

Exploring barriers to remittances in
sub-Saharan Africa series

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Acronyms

AML/CFT	anti-money laundering and combating the financing of terrorism
ATM	automated teller machine
BoU	Bank of Uganda
COMESA	common market for eastern and southern Africa
EAPS	East African payment system
ECS	electronic clearing system
EFT	electronic funds transfer
G2P	government to person
GDP	gross domestic product
FSP	financial service provider
KYC	know your customer
MFI	microfinance institution
MMO	mobile money operator
MNO	mobile network operator
MTO	money transfer operator
OTC	over-the-counter
POS	point-of-sale
REPSS	regional payment and settlement system
RSP	remittance service provider
RTGS	real-time gross settlement
SDG	sustainable development goals
SSA	sub-Saharan Africa
UAE	United Arab Emirates
UCC	Uganda communications commission
UGX	Ugandan shilling
UNISS	Ugandan national interbank settlement system
USD	US dollar
USSD	unstructured supplementary service data

Key definitions

Mobile money operator (MMO):	A licensed mobile money service provider that develops and deploys financial services through mobile phones and mobile telephone networks.
Mobile network operator (MNO):	A company that has a government-issued licence to provide telecommunications services through mobile devices.
Remittance service provider (RSP):	An entity providing services that enable the transfer of remittance funds.

Source: Authors' own based on AFI (2013)

About the barriers to remittances in SSA series

The average cost of remittances to sub-Saharan Africa (SSA) is currently 9.4% of the value of the transaction, compared to the global average of 7.1% (World Bank, 2018). Informal flows are rife, especially in SSA, and informality is increasing in many corridors. High informality is indicative of a formal market that is not functioning optimally to affordably serve people's needs. The G20 and the Sustainable Development Goals (SDGs) made it an explicit target to reduce the price to between three and five percent of the transaction value. However, a fine balance needs to be struck between lowering the cost and keeping remittance business profitable for providers, especially in hard to reach areas, so that access for rural consumers is not compromised. To do so, there needs to be an understanding of the market impediments that are preventing formal costs from decreasing and that hinder further expansion of access points for consumers. This includes an understanding of both informal and formal flows and the various barriers that constrain the formal market.

This note is the third in a series of seven notes that explores the barriers to remittances in SSA to conclude on what is required to enable the formal market to fulfil its true potential.

The series is organised as follows:

- Volume 1 provides an overview of key remittance corridors in SSA, from the perspective of both the receiving and sending countries. It analyses the correlation between migration and remittances and introduces a categorisation of countries.
- Volume 2 outlines and ranks the market barriers to the efficient flow of remittances in SSA, drawn from existing literature and stakeholder interviews.
- Volumes 3 to 6 explore how the barriers manifest in the region by presenting four country case studies from SSA (namely Uganda, Ethiopia, Nigeria and Côte d'Ivoire).
- Volume 7 draws conclusions and recommendations for SSA on how to overcome the barriers to reduce informality and costs without compromising access in the region.

This note explores the state of the remittance sector in Uganda and unpacks the key challenges and best practices within the industry, drawing on in-country stakeholder consultations undertaken in September 2017 and desktop research.

1. Introduction

A lifeline for households. Remittances are non-reciprocal transfers of money from an individual or household in one place to another individual or household in another place¹ (Hougaard, 2008). They can take many forms but are typically associated with working migrants that send regular amounts of money to support their families and communities back home. The advantage of these payments is that they usually flow directly into the hands of households, which increases household income and reduces the likelihood of households falling into poverty (International Organisation for Migration, 2005). This monetary support has positive effects on both education and health outcomes, and it has been shown to support human capital development particularly in children (Gupta and Pattillo, 2009; Hassan, et al., 2017).

Uganda's remittance market is thriving, yet costs high. Volume 1 of this series (“Where are the flows?”) revealed the position of Uganda as a migrant destination and net recipient of remittances. Remittance inflows are currently at a record high and contribute significantly to gross domestic product (GDP). Informal inflows and the cost of sending remittances are high, however, despite the significant developments in market structure, regulation and access which have taken place in recent decades. This report is aimed at understanding the market conditions for remittances and, in particular, the cost drivers for consumers to access the remittances in the last mile.

Case study outline. This case study outlines the barriers and enablers of remittances in Uganda. It is organised as follows:

- Section 2 introduces the remittance sector in the country, including remittance flows, the actors, the regulatory framework and the infrastructure underpinning money transfers.
- Section 3 discusses the country-specific remittance barriers and enablers in terms of business case, regulation, infrastructure and consumer-facing elements.
- Section 4 offers recommendations and conclusions for actors already active in the market and for those who wish to enter.

¹ Remittances can be “domestic”, meaning the sender and receiver of the remittances are within the same country (but still in disparate locations), or “international”, meaning that the sender transfers money from one country to a recipient in another country (Hougaard, 2008).

2. Remittance sector overview

2.1. Remittance market

Uganda net recipient of remittances. Over the past 20 years, remittance inflows in Uganda have been increasing steadily while outflows have remained relatively stable, as depicted in Figure 1. This shows that Uganda is a net recipient of remittances.

