Technical Note

Financial Regulations for Financial Inclusion –Paraguay–

BANCO MUNDIAL
BIRF • AIF | GRUPO BANCO MUNDIAL
América Latina y el Caribe
Oportunidades para todos

FIRST initiative

November 2014

1818 H Street NW

Washington DC 20433

Telephone: 202-473-1000

Internet: www.worldbank.org

Acronyms

ACH	Automated Clearing House
AFD	Agencia Financiera de Desarrollo
AML	Anti-Money Laundering
AML/CFT	Anti-money Laundering/Combating the Financing of Terrorism
ATM	Automated Teller Machine
ATS	Automated Transfer System
BCP	Banco Central del Paraguay (Central Bank of Paraguay)
BNF	Banco Nacional de Fomento
CAH	Crédito Agrícola de Habilitación
CCT	Conditional Cash Transfer
CCTV	Closed Circuit Television
CDD	Client Due-Diligence
CGAP	Consultative Group to Assist the Poor
CNV	Comisión Nacional de Valores (Securities Commission)
CONACOM	Comisión Nacional de la Competencia (National Commission for Competition)
CONATEL	Comisión Nacional de Telecomunicaciones (National Telecomunication Commission)
CSD	Central Securities Depository
DGRV	German Confederation of Cooperatives
EEDES	Empresas Emisoras de Dinero Electrónico (E-money companies)
EMPES	Entidades de medio de pago electrónico (Companies that provide electronic payments)
FATF	Financial Action Task Force
FG	Fondo Ganadero
IADB	Inter-American Development Bank
IFC	International Finance Corporation
INCOOP	Instituto Nacional de Cooperativismo (National Institute of Cooperativism)
KYC	Know Your Client
LAC	Latin America and the Caribbean
MFI	Microfinance Institution

ML	Money Laundering
NGO	Non-Governmental Organization
NPL	Non-Performing Loans
OTA	Over the Air
PAR	Portfolio at risk
PIN	Private Identification Number
POS	Point of Sale
RTGS	Real Time Gross Settlement System
SEDECO	Secretaria de Defensa del Consumidor y el Usuario (National Secretary for Consumer Protection)
SEPRELAD	Secretaría de Prevención de Lavado de Dinero o Bienes (Secretary for the Prevention of Money Laundering)
SIB	Superintendecia de Bancos (Superintendence of Banks)
SIPAP	Sistema Nacional de Pagos Electronicos del Paraguay (National Electronic Payment System of Paraguay)
SIS	Superintendencia de Seguros (Superintendence of Insurance)
SMEs	Small and Medium Enterprises
SMS	Short Message System
TF	Terrorism Financing
VAT	Value added tax
WMD	Weapons of Mass Destruction
WOCCU	World Council of Credit Unions

Exchange rate: 1 US$ = Gs. 4,500, average exchange rate from January to April 2014, published by BCP.

Monthly minimum wage: Gs. 1,824,055 = August 2014.

Acknowledgements

This technical note was prepared by Mariana Paredes under the supervision and edition of Jane Hwang.

The team thanks Yoko Doi, Monzerrat Garcia, David Grace, Maria Cristina Heisecke Paredes, Celina Lee, and Doug Randall, for their substantive comments during various stages of this project. Emily Adeleke, Leyla Castillo, Jennifer Chien, Brett Coleman, Xavier Faz, and Korotoumou Ouattara also provided invaluable insights to this technical note.

The team gratefully acknowledges the Paraguayan authorities, including the Banco Central, Ministerio de Hacienda, Instituto Nacional de Cooperativismo and Secretaría Técnica de Planificación del Desarrollo Económico y Social, for their cooperation and collaboration throughout the project.

Finally, the team is particularly appreciative of the financial sector community in Paraguay who generously gave their time and views through extensive meetings and discussions to provide their information and perspective of the financial sector in Paraguay.

Table of Contents

Boxes

Tables

Executive Summary[1]

This Technical Note focuses on the key legal and regulatory aspects affecting financial inclusion in Paraguay. These aspects are concentrated in regulations that often raise the cost of providing financial services and also pose constraints to access these services. Among these constraints, some affect the cost of access, delivery and usage of financial services, which in turn increase costs of these financial services or generate non-viable business models, thereby limiting the development and implementation of financial products for low-income populations. The analysis provided in this note also points out the uneven regulatory landscape governing financial services offered by different institutions, which have resulted in negative effects for financial inclusion. An uneven regulatory landscape can introduce distortions in pricing of financial products and credit risk management policies while allowing the development and growth of non-regulated/non-supervised financial product providers. This poses challenges for the deepening of financial inclusion in Paraguay, for the extension of financial services requires not only strong financial institutions but also equal market conditions for the same product offered across the financial sector.

There are three main regulatory categories of financial service providers in Paraguay: 1) regulated and supervised entities by the Central Bank 2) cooperatives regulated and supervised by the Cooperative Regulatory Body and 3) formal entities providing financial services but not financially supervised, nor regulated. The first group is comprised of the financial institutions regulated and supervised by the BCP. This includes banks, finance companies, e-payment companies[2] (EMPES, acronym in Spanish) and insurance companies. The second group includes savings and credit cooperatives which are under a different set of laws and supervisory body (the National Institute of Cooperativism, INCOOP). The third group consists of financial service providers legally constituted and therefore formal companies, but not financially supervised.

