakeholders are important in creating gender-inclusive policies and programs (Tool 2). *The Philippines Commission for Women*, an agency focused on women's empowerment, protection and equality, was likewise made a part of the FISC. Their involvement ensured the incorporation of gender-lens in shaping FI programs and initiatives.



The NFIS committee is the coordination structure. It is chaired by the Central Bank. The Deputy Chairperson is a CEO of the insurance sector. Permanent members include the banking association, the capital markets, the stock exchange. There are representatives of the National Statistics Institute, the Telecommunications Regulatory Agencies, mobile money providers. Many other government stakeholders are part of the working group. All these actors agree on a strategy for FI and this includes the informal sector. Agriculture for instance plays a role here - there are actions under the strategy focusing on rural finance to ensure the agricultural sector has better access to finance. We all agree on a plan to improve the provision of credit, savings, and payment services to farmers, SMEs, and the low-income population, which works in the informal sector.”

Sandra Bila, Banco de Moçambique

### C) PROGRESSIVE COORDINATION ON INFORMAL SECTOR ISSUES

In addition to effective stakeholder mapping and leveraging the NFIS structures, FI policymakers should continue to pursue relevant partnerships and coalitions with informal sector stakeholders that are important to policy and program advancement. In **Angola**, the Banco Nacional de Angola coordinates with different ministries to ensure the smooth-running and success of the Bankita low-income bank accounts program, which has led to coordination in other areas of FI relating to the informal sector. This includes the Ministry of Justice and their responsibility for IDs. Further coordination involves the Ministry of Social Action, Family and Gender Promotion and the Ministry of Youth and Sports, relationships built on protocols with targets to close the gender gap in FI and ensure successful outreach to young people.



## SUMMARY

FI policymakers have an integral role in bringing the informal sector onboard, an important effort given how the informal sector looms for progress towards FI goals. In order to do so, there is an array of tools that should be contextualized, refined, and used. The tools presented here are based on real-world experiences, incorporating challenges to engagement with the informal sector, as well as pathways to overcome these barriers.

### TOOL 1 DATA AND INFORMATION



The key to evidence-driven policies and programs is (sex) disaggregated data, and information on the informal sector to support policymakers in their understanding, strategic thinking, and programmatic practice.

### TOOL 2 INCLUSIVE POLICIES AND PROGRAMS



Policies and programs that include the diversity of the informal sector are much more likely to be effective and find success. Policymakers and institutions should meaningfully include women, minorities, migrants, people living with a disability, and other relevant population sub-groups in the informal sector in order to make sure that FI programs address specific needs and vulnerabilities.

### TOOL 3 TAILORED SOLUTIONS



Gender-sensitive financial products designed specifically for the informal sector are gaining traction globally. Design processes need to ensure that products work for informal sector workers and MSMEs, with potential for learning and scale.

### TOOL 4 DIGITAL PLATFORMS AND INSTRUMENTS



Digital tools hold much promise for successful engagement with the informal sector - including mobile money, interoperable e-commerce, digital platforms, and other FinTech - and FI policymakers have an important role to play in intelligent regulation and facilitation.

### TOOL 5 FINANCIAL COOPERATIVES



Financial cooperatives work directly with their members, many of whom are informal sector workers or MSMEs. With growing success in certain AFI member countries, financial cooperatives offer a tool to connect with people from different backgrounds and enhance their FI where formal financial service providers may not be making the desired gains with the informal sector.

### TOOL 6 COORDINATION



Coordination is essential to successfully bring the informal sector onboard. FI policymakers must partner with relevant informal sector stakeholders, from government bodies to unions and regulatory bodies to women's organizations. Multi-stakeholder coordination will support policies and regulations working from end-to-end and ensure that different informal sectors are reached with valuable FI policies and programs.

## ANNEX - KEY INFORMANT INTERVIEWS

TABLE 1: KEY INFORMANT INTERVIEWS (2020)

COUNTRY	NAME	ORGANIZATION
THE PHILIPPINES	Jenny Romero, Mary Jessil R. Santos & Golda Cainglet	Central Bank of the Philippines <i>Bangko Sentral ng Pilipinas (BSP)</i>
ANGOLA	Teresa Pascoal, Catarina Joao, Margareth da Silva and Adioso Pimenta	Central Bank of Angola <i>Banco Nacional de Angola (BNA)</i>
EL SALVADOR	Otto Boris Rodriguez, Clemente Alfredo Blanco, Hazell Raquel Del Cid Marroquín, Ricardo Contreras & Jorge Alberto Flores Torres	Central Reserve Bank of El Salvador <i>Banco Central de Reserva de El Salvador (BCR)</i>
MOZAMBIQUE	Sandra Bila	Bank of Mozambique <i>Banco de Moçambique</i>
NEPAL	Prakash Shrestha	Central Bank of Nepal <i>Nepal Rastra Bank (NRB)</i>
ECUADOR	Jorge Moncayo	Central Bank of Ecuador <i>Banco Central del Ecuador</i>
TUNISIA	Mahmoud Montassar Mansour	Microfinance Supervisory Authority of Tunisia <i>(Autorite de Controle de la Microfinance)</i>
-	Killian Clifford & Mariana Lopez	GSMA
-	Valerie Breda	ILO - Social Finance Unit

TABLE 2: INFORMATION SUPPLIED (2020)

COUNTRY	NAME	ORGANIZATION
THE GAMBIA	Fatou Deen-touray	Central Bank of the Gambia (CBG)
THE SOLOMON ISLANDS	Riley Henao Mesepitu	Ministry of Commerce, Industry, Labour and Immigration
ANGOLA	Teresa Pascoal	Central Bank of Angola <i>Banco Nacional de Angola (BNA)</i>

## ACRONYMS AND ABBREVIATIONS

<b>AFI</b>	Alliance for Financial Inclusion
<b>AML</b>	Anti-Money Laundering
<b>ATF</b>	Anti-Terrorist Financing
<b>ATM</b>	Automated Teller Machine
<b>BCE</b>	Banco Central del Ecuador
<b>BNA</b>	Banco Nacional de Angola
<b>CBG</b>	Central Bank of the Gambia
<b>CGAP</b>	Consultative Group to Assist the Poor
<b>CONAFIPS</b>	Corporacion Nacional De Finanzas Populares y Solidarias (National Corporation for Popular and Solidarity-based Finance)
<b>COVID-19</b>	Coronavirus Disease 2019
<b>FI</b>	Financial Inclusion
<b>FinTech</b>	Financial Technology
<b>GSMA</b>	Global System for Mobile Communications Association
<b>ID</b>	Identification Documentation
<b>ILO</b>	International Labor Organization
<b>KYC</b>	Know Your Customer
<b>MSME</b>	Micro, Small and Medium Sized Enterprises
<b>NFIS</b>	National Financial Inclusion Strategy
<b>NGO</b>	Non-Governmental Organization
<b>RegTech</b>	Regulatory Technology
<b>RFIP</b>	Rural Financial Institutions Program
<b>SACCO</b>	Savings and credit cooperatives
<b>SBD</b>	Solomon Island Dollars
<b>SEPS</b>	Superintendencia de Economia Popular y Solidaria
<b>SSE</b>	Social and Solidarity Economy (Ecuador)
<b>USD</b>	United States Dollars
<b>WIEGO</b>	Women in the Informal Economy: Globalizing and Organizing

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