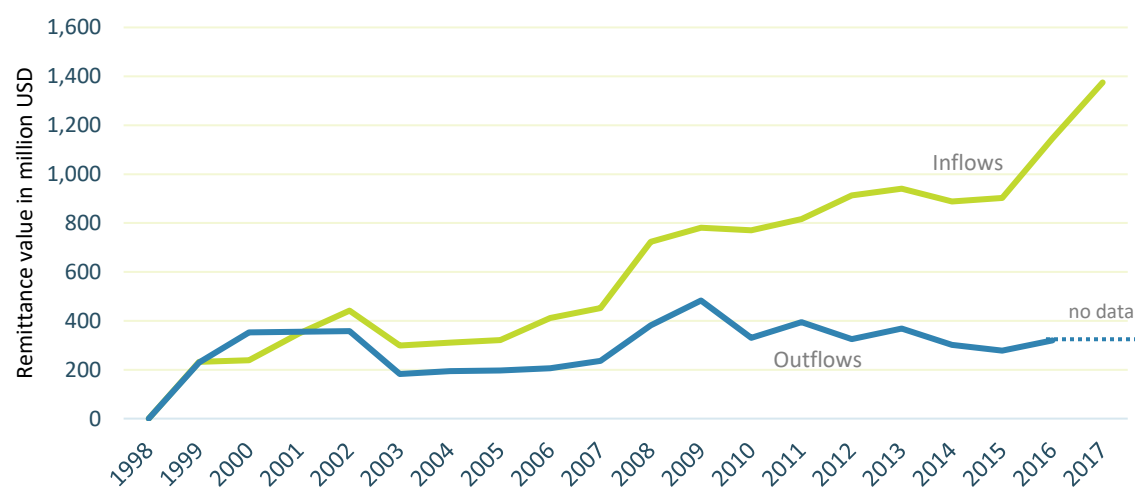


Figure 1: Uganda remittance inflows and outflows over time

Source: World Bank, 2017

With well over USD1 billion flowing into the country in 2016, Uganda is the sixth-highest recipient of remittances in Africa². Especially over the past three years, inflows have risen sharply with an average increase of 13% per year – almost double the growth in inflows into neighbouring Kenya (averaging 7%). Inflows in 2016 added the equivalent of around 4% to the Ugandan GDP, making remittances a vital source of capital for economic growth and development (World Development Indicators, 2016).

Most remittances received from developed countries and neighbours. Figure 2 shows that in 2016, Uganda received the highest amount of remittances from the UK (around USD275 million), followed by South Sudan and Rwanda³. Kenya is the most popular destination country for Ugandan migrants, followed by South Sudan, Rwanda, the UK and the US. The diaspora in the UK sends almost USD4,000 per person per year back home. By comparison, the diaspora in Kenya sends USD170 per year. This emphasises the importance of well-functioning

² After Nigeria, Morocco, Ghana, Senegal, Tunisia and Kenya.

³ While the World Bank data does not show any data on the Middle East being a destination for Ugandan migrants or a source country for remittances, other sources report a diaspora of at least 65,000 Ugandans in Saudi Arabia and the United Arab Emirates (UAE). These migrants tend to do mostly domestic work given the high earning potential. In 2016, the Ugandan government intervened to control the placement of Ugandan domestic workers in Saudi Arabia and UAE through agencies, due to poor labour conditions. This led to a higher incidence of trafficking or placement in countries such as Oman (The Monitor, 2017). The Bank of Uganda reported that the recent remittance growth rate into Uganda can largely be attributed to an increase in flows from the Middle East, where labour conditions for migrant workers have allegedly improved (BoU, 2016). Yet incidences of Ugandan migrants committing suicide due to poor labour conditions in those countries continuously surface (The Monitor, 2018).

remittance systems to facilitate larger amounts from abroad, as well as small-value, high-volume payments within the region. Overall, Uganda receives 49% of the value of remittances from developed countries and 51% from developing countries, especially neighbours (World Bank, 2016).

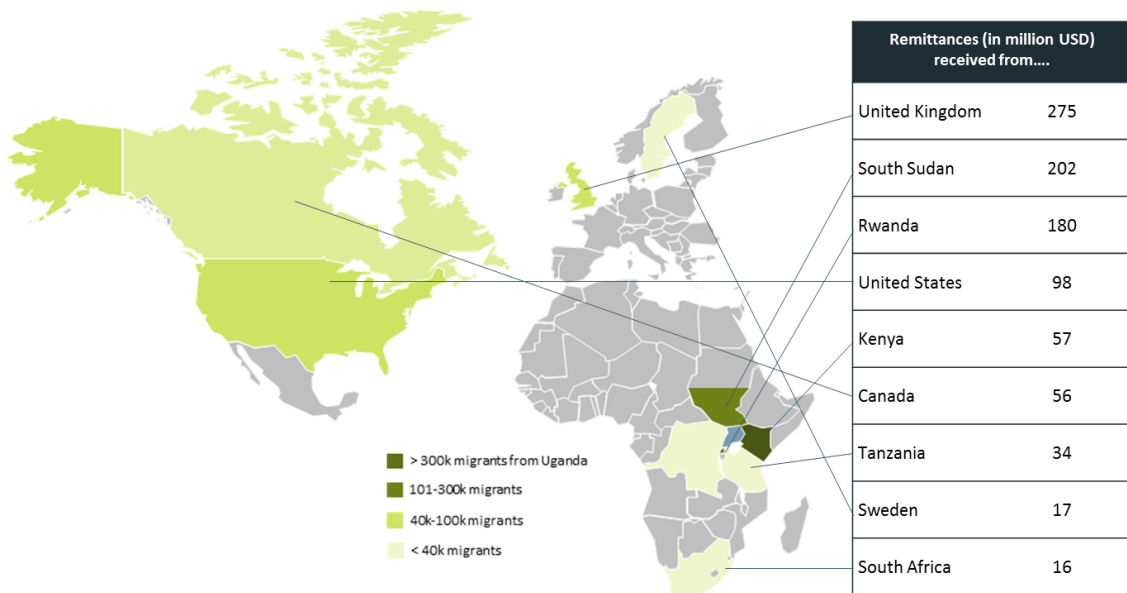


Figure 2: Ugandan migrant stocks abroad (2017); Uganda remittance inflows (2016)

Source: World Bank, 2016 and 2017

Uganda an important destination for refugees. Currently, around 42 million people live in Uganda, 4% of which are foreign migrants (World Bank, 2017). The World Bank estimates that Uganda hosted around 1.2 million refugees in 2016 – the highest number in Africa and seventh in the world. The number of South Sudanese alone increased by 750,000 in the last three years but there is also a large number of Congolese and Rwandan refugees. Given the substantially higher rate of remittance inflows since 2015, it is safe to assume that both formal and informal remittances are flowing across borders to support the high number of refugees in Uganda. This means that remittance services need to cater for refugee camp residents with limited access to formal identification and formal financial institutions.

Remittances flow both formally and informally. Informal means include sending or receiving money via buses or taxis through trusted individuals as well as informal dealers offsetting trade payments without money actually crossing the border. They can also happen on the back of illicit financial flows and are often as sophisticated in terms of foreign exchange and accounting systems as formal services. In terms of formal means, remittances can flow via banks who partner with licensed financial institutions such as money transfer operators (MTOs), the post office, microfinance institutions (MFIs) or mobile money operators (MMOs). Mobile money is increasingly successful in Uganda and has driven a lot of the growth in remittance volume and value (Stakeholder interviews, 2017).