The narrow scope of the definition of financial activities together with the narrow supervision outreach set by the Central Bank of Paraguay has led to a landscape where similar products are provided both by regulated and non-regulated providers, setting an unlevel regulatory field for financial operations. The financial sector law states that institutions conducting financial intermediation must be supervised by the Superintendence of Banks, BCP. However, the Paraguay financial sector market has developed financial products offered by companies that fall outside this scope like insurance and products similar to deposit-taking[3], and poses challenges in the enforcement of non-prudential rules that should be applicable to all those providing loans based on proprietary funds. This division has also made regulation enforcement a challenge. For example, unregulated and unsupervised entities do have to abide by the usury interest rate regulation, but there is no supervisory body to enforce that they comply with this regulation. Also, they do not have to fulfill information reporting requirements, and comply with transparency norms.

The financial regulations in Paraguay set a general framework for operations permitted to financial institutions supervised by BCP (via SIB or SIS). The existing general framework allows financial institutions to design specific products tailored to their market targets. Therefore, regulation on specific products is not found to be limiting financial inclusion in Paraguay. Nevertheless, anti-money laundering (AML) general rules and the established minimum requirements for opening accounts do need a special analysis since these can prevent members of the low income population from accessing formal financial services. Important advances have been made in Paraguay to develop regulations to enable the development of low value and low risk products for financial inclusion like: basic savings accounts, e-payments and the use of agents to provide financial services. A microcredit definition has been already introduced though refinement is still needed.

Cross cutting regulation for financial products has been changing though more refinement is needed. Rules on delivery channels to allow coverage expansion and rules to improve transparency to better protect consumers are still needed. The operational risk management framework should also improve to include specific rules and minimum requirements. These changes will improve the general strength and health of the financial institutions to benefit the newly financially included population.

[1] This regulation technical note will be complemented by a demand-side technical note and a supply-side technical note on financial inclusion. The three notes will served as the analytical base for the National Financial Inclusion Strategy.

[2] Currently, no EMPEs have been approved yet. There are two companies who have applied to be an EMPE. Their application is under review by the BCP.

[3] E-wallets has been an example in other countries.

Introduction

This Technical Note is one of three Technical Notes developed by the World Bank with the purpose of informing the Paraguayan National Financial Inclusion Strategy. This Technical Note will provide an assessment of the current state of financial regulation from the financial inclusion perspective in the country. The findings of the three technical notes as a whole will help identify market gaps, unmet demand, and other opportunities to help mobilize the sector towards a more inclusive financial system.

The first section in this note focuses on the general regulatory landscape governing financial providers in Paraguay, and the following sections provide more details into each of these providers and the different products offered. Section 1 presents an analytical description of the financial sector structure in Paraguay and its general financial legal framework. Section 2 focuses on the legal and regulatory framework governing the financial institutions and entities as well as on the associated regulatory constraints from the financial inclusion perspective. Section 3 describes partially regulated or non-regulated financial service providers operating in Paraguay. Section 4 explains the regulatory framework for financial products offered in Paraguay including the recent important advances made with the introduction of specific regulations that promote financial inclusion; mainly on basic accounts, e-payments, and banking correspondents to provide insights on their role in financial inclusion and identifies specific regulation that may still be limiting financial inclusion. Since the objective of this Technical Note is to contribute to the design of a financial inclusion strategy, and given that Paraguay has already introduced specific products for financial inclusion, this analysis focuses on the products already introduced to assess their characteristics for financial inclusion and identifies further changes needed. Section 5 includes the analysis of cross-cutting regulation (beyond financial inclusion specific) applied to all financial institutions to assess their role in financial inclusion. Section 6 presents a summary of the policy recommendations that results from the analysis provided in each section. When relevant, perspectives from international experiences in conducting legal and regulatory reforms to promote financial inclusion have been included.

This regulation analysis is based on information and interviews gathered as of June 2014, through a desk review of the financial sector's laws and regulations as well as complemented by a mission from May 16th to May 31st. Annexes 1 and 2 provide the list of regulations reviewed and the interviews conducted. Regulations reviewed include those publicly available but limitations were found in identifying the current legal and regulatory norms in place in the absence of a singular and unified code of financial laws, resolutions and circulars from the supervisors. The laws and regulations currently in force and related to the financial sector in Paraguay are not gathered in a general code for the financial sector, such as in other countries.[4] The absence of this unified code makes it difficult to be certain about the latest updates in the current regulatory framework. For example, Colombia has an organic statute for the financial sector containing all the laws and a singular decree containing all mandates, as well as two supervision norms gathering all the relevant norms.

[4] In Paraguay, the Laws are issued by Congress, Decrees are issued by Government and Resolutions and Circulars are issued by regulators.

1. *Overview of regulatory structure for financial service providers*

This section will provide a brief overview of the financial regulators and financial service providers operating in Paraguay. The laws and regulations governing the financial sector will be briefly noted to provide a general view of the financial regulatory framework for financial inclusion. Expanding financial inclusion implies considerably increasing the financial sector's outreach, the general characteristics and regulations that frame the financial sector's activities are key to provide safe and sound financial products to a larger number of people in Paraguay.