International MTOs and banks handle most cross-border remittances; MNOs dominate domestically. The Bank of Uganda (BoU) estimates that in 2016, 75% of cross-border remittances were received through formal channels. International MTOs accounted for 50% of flows entering the country, followed by bank accounts at just under 31%. Mobile money constituted 11% of the total value while local MTOs (8%) and the post office (0.2%) handled the rest. Remittance recipients cited ease of access and the sender’s choice as drivers for using

international MTOs (BoU, 2016). In the case of domestic remittances, FinScope (2018) estimates that around 10 million adults in Uganda send or receive money within Uganda and 82% of them do so via mobile money (FSD Uganda, 2018).

High remittance prices depending on channel. Sending money to Uganda is costly: a transfer of USD200 from the UK costs on average 7.3% of the amount sent, which is 2% higher than the highest limit targeted by the SDGs. For remittances sent from Kenya and Tanzania, mobile money providers are on average the cheapest (1% to 5% of the transaction amount)⁴ compared to banks and MTO fees (4% to 18% of the transaction amount) which offer over-the-counter (OTC), i.e. cash services (World Bank, 2018). A country assessment in 2016 found that informal remittance channels in Uganda are cheaper compared to formal channels. Recipients only pay a small commission fee to informal agents, which is lower than commission payable to formal agents (UNHCR & UNCDF, 2018). The newly introduced mobile money tax has increased the cost for provider and consumer, widening the gap between informal and formal mechanism costs even further.

2.2. Regulatory background

This section focuses on the regulatory background to conduct remittance services in Uganda. It looks at the regulation around licensing, know-your-customer (KYC) requirements and mobile money provision.

BoU is the main regulator for remittances. The remittance sector is governed by the central bank – the BoU. Remittance providers need to apply to the central bank for a money remittance licence to do business in Uganda, as outlined in the Foreign Exchange (Forex Bureaus and Money Remittance) Regulations (2006). Licence requirements are clearly outlined; four separate types of licences exist⁵. Currently, 25 commercial banks, 58 MTOs, seven mobile network operators (MNOs), three deposit-taking MFIs, seven non-deposit-taking MFIs and the post office offer cross-border or domestic remittances in Uganda (IFC, 2017). As per the Financial Institutions Act (2004) and Foreign Exchange Act (2004), all payments, including clearing and settlement, in domestic and foreign currency have to be made through a bank.

RBA is required yet not applied in KYC due to lack of country risk assessment. Several laws and regulations⁶ address know-your-customer (KYC) general requirements to participate in financial services. The Anti-Money Laundering (AML) regulations (2015) state that financial institutions are to develop risk-based approaches (RBA) around KYC on an ongoing basis to establish an ongoing relationship, i.e. to open an account. To date, financial service providers (FSPs) have faced challenges in developing a risk-based KYC approach due to the lack of data on national, sectoral and customer and product-specific money laundering and terrorist financing risks (UNCDF, 2017). As a result, remittance service providers (RSPs) have largely maintained the status quo on relying on disproportionately stringent KYC requirements (Stakeholder interviews, 2017).

⁴ Given that around 75-85% of all retail transactions in Uganda are still performed with cash, the relatively lower cost of using mobile money for these transfers can be partially offset by the consumer need to cash-out. Even if people send or receive remittance through mobile money they need to engage agents to pay in and out, essentially making it a cash transaction. Agents charge a cash-out fee that is not always included in the calculation of remittance fees (Stakeholder interviews, 2017).

⁵ Class A: International Money Transfer Agency Licence; Class B: Forex Bureau Remittances Licence; Class C: Direct Entrants Licence; Class D: Sub-Agent's Licence.

⁶ Including the Financial Institutions Act, 2004, Financial Institutions (Anti-Money Laundering) Regulations, 2010, Mobile Money Guidelines, 2013, Anti-Money Laundering Act, 2013, Anti-Money Laundering Regulations, 2015, Registration of Persons Act, 2015, Anti-Money Laundering (Amendment) Act, 2017 and the Financial Institutions (Agent Banking) Regulations, 2017 (UNCDF, 2017).

Some KYC requirements exclusionary. In general KYC requirements stipulate that potential customers need a national ID, a passport or a driver's licence to conduct remittance transfers once an account has been opened. For refugees, a refugee ID card is required. According to FinScope (2018), 84% of adults have a valid ID document to prove their identity, which leaves 16% of adults potentially excluded from remittance services (BoU, 2016). While this is lower when compared to other countries, such as Nigeria (54% of adults do not have ID) or Tanzania (26% of adults do not have ID), this still amounts to over 3.2 million Ugandan adults that are potentially excluded due to not having an official ID. In addition, to open a financial institutions account that would make sending and receiving remittances more cost-effective, the AML regulations (2015) stipulate the need for proof of address, which can increase the KYC burden substantially for consumers. In the absence of specific requirements in the mobile money guidelines, there is a lack of clarity regarding appropriate KYC requirements for informal and semi-formal mobile money agents (UNCDF, 2017). Mobile money agents technically need to be a registered business with a physical address and have an account in a licensed financial institution.

Mobile money transfers governed by two regulators. MMOs need to be directly licensed by the BoU or need to partner with an institution with a BoU licence (e.g. a bank or a deposit-taking MFI). Licensing is based on a case-by-case review and can take several months to complete. Presently, of the seven MMOs in Uganda only two are currently permitted to provide cross-border money transfer services (UNHCR & UNCDF, 2018). The mobile money industry is overseen by two regulatory authorities, the BoU and the Uganda Communications Commission (UCC). MNOs are licensed by the UCC. The BoU has authorised mobile money services by issuing "no objection" letters to the commercial banks who partner with the MNOs, and the BoU requires the bank to hold the balances recorded in the mobile wallet in an escrow account. Effectively, the BoU regulates the MNO's mobile money offering indirectly through the partner bank, having the ultimate power to withdraw the bank's licence in cases of irregular conduct by the mobile money provider (UNHCR & UNCDF, 2018).

Mobile money regulated via guidelines, not regulation. Mobile money guidelines were released by the BoU in 2013 as a response to the rapidly evolving sector. The guidelines are meant as an interim measure to facilitate the operation of mobile money while a more comprehensive legal and regulatory framework is being developed (IFC, 2017). Although the guidelines are generally treated as binding, the legal status thereof is ambiguous (Stakeholder interviews, 2017).