In Paraguay, financial service providers can be divided into three different groups when considering regulation and supervision. The first group includes banks and finance companies [5] supervised by the Superintendence of Banks (SIB) as well as insurance companies supervised by the Superintendence of Insurance (SIS), with both supervisory bodies housed within the Central Bank of Paraguay (BCP). The second group includes cooperatives which operate under a different set of regulations and under a different supervisory body – the National Institute of Cooperatives (INCOOP). The third group includes a range of non-supervised and/or non-regulated financial service providers, though they are formal registered organizations. The main characteristics of the financial service providers identified are described in Table 1.

Capital market providers and pension schemes are also mentioned as potentially important for the later stages of financial inclusion. Even though capital market products (long-term debt or equity products) are not aimed at the low income populations, a brief description is included in this section as financial services to be further developed for the overall financial market. Pensions are also included as a means to provide long-term savings products for all Paraguayans.

The main regulatory and supervisory bodies for the financial sector and capital markets in Paraguay are[6]:

- **Central Bank of Paraguay (BCP)**. According to the Organic Law of the Central Bank of Paraguay **(**Law No. 489 of June 29, 1995), the BCP is in charge of promoting effectiveness, stability and solvency of the financial system. This mandate is carried out through the Superintendence of Banks (SIB). BCP is the financial system regulator and is also in charge of the payment system oversight and the circulation of currency in the economy. In this capacity, BCP can issue regulations aimed at developing and stimulating the payments system's operations including the clearing and settlement process between banks and other financial institutions.
    - **Superintendence of Banks (SIB)**. The SIB is part of the BCP and was created by the Organic Law of the Central Bank (Law No. 489 of June 29, 1995). According to its mandate, the SIB is in charge of the supervision and control of the financial sector: banks, finance companies and other financial intermediation institutions[7] or anyone developing the same activities and foreign exchange companies. However, as shown below, supervisory scope only reaches those authorized to perform financial intermediation activities.
    - **Superintendence of Insurance (SIS)**. The SIS is also part of the BCP. It was created by the Insurance Law (Law No. 827 of February 12, 1996) and is in charge of the supervision and control of the insurance sector.
- **National Institute of Cooperatives (INCOOP)**. All cooperatives[8], including the savings and credit cooperatives, are under the regulation and supervision of INCOOP. INCOOP was created initially in 1994 by the Cooperative Law (Law 438 of October 21, 1994) and later reformed by the Organic Law of INCOOP (Law 2157 of June 16, 2003) as the regulator and supervisor for the whole cooperative sector. INCOOP is not a specialized financial supervisor[9].
- **Comisión Nacional de Valores (CNV)**. Created by Law 1284 of July 29, 1998, the

[5] Within this regulated group there are the e-payment companies (EMPES, acronym in Spanish). They have a regulatory framework, but as of August 2014, there are no EMPES registered at BCP.

[6] This section *only* includes those bodies that regulate and/or supervise financial activities. General legal framework governing general economic activities in Paraguay is beyond the scope of this Technical Note.

[7] Article 1, Law 861, 1996 refers to these institutions in general terms without specifying which ones.

[8] Law 438/94 determined that cooperatives can be either specialized or multipurpose. Article 102 of Decree 14052/96 defined multipurpose cooperatives as those performing two or more activities of the following: savings and credits, production, consumption, utility, labor, and/or general services. Article 104 (Decree 14052/96) defined specialized cooperatives as those performing just one of the mentioned activities. Thus, according to these activities, cooperatives are classified as savings and credit cooperatives, production cooperatives, other cooperatives (consumption, labor, services, housing, etc), and integrated organizations (confederations, federations and central cooperatives.)

[9] INCOOP is in charge of supervising all the cooperatives regardless of the type of activities performed (savings and credit or other), so it is not dedicated *only* to supervising cooperatives performing savings and credit activities. In this regard, it is not a "specialized financial supervision body".

CNV regulates and supervises the public securities market, issuers, the stock exchange, brokers and all participants in the stock market. This Commission is related to the Executive Power through the Ministry of Industry and Commerce as defined by Art 164 of the mentioned Law.

Outside of the supervised financial sector, there are financial service providers that are partially regulated and others that operate in the market without supervision or regulation. There are seven general types of these financial providers: 1) non-profit microfinance institutions/non-government organizations (NGOs) 2) *casas de credito* 3)*casas comerciales* 4) *cajas mutuales* 5) pawn shops 6) pre-paid medicine companies; and 7) international and domestic money transfer service providers and payment processing companies (perform activities similar to postal payment services used in other countries). This group of financial service providers is not financially supervised since the norms in Paraguay only apply when a complete cycle of *financial intermediation* occurs; that is when deposits are mobilized to lending or investment[10]. If either of the above is performed exclusively, the regulatory framework for financial activities is not applicable to those providers. For example, if institutions only conduct credit operations and do not take deposits, such as the *casas de credito*, the financial laws and regulations set by BCP do not apply. In the case of Paraguay, no other supervisory body is in charge of overseeing these providers' activities. This limitation has negative consequences on transparency, credit information reporting and consumer protection that need to be taken into account when promoting financial inclusion, as will be discussed in Sections 2 and 3. The exceptions in this category are the pawn shops and the *cajas mutuales* because they do have a law that governs them, though supervision is lacking. Pawn shops are governed by Law 2283 of November 10, 2003**,** in which the Ministry of Finance is the regulator but the local municipalities should ensure the monitoring and compliance of the law (i.e. licensing and inspections of the pawn shops). *Cajas mutuales* are governed by Law 3472 of May 29, 2008, but these are not currently supervised by any authority.