Agent exclusivity is prohibited; interoperability is recommended but not mandated. The mobile money guidelines address competition issues by prohibiting exclusivity between banks and MNOs, as well as between MNOs and their agents. The guidelines also encourage (but do not expressly require) mobile money operators to use systems or standards that are interoperable with other payment systems locally and internationally (IFC, 2017).

Agency banking aimed at financial inclusion expansion. In 2016 the BoU released a draft amendment to the Financial Institution Act to allow agency banking. This has the potential to make great strides towards the expansion of banking products in addition to remittances, especially in rural areas (InterMedia, 2017). The potential of agents to act as catalysts for financial inclusion and digital expansion increases with the number of financial services they are allowed to conduct as they bring formal services closer and hence increase the consumer value of such services, ultimately increasing demand. Early evidence suggests that the number of banked consumers has increased since agency banking was adopted (EABW, 2018).

2.3. Infrastructure

This section focuses on the Ugandan payment system conditions as the basis for efficient remittance provision. Financial access points are described, as well as the status of the mobile, internet electricity and road infrastructure.

National payment system comprising RTGS and clearing system. Uganda has a Real Time Gross Settlement System (RTGS) which is known as the Ugandan National Interbank Settlement System (UNISS). There is also an Electronic Clearing System (ECS), which clears cheques, direct debit and credit transfers. Both of these systems fall under BoU oversight. Private sector players provide a number of payment systems and instruments, including mobile money, cross-border remittances and internet banking services (BoU, 2017). There is no national switch. Each of these elements is discussed in more detail below:

- **UNISS** is a multi-currency system settling transactions in Ugandan shillings (UGX) and other foreign currencies including the US dollar (USD), the British pound, the euro, the Kenyan shilling, the Tanzanian shilling and the Rwandan franc. It is a systemically important payment system, i.e. deemed significant for financial stability. UNISS processes time-critical, high-value payments between banks and facilitates settlement from other multilateral settlement systems. Only commercial banks have access to UNISS and act as intermediaries for other financial institutions.
- The **ECS** automates the process of clearing cheques and electronic funds transfer (EFT) like-for-like transactions, both in UGX and foreign currencies⁷. Both EFT clearing volume and value is steadily increasing year-on-year while cheque transactions are gradually falling (BoU, 2017).
- Banks, mobile money operators and other FSPs utilise **Interswitch**, a private payment and transaction processing company for switching services. Interswitch links 16 financial institutions, four mobile money networks and five FSPs in Uganda. Consumers can access funds from automated teller machines (ATMs), including remittances received through connected MTOs, yet volumes are still low (Stakeholder interviews, 2017).

Uganda also part of regional payment systems. At a regional level, Uganda operates under the East African Payment System (EAPS) and the Common Market for Eastern and Southern Africa (COMESA) Regional Payment and Settlement System (REPSS). Neither systems are particularly well used, with relatively little transaction volume and values flowing through them, yet they are also not particularly expensive to run (Cenfri, forthcoming). Both systems are discussed in more detail below:

- The **EAPS** is a multi-currency system connecting the RTGS of Kenya, Rwanda, Tanzania and Uganda. Under this mechanism, payments are made in the currencies of the destination countries. Under the EAPS, the sender pays a transfer fee as well as a receiving fee charged by some banks (BoU, 2017).
- Uganda has been part of the **REPSS** since 2014. The REPSS is a cross-border clearing system for the transfer of funds within COMESA in US dollars and euros. The system is operational in eight member-states: the DRC, Kenya, Malawi, Mauritius, Rwanda, Swaziland, Uganda and Zambia. The volume flowing through REPSS is low and clearing and settlement windows are more structured to large and non-time critical applications (COMESA, 2018).

⁷ Including the US dollar, the British pound, the euro and the Kenyan shilling

Traditional financial access points in decline; agents on the rise. In 2017, there were 24 commercial banks with 546 bank branches and 818 ATMs. Notably, both bank branches and ATMs are in decline. The number of bank and mobile money agents, however, is ever-increasing. There were an estimated 147,000 agents in 2017, an increase of 23% from 2016 (BoU, 2017). This is in line with the rising number of consumers accessing mobile money: from 19.6 million registered customers in 2016 to almost 23 million (54% of the population) in 2017 (BoU, 2017).

Ugandans mostly live in rural areas with lower levels of electricity and mobile phone penetration. 76% of Ugandan adults live in rural areas while 24% reside in urban centres (CIA, 2018). Yet infrastructure necessary for remittance expansion is skewed towards urban areas:

- **Mobile and internet.** Adults in rural areas are less likely to have mobile phones than their urban counterparts: 46% of rural adults have a phone while 70% of urban adults own one. In comparison to Kenya, Uganda has a relatively low rate of mobile phone ownership with more than a quarter of mobile money users accessing the service through someone else's or an agent's account due to not having their own phone (InterMedia, 2017). Only 10% of all adults have access to the internet (FSD Uganda, 2018).
- **Electricity.** Roughly 27% of Ugandans have access to electricity – 57% in urban areas and 18% in rural areas) (World Development Indicators, 2016). This drastically limits the expansion potential of digital remittance services.
- **Roads.** The road network in the rural parts of the country is poor and the road quality deteriorates especially during the rainy season (D+C, 2015).

3. Market barriers and enablers

The barriers described in the following sections reflect the findings from interviews conducted with regulators and remittances and payments service providers in the remittance value chain in Uganda in September 2017. These barriers were considered by industry stakeholders to be either cost drivers, impediments to accessing services or as hindering market development.

The market barriers and enablers are presented through four different lenses: **business case or commercial** factors are those that impact on a provider's ability to offer services at different costs or expand their access points. **Regulatory** implications relate to specific clauses relevant for cost of and access to remittances. Remittances need to be set in an adequate environment to be able to be accessed by all – **infrastructure** factors describe the supporting conditions in Uganda. **Consumer-related** issues highlight the realities for the consumer on the ground that can act as drivers or barriers for using formal remittances.

3.1. Business case or commercial factors

Given the fact that Uganda is a net recipient of cross-border remittances, convenient and accessible cash-out options mostly determine the success of the players. Uganda has a very large agent network, especially driven by the success of mobile money through agents, which has facilitated broad acceptance. The barriers discussed in this section therefore mostly relate to mobile money operations. Most agents offer only the services of the dominant MMOs, impacting negatively on competition. The agent business model comes with many challenges, including liquidity management, training and recruitment. Traditional RSPs also face challenges, however, mainly related to the cost of needing a banking partner. For all formal services, informality presents a real barrier to gaining scale in channels, especially cross-border (Stakeholder interviews, 2017). Below, each of these barriers is discussed in turn.

Agents central to the RSP business model, but they are also a major cost driver. Mobile money is one of the most widely used remittance channels to send remittances domestically in Uganda. OTC MTOs are most frequently used for international transfers. Agents are crucial for both business models, as they assist customers with low literacy levels to navigate a complex system with many charges and fees. The cost of managing agents was mentioned during interviews as one of the major overhead costs for RSPs. Agent management costs include liquidity management, training, recruitment and remuneration:

- **Liquidity management.** Stakeholder interviews suggested that agent liquidity management is the largest cost driver for RSPs. Managing the floats of close to 150,000 agents nationwide is a costly operation, especially in areas with poorer road infrastructure and patchy electricity. Increasingly, providers are entering into partnerships with super agents such as petrol stations and MFIs. Float vendors and firms which specialise in liquidity management have partnered with some RSPs. These firms essentially provide working capital loans to mobile money agents.
- **Training.** Mobile money agents need to be continuously trained on how to deliver new products and how to comply with anti-money laundering and combating the financing of terrorism (AML/CFT) regulation so that MMOs remain compliant with the law.

Furthermore, stakeholder interviews suggest that while exclusive partnership agreements have been abolished, agents tend to have a preferred service provider and it is hard to shift their mindset or incentivise them to use the newer products or providers.

- **Recruitment.** There is a high turnover in agents, meaning that there is a constant need to recruit new agents and train them. Furthermore, there is a vast number of informal businesses wanting to become agents yet lacking the required documentation (Stakeholder interviews, 2017).
- **Remuneration.** Legislation that banned agent exclusivity has allowed for increased reach of MMOs and banks through existing agents. However, this had brought with it an increased competition for agents. Mobile money providers now need to factor in the cost of incentivising agents to promote their products over those of other mobile money providers. Stakeholders mentioned during interviews that these incentives can range from t-shirts and other memorabilia with corporate branding, to mobile phones and tablets.

Oligopoly in mobile money market causing high barriers to entry, stifling competition. Agent exclusivity was only prohibited four years after the first mobile money operator engaged in business. This resulted in high barriers to entry for new players, as incumbents were able to capture the majority of the market in the absence of competition. The current lack of interoperability reinforces their position. Network effects mean that clients are still essentially captured by one or two operators given that their social network operates within the same operator service. In the absence of competition, incumbents are less incentivised to lower prices and increase access for consumers (Stakeholder interviews, 2017).

MNOs being considered as expensive partners; alleged anti-competitive behaviour. Smaller RSPs revealed during interviews that if they want to use MNOs as a channel for sending remittances, they are sometimes charged as much as 2% on the value of a transfer for international remittances. Interviewees from a large commercial bank echoed these sentiments, stating that some MNOs negotiate for bigger shares of revenue to the point that it drives the price of money transfer products up. This leads them to believe that MNOs are too focused on short-term profit and not growing the digital financial services market. Furthermore, several potentially anti-competitive issues were raised during interviews, namely restricted access to infrastructure, lack of interoperability and de facto agent exclusivity:

- **Restricted access to infrastructure.** Stakeholder interviews mentioned that larger MNOs invested heavily in infrastructure, such as towers, when mobile money was first introduced. They now rent out this equipment to other MNOs for a fee, especially in rural areas. Interviewees suggested that the practices are not always competitive, with larger MNOs restricting access to their infrastructure to other MNOs, which impacts on service delivery. In addition, some MNOs have been known to withhold unstructured supplementary service data (USSD) access for other RSPs to stifle competition (Stakeholder interviews, 2017).
- **Lack of interoperability.** The interviews revealed that the suggested (as opposed to mandated) MMO interoperability set up in the mobile money guidelines in 2013 has not been fully implemented. The dominant MNOs are said to slow the process down, so they can keep charging high fees (Stakeholder interviews, 2017). For example, for the tier UGX30,001–UGX45,000, within which a large number of transfers fall (equivalent to around USD10⁸), both MTN Uganda and Airtel Uganda customers must pay UGX2,800 (or around 6.2% of the upper limit of the transfer value of UGX45,000) to transfer to an unregistered

⁸ USD1 is equivalent to UGX3,776.40 (OANDA, 2018).

user, compared with UGX1,100 (or around 2.4% of the upper limit of the transfer value of UGX45,000) to a registered user (Macmillan, et al., 2016).

- **Legacy agent exclusivity.** When the regulatory changes on agent exclusivity came into effect, it was not easy to convince agents to also offer rivaling services, especially because there were reports of physical attacks on agents who were offering different services. In one instance it took an MMO over two years to build a sizeable agent force as the first-mover competitors offered higher commission and threatened agents (Stakeholder interviews, 2017). Agents in Uganda often choose to only work with the dominant provider (e.g. master agents), as more network subscribers mean more customers and better commission (Macmillan, et al., 2016).

Informal market a major competitor for formal RSPs. Stakeholder interviews revealed that informal or unregulated RSPs are one of the major competitors to formal RSPs. According to the interviewees, many Ugandans in the diaspora send remittances through friends and family. Those sending remittances within Uganda's borders also use buses which travel to more rural and remote areas. There is anecdotal evidence through interviews that although some informal RSPs charge a fee for these transfers⁹, many informal RSPs charge no fee at all¹⁰ and are trusted more than formal providers. The scale of informal flows is hidden from the regulator and hence it is hard to estimate their true size (Stakeholder interviews, 2017).

RSPs limited in the services they offer due to lack of data. RSPs, particularly MNOs, expressed an interest in expanding their payments offerings to cross-border remittances during interviews, but stated that they did not have the necessary data to motivate for the business case to do so.

Partnerships expensive for non-bank RSPs. Uganda's remittance market is heavily reliant on partnerships due to the setup of the regulation, which requires banks to conduct all payments. Banks have a different risk framework and require due diligence that is disproportionate to the risk of the predominant low-value, high-volume remittance transactions. This can stifle RSP product and system innovation. As banks are responsible for the due diligence of their partner institutions with regards to AML/CFT, the regulatory burden for partners is disproportionately expensive as it creates additional layers of agent supervision and monitoring costs (Stakeholder interviews, 2017).