[10]Article 1 of Law 861, of June 24 says: "The subjects of this law are all financial institutions and natural or legal persons, whether public or private, domestic or foreign entities whose activity consists of or includes the usual taking of financial resources from the public in the form of mutual, deposits, financial assets repos, or any other contractual arrangement which entails the obligation to repay, to use them alone or together with its equity or other resources from other funding sources; grant credits from different modalities, or investments, for any purpose and in any kind, irrespective of the legal form or name used by the subjects or activities that they perform, or any other activity which in the opinion of the Central Bank of Paraguay is assimilated to financial intermediation. "

Table 1.Financial services providers in Paraguay

Financial provider	Organizational format	Ownership	Regulatory status	Range of financial services allowed	Number of providers
First and second tier banks	Corporations (stock company). Single purpose State owned financial institutions	Private sector and public sector ownership	Regulated and licensed by BCP. Supervised by SIB.	Checking accounts, savings, term deposits, issue securities, loans, leasing, factoring, payments, investments in securities and shares, manage trust funds, foreign exchange operations and loan securitization, money transfers	First tier banks[11]: 16[12] Second tier banks[13]: 1[14] Other public financial providers: 2[15]
Finance companies	Corporations (stock company). Single purpose	Private sector and public sector ownership	Regulated and licensed by BCP. Supervised by SIB.	Savings, term deposits, issue securities loans, leasing, factoring, payments, investments in securities and shares, manage trust funds, foreign exchange operations, money transfers	12
Insurance companies	Corporations (stock company). Single purpose	Private sector and public sector ownership	Regulated and licensed by BCP. Supervised by SIS.	Insurance of individual risks and assets.	35
Savings and credit cooperatives **Type A: assets over US$11 million.**	Membership-based cooperative. Multipurpose.	Members	Regulated and supervised by INCOOP	Savings and credit (including debit and credit cards) to members in local currency, investments in securities, leasing, factoring, payments, money transfers. Provision of non-financial services. Only for members[16].	330[17]
Type B: assets between US$1 million to US$11 million.	Membership-based cooperative. Multipurpose	Members	Regulated and supervised by INCOOP	Savings and credit (including debit and credit cards) to members in local currency, investments in securities, leasing, factoring, payments. Provision of non-financial services. Only for members.	
Type C: assets under US$1 million.	Membership-based cooperative. Multipurpose	Members	Regulated and supervised by INCOOP	Savings and credit to members in local currency, investments in securities, leasing, factoring, payments. Specific prior authorization for: payments and transfers; credit line intermediation. Debit	

[11] First tier banks are commercial banks that provide financial services for individuals and enterprises.
[12] Includes 15 private banks and 1 public bank (Banco Nacional de Fomento)
[13]Second tier banks are agencies that only lend to other banks, finance companies and cooperatives using funds from loans provided by multilaterals with state's guarantee, donations, or bonds.
[14]Agencia Financiera de Desarrollo
[15]Credito Agricola de Habilitacion and Fondo Ganadero are public financial institutions that provide public specialized credit. These institutions have their own organic laws and are also subject to the Financial Sector Law.
[16]Services to non-members can be implemented with approval of exception from INCOOP.
[17] This number refers to cooperatives whose primary business is financial services according to the Supply Side Technical Note.

				cards must be issued by Types A or B cooperatives. Using ATM with Types A or B backup. Provision of non-financial services. Only for members.	
E-payment providers (EMPEs)	Corporations (stock company). Single purpose	Private sector and public sector ownership	Regulated, licensed and supervised by BCP	E-money operations and non-banks e-transfers	N.A. [18]
Casas de Bolsa	Corporations (stock company). Single purpose	Private sector and public sector ownership	Regulated, Registration required at CNV	Buying and selling debt and equity securities	7
Non-profit microfinance institutions (MFIs)/NGOs	Non- profit associations, foundations, corporations.	Private sector individuals or entities	No regulation and no supervision	Loans and non-financial services	2
Casas de Crédito	Corporations (stock companies)	Private sector individuals or entities	No regulation and no supervision	Loans	N.A.
Casas Comerciales	Corporations (stock companies)	Private sector individuals or entities	No regulation and no supervision	Selling of goods and services on credit.	N.A.
Pawn shops	Individuals or legal entities	Private sector entities or individuals	Regulated by Ministry of Finance. Licensed and inspected by local municipality.	Loans with pledge on assets	N.A
Medicina Prepaga / Pre-paid medicine companies	Corporations (stock companies)	Private sector individuals or entities	Regulated and supervised by the Superintendence of Health under the Ministry of Health	Coverage over future health problems	65
Payment service providers and remittances providers	Corporations (stock companies)	Private sector entities	No regulation and no supervision, exceptions being AML/CFT regulations issued by SEPRELAD	Payment collection services and sending and receiving remittances	N.A

Source: Based on laws and regulations for the financial services and insurance in Paraguay, and findings from the Supply-side Technical Note. See detailed list of regulations in Annex 1.

[18] BCP is currently in process of evaluating 2 operators that have requested a license to be an EMPE. A recent an extension was granted to the 2 applicants in order to adjust to the new EMPE requirements.

2. *Regulated financial service providers in Paraguay*

This section describes the general regulatory framework for regulated financial service providers in Paraguay. This overview focuses on identifying the general financial regulation applied to each type of financial provider in order to determine if there are regulatory distortions that affect the provision of financial services. The financial service providers analyzed in this section include banks, finance companies, cooperatives, insurance companies, e-payment service providers, pensions and the capital markets. This analysis is important from the financial inclusion perspective to determine the ability of the financial sector's general regulatory framework to facilitate equivalent and adequate access to safe financial services for all of the banked and unbanked population in Paraguay.

A. BANKS AND FINANCE COMPANIES

In Paraguay, financial intermediation activities by commercial banks and finance companies are governed by two laws and their subsequent regulations - the Organic Law of the Central Bank of Paraguay (Law 489, of June 29, 1995) and the Financial Sector Law (Law 861, of June 24, 1996) (Table 2). There are 16 banks and 12 finance companies currently operating in Paraguay. Financial intermediation activities are defined by the financial sector law as *any activity, including regular deposit taking in any form that entails repayment of obligations, to provide credit or investments* regardless of the legal form or denomination used by the companies or subjects developing these activities. According to the Financial Sector Law (Law 861, of June 24, 1996), institutions in the financial sector must be corporations (stock companies) with capital being represented by nominative shares. The requirement to be stock companies is to ensure certain corporate governance standards, and the purpose of minimum capital requirements is to make certain the institution's financial and operational stability. Banks and finance companies are covered by deposit insurance of all public liabilities up to 75 monthly minimum wages[19] - US$30,000 per person. The only exception is BNF whose liabilities are guaranteed by the Government of Paraguay. All commercial private banks and finance companies must comply with the Financial Sector Law, while public banks have also to abide by their Organic Laws that prevail over the Financial Sector Law.

Table 2. Legal basis of banks and finance companies

Regulation/ Law	Description
Law 489, of June 29,1995	Organic law for the Central Bank of Paraguay (BCP)
Law 861, of June 24,1996	Financial Sector Law: Regulates banks, finance companies and other loan companies. Creates Superintendence of Banks (SIB)

Minimum capital[20] requirements and rules on capital adequacy for banks and finance companies are defined by the Financial Sector Law. The Law defines the specific risk weight of assets, while the capital adequacy ratio is defined as a minimum of capital equal to 8% of risk-weighted assets. The law also permits the BCP to adjust this limit up to 12%. In 2012, through Resolution 3, Act 4, from February 2, 2012, BCP defined the ratio at 12%. Details are described in Table 3.

[19] At the time of writing, monthly minimum wage is currently set at Gs. 1,824,055, equivalent to around US$ 405

[20] Capital: represents the equity stake of the owners of a company, in this case a financial institution. It represents the residual assets that would be due to stockholders after paying all claims such as secured and unsecured debt, deposits and other liabilities. This equity cannot be withdrawn from the company and in the case of financial institutions there are minimum amounts required to create a new financial institution.

Table 3. Minimum capital requirements and capital adequacy for banks and finance companies

Regulation	Law 861/1996. Resolution 3, Act 4, from February 2, 2012 (BCP)
Minimum capital entry requirement	• Banks: US$ 8.8 million. • Finance companies: US$ 4.4 million.
Capital adequacy rules	
Minimum effective capital versus Risk-weighted assets	• 12%. Capital is required to be at least 12% of risk weighted assets.
Assets classification according to repayment risk levels	
Risk category 1: weight 0%	• Cash and deposits at the Central Bank. • Investments in sovereign securities: Treasury and the BCP. • Undisbursed loans. • Cash backed loans.
Risk category 2: weight 20%	• Investments in securities issued by multilaterals. • Deposits in first class foreign banks. • Loans to first class foreign banks. • Loans, guarantees and collaterals, and credit letters with counter guarantees from first class foreign banks.
Risk category 3: weight 50%	• Time and term deposits in local banks and finance companies. • Loans guaranteed by local banks and finance companies. • Interbank loans and bonds issued by local banks and finance companies. • Loans guaranteed with mortgages, pledge and warrants. • Rights in foreign exchange futures.
Risk category 4: weight 100%	• Deposits in other foreign banks. • Loans to other foreign banks. • Loans, guarantees and collaterals, and credit letters with counter guarantees from other foreign banks. • Loans not qualified in other categories. • Investments and bonds issued by local companies. • Securities and debt instruments. • Fixed assets and other foreclosed assets. • Possession of precious metals. • Deferred assets.

Source: Law 861/1996 and Resolution 3, Act 4, from February 2, 2012 (BCP)

Public financial institutions

Currently, there are 4 public [21] institutions providing financial services in Paraguay under SIB supervision. The four public institutions are: 1) Banco Nacional de Fomento (BNF), 2) Fondo Ganadero 3) Credito Agricola de Habilitacion (CAH) and 4) Agencia Financiera de Desarrollo (AFD). Each of the four institutions must comply with the Financial Sector Law, but depending on the individual public financial institution, they each have separate additional laws to comply with. As stated by the Financial Sector Law, their financial services provisions should allow competition on equal terms with the rest of the financial sector. The Organic Law of each of these public financial institutions prevails over the Financial Sector Law setting a different framework for these institutions. (Table 4) [22]. However, according to BCP, all have to abide by the general prudential regulation applied to the rest of the regulated financial institutions.

[21] These are state-owned financial institutions. In Paraguay as in other countries in LAC they are refered to as "public".

[22] Within the public institutions related to loan provision, SENAVITAT (in Spanish Secretaría Nacional de la Vivienda y el Hábitat) is the governing body for general housing policy created in 2010.