3.2. Regulation

The regulatory requirements for cross-border remittances are relatively clearly outlined, compared to many other SSA markets. There are no caps on outward remittances and no foreign exchange controls exist. According to interviewees, the regulator comes across as mostly open-minded and eager to advance the sector.

However, regulation around mobile money is unclear and lags behind the rapid technological advances in the market, preventing inclusive development. The newly introduced mobile money tax threatens the progress of mobile remittance services. Services are weakened by challenges in implementing a risk-based approach to AML/CFT and by the fact that e-signatures are prohibited. Each of these barriers is outlined below.

⁹ One interviewee estimated that bus drivers charge approximately UGX40,000 (USD10) to deliver a UGX1 million (USD265) remittance, which works out to about 4% of the value of the remittance.

¹⁰ Mainly where the informal flows occur on the back of illicit wholesale flows.

Underdeveloped mobile money regulation causes uncertainty. Given that the 2013 mobile money guidelines are not binding, several issues for MMO providers arise. These include which regulator is responsible for which service, the limits of mobile money wallets, licensing and price changes (Stakeholder interviews, 2017):

- **Lack of coordination between BoU and UCC.** The UCC licences mobile network operators, yet mobile money operations are regulated by the BoU. The BoU mandates that mobile money providers need to partner with a BoU-regulated entity. Therefore, two regulators are overlapping, and the jurisdictional reach is not clearly defined. Providers mentioned during interviews that this creates an unlevel playing field: MNOs can approach the UCC if they are unhappy with BoU decisions, while financial institutions do not have the same opportunity. Furthermore, interviewees stated that neither regulator takes a clear stance on new developments in the digital financial services sector and how the services should be regulated. This creates long waiting times, potential reputational damage¹¹ and operational uncertainty.
- **Ad hoc approach to regulation for innovation; licensing delays with banks and BoU.** MNO interviewees revealed that opening a trust account with a bank as per the regulation can be onerous, with one stakeholder mentioning that it takes more than 20 different documents to set up this trust account. This is costly for providers, especially because the delays in set-up affects their ability to obtain a licence from the BoU. Many providers mentioned that licensing delays by the BoU are a big cost-driver. Each licence needs a letter of no objection from the BoU, which is reviewed on a case-by-case basis. This ad-hoc approach to regulation for innovation leaves especially new entrants without a legal framework to test their solutions. Some interviewees cited incidences of the BoU taking up to six months to respond to requests. In the fast-changing world of digital financial services, these turnaround times are too slow and can be costly for service providers, particularly for new entrants to the market. Interviewees believe that this could partly stem from a lack of understanding by the regulator of the technology behind the newer solutions (Stakeholder interviews, 2017).
- **Price changes.** One non-bank provider laments that the guidelines allow mobile money providers to change their pricing at any time, which enables them to react to market changes quickly. MFIs, on the other hand, need to communicate price changes at least 30 days in advance, causing an unlevel playing field.

Remittance licences are expensive to obtain and renew. The BoU requires RSP licences to be renewed annually. The annual cost of a licence is UGX2 million (around USD520) per licence, but each branch of the RSP must have its own licence. This was mentioned as a significant cost-driver, especially for smaller remittance providers (Stakeholder interviews, 2017).

Challenges in implementing RBA. To date, banks, mobile money service providers and other FSPs have faced challenges in developing a risk-based KYC approach due to the lack of data on AML/CFT risks. For example, many businesses in Uganda are informal and semi-formal. Should they seek to serve as agents, they cannot comply with all of the KYC requirements for legal entities, yet the risk presented by these businesses has not been adequately explored (UNCDF, 2017). The lack of data also leads to a culture of overcompliance, as providers tend to be risk-averse if they could incur hefty fines or partnership termination (Stakeholder interviews, 2017).

¹¹ The decision of the UCC to disable mobile money platforms and key social media sites during the Presidential elections in February 2018 due to 'national security' left consumers without access to their electronic funds for up to four days. The restriction came without notice and caused immense reputational damage to the whole industry as well as financial losses to agents and MMOs, while leaving consumers financially vulnerable (Bold and Pillai, 2016).

In the absence of guidance around KYC based on risk and the lack of KYC tiers in the interim, providers appear to differ in their interpretation of the requirements of documentation. Especially MMOs seem to apply less stringent controls, leading to concerns by partner banks (Stakeholder interviews, 2017).

Confusion around acceptance of local IDs. The BoU has not specifically outlined if ‘local’ IDs¹² as opposed to the national ID, passports and driver’s licences are an accepted KYC document. 16% of Ugandans do not have a national ID. Although the RBA approach would seemingly allow more freedom for RSPs, it has led to overcompliance as most of the RSPs do not accept local IDs in fear of violating the regulation. MNOs, for example, have expressed concern that many of their customers are too young to have national IDs, therefore they are unable to encash remittances sent to them by their guardians (Stakeholder interviews, 2017).

E-signatures are forbidden, increasing operational cost. Regulation requires that all registration of new customers by RSPs must be done in writing. Electronic signatures are not accepted. This means that both paper and digital copies of forms need to be stored by the service provider. This introduces a huge amount of inefficiency and cost in the registration process for both the consumer and the service provider (Stakeholder interviews, 2017).

Mobile money tax threatens to cause immense disruption in uptake and usage. A controversial 1% tax on all mobile money transactions and daily levy on social media usage came into effect in July 2018. This tax has since been reduced to 0.5% for cash withdrawals. MNOs in particular are advocating for a review of this policy given the potentially catastrophic effects on uptake and usage of mobile money, disproportionately affecting low-income consumers. Digital government-to-person (G2P) payments are affected just as much as person-to-person payments. Mobile money taxation undermines investment at a time when mobile operators are already under significant cost pressure to expand networks and improve service quality, in line with the national financial inclusion strategy. According to early news reports, agents have already reported a drop in the usage of mobile money (The Observer, 2018). A potential consequence is that consumers rather transact informally.

3.3. Infrastructure

The national payment system is well equipped to handle most forms of transactions, yet it is not optimally utilised and could benefit from more regional integration to increase scale. Integration with bank systems increases the operational cost for non-bank RSPs. Road, electricity and mobile phone penetration issues prevent further expansion of remittances services. These challenges are discussed in more detail below.

System integration costly. The need to partner with banks and hence integrate services to the banks’ back-end system has caused issues for non-bank RSPs. Bank infrastructure is often much older and, in the absence of the necessary skills, it can take a long time to integrate the systems (Stakeholder interviews, 2017). Different scheme rules and protocols dictate the way messages are sent through the payments system and a lack of interoperability between payment and remittance service providers means that FSPs often have to negotiate bilateral relationships with each other, which is highly inefficient.

Interoperability affected by lack of access to switch. In the absence of a national or regional switch or interoperable network, non-bank RSPs have had to invest in their own solutions. Banks especially have heavily invested in their own switches and in setting up bilateral partnerships and are not as interested in adopting a new system. The lack of switch has been

¹² Local or Village IDs are issued by the local chief or village leader and the local ward (Stakeholder interviews, 2017).

lamented by smaller non-bank RSPs who do not have the funds or bargaining power to efficiently set up a similar mechanism – they advocate heavily for access to a national or regional switch (Stakeholder interviews, 2017). As discussed in Section 4, a regional rather than national switching solution should be considered.

Lack of access to national ID database increases operational costs. While the roll-out of the national ID is in full swing, RSPs have no access to the national ID database yet. This requires each RSP to set up their own, competing customer database, which is inefficient and costly (Stakeholder interviews, 2017). As soon as the database goes live, RSPs will be expected to retrofit their systems to comply with the rules of the database, which could have been avoided if the database were accessible as soon as onboarding started, even if not all residents are captured yet. Providers could have actively influenced the design of the database by getting access from day one.

Poor road networks make delivering financial services outside of rural areas difficult. The poor road infrastructure can make it difficult to provide financial services outside of urban areas. RSPs mentioned during interviews that the poor road infrastructure and the resulting difficulty in liquidity management impact on their expansion strategy, leaving many areas underserved by formal financial services.

Poor electrification affects service in remote areas. The poor electrification rate, particularly in rural areas, makes it difficult for MNOs to provide network coverage in these areas. Those which do service these areas are forced to use diesel generators to keep their mobile network towers online, which is very costly. For RSPs which rely on network coverage or internet connectivity to complete transactions, it is a major challenge. This means that it is often difficult to justify the business case for expanding network coverage to these areas without having to charge consumers high fees in order to cover the cost of servicing these rural areas (Stakeholder interviews, 2017).

RSPs suffer reputational damage when networks go down. Many RSPs rely on the network coverage of MNOs to complete transactions. These RSPs use customised point-of-sale (POS) devices which connect to the mobile network using SIM cards to process transactions. When the networks are down, transactions cannot be completed. According to stakeholder interviews, customers tend to blame RSPs for providing a poor service, when in fact the problem has been caused by the MNO networks. This results in reputational damage for the RSPs, but also leads customers to lose confidence in formal digital financial services. Before these RSPs would get around this problem by manually switching between the SIM cards of different MNOs to see which network is operational at the time, but now they have developed POS devices with dual SIM card compatibility. These dual SIM card POS devices are enabled to switch between networks when the network of one operator is down, allowing a more uninterrupted uptime for the RSP and a better service for customers. However, dual network SIM devices cannot overcome network downtime in areas where there are shared network systems or infrastructure.

3.4. Consumer-related issues

While Ugandan consumers were quick to enjoy the benefits of mobile money as seen in the increased uptake of mobile remittances, there is still a large preference for cash. Between 75% and 85% of retail transactions in Uganda are still handled in cash. This indicates a lack of digital ecosystem or sufficient use cases to switch to purely digital services. This reliance on cash drives up cost for remittance providers, especially in rural areas. Trust in digital services is still

nascent and education campaigns are necessary. Low literacy levels reinforce the reliance on agents. Each of these issues is discussed below.

Reliance on cash even in digital remittances services. Consumers overwhelmingly prefer cash transactions in remittances and trust in digital remittances services is still emerging. Several stakeholders mention that while mobile adoption has been excellent, trust in mobile financial services is fragile. Consumers in rural areas need in-depth technical education and literacy training to comprehend get to grips with the newer remittance solutions. A large number of rural customers completely rely on agents to conduct services for them, even using the agent's mobile phone in the absence of their own. This reinforces the reliance on cash and face-to-face services, which are costly for providers to handle. It was mentioned during the interviews that there are insufficient customer recourse mechanisms, especially in the case of mobile money transfers. These include long waiting times to recover funds in cases where they were sent to the wrong mobile number. It is also only possible to recover funds if they have not been withdrawn from the recipient account yet (Stakeholder interviews, 2017).

Lack of digital use cases reinforces customer cash preference. Consumers' preference for cash remittances is exacerbated by an absence of digital use cases (Stakeholder interviews, 2017). Together with digital G2P transfers, remittances are often the first point of exposure to a digital financial service for many consumers. If the central bank and providers want to encourage consumers to keep their received values in digital wallets and accounts, they need to be able to meet consumer needs just as well as cash can (Bester, et al., 2016). However, this is currently not the case in Uganda. Especially in rural areas, mobile money cannot be used to pay for most items and the number of G2P payments is still low (Stakeholder interviews, 2017). The new mobile money tax now distorts the usage of digital value and places more emphasis on cash and informal services. Until the payment value chain is fully digitised, providers have to make costly provision for better integrated cash handling including convenient points of encashment.

Low levels of literacy make using formal financial services inaccessible for many. English is used in formal financial institutions, including when forms are filled out to open accounts of complete transactions. Even for mobile money transactions, drop down menus are usually in English, although some MNOs do accommodate some local language options. For Ugandans who do not speak or understand English, particularly those in rural areas or with little formal education, this acts as a barrier to access. For mobile money transactions, the language barrier can be overcome by having transactions facilitated by agents, which increases the costs for RSPs to ensure continuously good service for its consumers, but it does raise consumer protection issues. Stakeholders mentioned during interviews that incidences of agent fraud are increasing (Stakeholder interviews, 2017).

4. Conclusion and recommendations

Remittances play a key role for Ugandans and refugees alike, providing vital funds from friends and families abroad. Uganda is a net recipient of remittances given large flows that the Ugandan diaspora remits home as well as the inflows that are supporting the enormous refugee population. Uganda's open border policy towards refugees from crisis-ridden neighbouring countries is particularly commendable given the current global rise in anti-immigration sentiments and policies. The remittance sector in the country is further advanced than in most countries in Africa, yet challenges remain. While formal remittance flows into Uganda are the sixth highest in Africa, it is estimated that both domestically and regionally a large proportion of personal transfers are still made informally.