Table 4. Public financial institutions in Paraguay

Name	Regulation	Description
Banco Nacional de Fomento (BNF)	Decree-Law 281 of March 14, 1961 Law 861 of June 24 1996 Law 2100 of June 26, 2003 Law 2502 of December 30, 2004	• First tier bank, allowed to take deposits. • Law 2,100 of June 26, 2003 allows it to perform all banking operations and services nationwide including foreign trade operations. • Among the whole range of loans, BNF is allowed to grant agriculture loans to small and medium enterprises, up to US$22,000 for short-term loans (max 12 months), US$67,000 for up to 3 years and US$156,000 for loans over 5 years. • Loans per individual are limited to US$150,000; this limit does not include loans to cooperatives for production or consumption, to financial institutions, exports, sales of assets or loans restructured before Law 2,502. • Not covered by deposit insurance. • Financial prudential regulation is applicable.
Fondo Ganadero	Law 861of June 24, 1996 Law 3359 of September 20,2007	• Executing agency for local and foreign loans granted by multilaterals and other organizations to Paraguay to support cattle development projects. • It provides technical assistance and investment finance to producers. • According to Law 3359/2007 (Art 4 (b)), with authorization from the Superintendence of Banks, it could accept medium to long term deposits from natural or legal persons for livestock activity (no authorization was given yet). • Financial prudential regulation is applicable.
Crédito Agrícola de Habilitación (CAH)	Law 551 of December 19, 1975 Law 861of June 24 1996	• Provides loans, technical and organizational assistance to low-income agricultural producers especially those integrated in associations. Funded with public resources. • Financial prudential regulation is applicable.
Agencia Financiera de Desarrollo (AFD)	Law 861of June 24 1996 Law 2640 of July 27, 2005 Law 3330 of October 18, 2007 Law 3655 of November 21, 2008. Decree 7395 of April 24, 2006	• The only second-tier public bank. • It was appointed as the executive agency for loans and donations for financial development programs with sovereign guarantee, and the only public mechanism to provide funding to first-tier financial institutions and cooperatives under INCOOP's supervision. • Public programs were eliminated as a result of the creation of AFD: Fondo de Desarrollo Campesino (FDC); Fondo de Desarrollo Industrial (FDI); Unidad Técnica de Ejecución de Proyectos del Banco Central del Paraguay (UTEP-BCP); Banco Nacional de la Vivienda (BNV). • Financial prudential regulation is applicable.

Source: Summary of Law's contents.

The manner in which first-tier public financial institutions operate may be a source of distortions in the financial sector because they are allowed to provide the same type of financial services as private-owned banks and finance companies. Though this is mentioned in the Supply-Side Technical Note of Financial Inclusion in Paraguay [23] it is important to provide a deeper analysis of the roles of these financial institutions. The role of public financial institutions operating in Paraguay should be evaluated and determined if they are providing financial services that are not already being provided by the private financial institutions and determine if they are providing services to fill the market gaps instead of substituting the private financial providers. In the past, distortions have been introduced by these institutions due to the support they had received from public funds to eliminate non-performing loans (NPL), a behavior that may allow a tolerant credit risk assessment. For example, BNF (the only first-tier public bank allowed to take deposits) benefited by the government's decision of eliminating NPLs from its financial statements. This action was legally supported through Law 2100 in

[23] The World Bank, Supply-Side Assessment of Financial Inclusion in Paraguay, 2014.

2003. The law permitted the transfer of high-risk loans to the Ministry of Finance in exchange for Treasury bonds at 80% of their face value[24].

Public policy decisions have given BNF market benefits while not all commercial banks and finance companies necessarily have the same benefits. For example, their experience with small savers is being built upon government conditional cash transfers (CCTs) by the Secretary of Social Action to be deposited in basic savings accounts under a pilot program with Fundación Capital in conjunction with BNF. Although this may be a role for a public bank it has also a crowding-out effect, for private-owned banks or finance companies could as also build low-amount savings products on CCTs payments. Another advantage is the privileged position of BNF in public payrolls with 68% of the total market and the management of the majority of the accounts of public institutions. This characteristic allows the bank to fund its lending operations without needing to be very aggressive on the savings side, thus limiting the need to be a competitive market player in the financial sector. As for using the basic savings accounts, the bank has just begun to develop a business model; however the industry reports great doubts on the business viability due to the associated transactions costs relative to the probability of low account balances. Even though BNF is defined as a public development bank playing in the same space with private commercial banks, it has inherent additional benefits due to its public status.

B. INSURANCE

Insurance services in Paraguay are governed by the Organic Law of the Central Bank of Paraguay (Law No. 489 of June 29, 1995) and the Insurance Law (Law 827 of February 12, 1996). Insurance activities are defined by the Insurance Law as any commercial transaction by which the insurer is obliged to compensate the person or people insured for damage, injury or loss caused by random, accidental or risk affecting the insured life or assets, in exchange for a specified premium. According to the Insurance Law, insurance firms must be single-purpose corporations (stock companies) with capital being represented by nominative shares. The only institutions authorized to provide insurance are stock companies and foreign companies' branches. The Insurance Law provides the legal foundation for the SIS which regulates insurance activities performed within Paraguay. Prior authorization by SIS is required for insurance operations and the Law clearly states that all those performing similar activities of substantial outreach fall within the supervision of the Insurance Law. Premiums are to be defined by the insurance companies with the oversight of SIS. Prior authorization for providing insurance products is required together with a minimum capital of US$500,000 per insurance line and insurance plans that comply with the Law. Table 5 summarizes the legal framework governing insurance activities in Paraguay.