This case study presents the main challenges that remittance providers are currently facing in the market. The business case issues encountered mostly relate to the agent business model deployed by mobile money operators as well as competition issues. Regulatory challenges exist around KYC regulation and the lack of the implementation of the risk-based approach as well as the incomplete mobile money guidelines. Infrastructure issues arise from the competing payment systems in Uganda as well as the limitations of the mobile, road and electricity network.

To bring more funds into the formal system to increase the scale of flows and ultimately reduce the cost, the following actions could be considered:

- ***Establish an e-money law and regulatory framework to increase regulatory certainty.*** The finance ministry, in conjunction with the regulator, could consider developing a bill and regulatory framework for e-money to replace the mobile money guidelines from 2013. Alternatively, a clarification or amendment of the mandates of the central bank and the communications regulator would be needed to clearly delineate the function of the BoU and the UCC. Such a move will create certainty around the provision of mobile money services for providers, including remittances, to cement mobile money's strong position to increase financial inclusion and drive electronic payments in Uganda. Mobile voice and data services should be regulated separately from mobile financial services.
- ***Mandate interoperability to increase efficiency and level the competitive playing field.*** Currently, two MNOs dominate the mobile money market, which increases systemic risk. Instead of recommending interoperability of channels and instruments as is currently the case, the regulator could consider mandating interoperability. Mandated interoperability has the potential to increase competition and to leverage scale of flows in the sector, thereby reducing the cost of remittances for the consumer whilst providing opportunities to scale up remittance receivers. In addition, it incentivises joint infrastructure roll-out by providers, including network expansion and electricity provision instead of setting up costly competing systems. It can separate infrastructure roll-out and financial service provision with more focussed business models.
- ***Conduct detailed retail risk assessment to guide the application of RBA.*** The risk-based approach to AML/CFT should be adequately implemented at regulator, FSP and RSP levels to ensure proportional KYC requirements for consumers. This requires the adequate assessment of AML/CFT risks within the country. Sending and receiving low-value funds by

lower risk consumers, should not require the same level of identification certainty or verification as higher-value transfers by higher risk consumers. Regulators need to hold FSPs and RSPs to account where they have applied an unnecessary high KYC standard to lower risk consumers. Key to the adoption of proportional KYC requirements is the implementation of a principles-based concept of identification. This includes the elimination of the proof of address requirement when opening financial institution accounts given its ineffectiveness in risk mitigation. In the absence of full ID penetration in the country and given the restricted access to the national ID database so far, other identification measures should be employed where a sufficient identification confidence level exists between one or more identifiers or identification elements to enable universal consumer access.

- ***Allow electronic signatures to lower operational costs.*** In the e-money regulation, electronic signatures should be broadly defined and explicitly given the same validity as paper signatures to ease the onboarding process for consumers and to reduce the burden of storage and administrative costs related to paper documentation and reporting for providers. Key to effective implementation of e-signatures is a balanced burden of proof, consistent with the law on paper-based signatures. Use of a biometric validation should be explicitly acknowledged as a form of signature.
- ***Abolish mobile money tax to encourage consumer adoption.*** The newly introduced tax on mobile services should be suspended and reassessed until the potential impacts are thoroughly assessed. Key to the consideration of mobile money tax is the need for a regulatory impact assessment that weighs the revenue gained against the cost to the economy of an accelerated move towards informalisation and the reduction in scale in financial services. The tax could place a disproportionate financial burden on low-income consumers, reducing the value of remittances they receive or send. The tax could also reverse the progress of the rapidly growing yet fairly nascent mobile remittances sector, discouraging consumer uptake of formal services in favour of informal remittance mechanisms. This not only has consequences for remittances but financial inclusion progress in Uganda as a whole.
- ***Monitor provider competition issues more closely to counter oligopoly.*** The outlined competition issues in the mobile operator space should be monitored closely by the UCC as the regulator, given its market conduct mandate to ensure that they do not harm the quality and expansion of remittances services, especially in rural areas.
- ***Expand use cases for mobile money to reduce the need for cash.*** Current use cases for e-money rarely go beyond personal transfers and airtime top-ups in Uganda, which entrenches the consumer need to cash-out the received digital funds. Instead of focusing on only digital merchant payments to drive the demand for digital value, it should be considered to digitise the entire payments value chain to decrease the consumer need to hold cash. G2P payment efforts could be expanded to drive the uptake of digital services if this is in line with cash infrastructure expansion to ensure that people can trust that digital value can always be converted to physical currency. Every rollout of digital financial services must emphasise the network use cases including digital value acceptance, liquidity and encashment points so as to not lead to consumer lock-out or hardship and to provide real utility to digital value.
- ***Emphasise regional rather than national integration of payments to increase sustainability.*** Uganda is part of regional payment systems and has a national one as well, which creates competition for flows and introduces cost inefficiencies. Instead of

considering a national switch, Uganda should seek access to a switch within the region to leverage larger scale in flows and contribute its card and mobile transaction numbers towards better scale and lower costs across the region. The goal is improved affordability for all RSPs instead of just the leading remittance market actors. There is an existing switch in Kenya, for example, that is lacking scale. It could be explored whether Ugandan shilling processing could be ringfenced on the Kenyan infrastructure while establishing the clearing house and rules in Uganda. In other words, the Kenyan switch is merely an operator while the clearing house remains on home soil. Uganda should weigh up very carefully the installation of another card/mobile switch in the region given the existing link with other East African countries through the EAPS and REPSS, which can be leveraged. Any additional switch will likely be redundant from the date of commissioning. There is likewise a significant opportunity for cross-border processing of EFTs in the region.

- ***Improve formal data collection to understand the market better.*** Consumer surveys such as FinScope could expand on their questions around remittances, especially on formal versus informal volumes and values, both international and domestic. Better data availability supported by government would aid providers and policy makers alike to improve the business case and targeted product offering.

Uganda has been a poster child on the continent in many aspects of remittances. A large number and high value of remittances are flowing freely through many channels and prices are competitive in the mobile money space. Its large agent network, the lack of capital controls and the high uptake of mobile money serve as great examples for other countries. However, Uganda could improve on the prices in corridors from developed countries and has several regulatory impediments that when removed could aid the sector significantly. Especially the introduction of the mobile money tax could have severe negative consequences and potentially reverse the impressive mobile money progress. Applying the risk-based approach and dropping the need for proof of address could further expand the reach of the formal system.

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