The Civil Code of Paraguay (Law 1183 of December 23, 1985) is also applicable to the insurance sector. The civil code of Paraguay defines in general terms the insurance contract (in the same terms included in Law 827, 1996), when the contracts are considered void and it states that the contracts can start when there is an agreement even before the policy is issued. It also includes general conditions and characteristics for the insurance policies, terms and who is responsible for the premium payments.

Insurance companies can only operate those insurance lines for which they have authorization; general insurance lines include assets and life. Insurance plans within these lines and contracts have to be registered at the SIS before their implementation. Information such as the specific text describing the insurance, the policy model, the premium and its technical basis are required to be shared with the SIS for the authorization process. Operations allowed by insurance companies include all those falling in the insurance definition together with guarantees to third party obligations that are similar to insurance operations, economically and technically. However, there is a specific prohibition for plans including raffles and those covering financial credit risk. The SIS is not authorized to regulate and supervise the health pre-paid schemes in Paraguay.

The insurance general regulatory framework in Paraguay does not impose restrictions to financial inclusion. Insurance companies are allowed to develop and implement general insurance products that can be tailored to the needs of low income populations. However, during the writing of this legal technical note, it was found insurance companies have shown little interest in providing micro-insurance products as is discussed in Chapter 4, Section D.

Table 5. Legal framework governing insurance activities

Regulation / Law	Description
Law 489 of June 29,1995	Organic law for the Central Bank of Paraguay (BCP)
Law 827 of February 12, 1996	The Insurance Law: Regulates insurance activities performed within the National Territory. Created SIS.
Law 1183 of December 23, 1985.	Civil Code of Paraguay

[24] Art. 5, Law 2,100/2003

C. COOPERATIVES

The cooperatives operating in Paraguay have a separate, independent set of laws from those governing the banks and finance companies. The National Constitution of Paraguay protects and guarantees the free organization and autonomy of cooperatives; setting an important legal difference from the banks and finance companies' activities and regulation. Due to the fact that cooperative activities are protected by the National Constitution, it has been interpreted that regulations issued by INCOOP cannot define requirements that may infringe on the constitutional definition of cooperatives. The Cooperative Law (Law 438 of October 21, 1994) regulates the creation, organization and operation of cooperatives and the cooperative sector. It defines basic characteristics for *any* cooperative in terms of minimum number of members, unlimited and variable capital, unlimited term of duration, voting rights, and the non-distribution of social reserves. According to this Law, cooperatives are social-interest, private legal entities that abide by the cooperative legal framework. They are not limited to a particular economic activity. This suggests that savings and credit cooperatives can legally simultaneously provide other business lines, all within the same cooperative. Cooperative financial service operations are subject to this Law so they are not required to be specialized and do not need prior licensing by INCOOP. INCOOP is a non-specialized financial regulator[25], in charge of promoting, regulating and supervising the entire cooperative sector. This includes regulating saving and credit cooperatives, as well as productive cooperatives and others (Table 6).

Table 6. Legal framework for the cooperative sector

Regulation/ Law	Description
Law 438 of October 21, 1994	Cooperative Law Regulates the creation, organization and operation of cooperatives and the cooperative sector Creates INCOOP
Law 2,157 of June 16, 2003.	Regulates the operation of INCOOP created by Law 438/1994.
• Resolution 499 of December 19, 2004.	General regulatory framework for all cooperatives
• Resolution 11,102 of November 19, 2013 and its modifications: ○ Resolution 11,343 of December, 2013. ○ Resolution 11,481 of February 6, 2014.	Regulatory framework for savings and credit cooperatives, including second-tier cooperatives of the saving and credit sector (centrales cooperativas de ahorro y crédito). Highlights of the resolutions: • Cooperatives are not required to specialize their financial services. • Controlling conflicts of interests and improving governance.

[25] INCOOP is in charge of supervising all the cooperatives regardless of the type of activities performed (savings and credit or other). Thus, given its broad supervision responsibilities, it is not considered a specialized financial regulator for it has to supervise savings and credit cooperatives together with those performing other economic activities.

The 1994 Cooperative Law is a general framework for cooperatives and does not define special requirements that are applicable to cooperatives providing specialized financial services. This has to do with the fact that the Cooperative Law (438/1994) allows cooperatives to provide financial as well as non-financial services to members (specialized versus non-specialized). This is the result of the historic process of cooperative development where they frequently started by being non-financial cooperatives and, as they grew, they started providing credits and savings combined with non-financial services. As financial services outgrew the non-financial services for cooperatives, INCOOP's supervision and regulatory framework has yet to fully adjust to the changing cooperative landscape. For example, the supervision and regulatory framework has yet to address the fact that some cooperatives operating in the market conduct both financial and non-financial activities which should be monitored to protect the sector's financial health. As such, individual cooperatives remain vulnerable to risks. Despite cooperatives playing a smaller financial role in the overall sector compared to banks and finance companies in terms of financial assets; it plays an important social role due to the sheer numbers of clients it has with the lower and middle income population. According to information gathered in the Supply Side Technical Note, cooperatives have 58% of total accounts held in Paraguay.

Deposit-taking authorization for cooperatives is defined by the Cooperative Law as a service available only from its members, however the same law also stipulates that on a case-by-case basis INCOOP can authorize cooperatives to offer services to non-members. Cooperatives are allowed to take deposits in local currency from members and other cooperatives, but according to the same law, INCOOP *could* allow the provision of financial services to non-members. Although this is currently not happening in practice, it is legally permissible.

Resolution 11,102 of November 19, 2013 modified by Resolution 11,343 of December 2013 and Resolution 11,481 of February 6, 2014 details the regulatory framework for first-tier[26] and second-tier[27] savings and credit cooperatives. Resolution 11,102 and its modifications, contain the specific framework that applies to cooperatives (specialized and multipurpose) that have savings and credit as their principal activity[28]. Even though this Resolution

[26] In the cooperative sector these are cooperatives formed by individuals.

[27] Second- tier cooperatives, in Spanish Centrales Cooperativas, are formed by three or more cooperatives and provide services to their associates (cooperatives not individuals).

[28] INCOOP annually emits a resolution classifying cooperatives based on its main activity (savings and credit, productive, and others) and its asset levels (Type A, Type B, Type C). Second-tier cooperatives (centrales cooperativas) are also classified. Representative organizations of cooperatives (confederaciones y

establishes the legal framework for savings and credit cooperatives, it does not express that these cooperatives should be single-purpose, so cooperatives can conduct both financial and non-financial services for their members. For example, there is evidence in Paraguay that a cooperative can provide both financial services and non-financial services, such as providing financial services and at the same time providing recreational and lodging businesses. This is permissible by the legal framework.

INCOOP's Resolutions 11,102 of November 19, 2013 and its modifications, define three levels of supervision according to the level of assets and types of financial operations allowed. As shown in Table 1, Type A cooperatives are those with assets over US$11 million that can take deposits and grant loans (including credit cards) to their members in local currency; they can conduct investments in securities, leasing, factoring, and provide payments. Type B cooperatives are those with assets between US$1 million to US$11 million and can take deposits and grant loans (including credit cards) to their members in local currency; they can also conduct investments in securities, leasing, factoring, and payments. Type C cooperatives are those with assets under US$1 million and can perform the same basic operations but need specific prior authorization to conduct payments and transfers and for credit line intermediation; they can provide debit cards but issued by Types A or B cooperatives and the use of ATMs requires the support of Type A or B cooperatives. In order to operate a cooperative in Paraguay, the only legal requirement is to register at INCOOP. Basic prudential regulation ratios are defined although minimum capital requirements are not required for a cooperative to operate in Paraguay. Table 7 defines the various requirements for cooperatives classified as A, B or C.

federaciones) are not classified. Before Resolution 11,102 the general framework defined by Resolution 499 of 2004 was applicable to savings and credit cooperatives as well.

Table 7. Minimum entry capital and capital adequacy requirements for cooperatives

Regulation	**Resolution 11,102 of November 19, 2013 from INCOOP**
Minimum capital entry requirement:	No minimum capital entry requirement. The only requirement is to register at INCOOP.
Capital adequacy rules (Minimum liquid equity / Risk weighted assets)	
Type A: assets over US$11 million.	10%. Liquid equity[29] is required to be at least 10% of risk-weighted assets.
Type B: assets between US$1 million to US$11 million.	15%. Liquid equity is required to be at least 15% of risk-weighted assets.
Type C: assets under US$1 million.	20% starting at 30% for the new ones. Liquid equity is required to be at 20% to 30% of risk-weighted assets.
Assets classification according to repayment risk levels	
Risk category 1: weight 0%	• Cash. • Investments in the BCP. • Investments in sovereign securities.
Risk category 2: weight 20%	• Deposits and investments up to 30 days in Type A cooperatives, central cooperatives, banks and finance companies. • Loans guaranteed with BCP's liabilities. • Investments in securities issued by the government. • Loans guaranteed by Type A's, second-tier cooperatives, banks and finance companies.
Risk category 3: weight 50%	• Long-term investments up to 30 days in Type B and C cooperatives. • Investments over 30 days in Type A cooperatives, second-tier cooperatives, banks and finance companies. • Mortgages and loans guaranteed with savings.
Risk category 4: weight 100%	• Loans not qualified in other categories. • Rest of assets and contingencies.

[29] Refers to the regulatory capital that financial institutions are required to hold in liquid form in relation to the risk-weighted assets. These requirements help financial institutions hold enough capital in order to honor withdrawals in the event of a default.

Resolution 11,102 of November 19, 2013 from INCOOP and its modifications also introduce rules for liquidity management. Cooperatives are required to have general policies for liquidity investments according to the solvency of the institution receiving the funds. These investments can be kept in other cooperatives, financial institutions under BCP's supervision, and the National Securities Commission (CNV). As for deposit concentration, INCOOP's resolution sets limits for deposits in one institution according to the type of the cooperative: Types A up to 35%, Types B and C up to 50%. Minimum liquidity reserve requirements must be at least 10% of the total deposits and at least 30% of their liquid assets must be available immediately. The liquidity gap must be calculated on a daily basis and reported weekly to INCOOP for Types A and B with assets over US$6.6 million (Gs.30,000 million). Other Type B cooperatives (with assets less than US$6.6 million) can report the gap on a monthly basis while Type C cooperatives can calculate it quarterly and report it every six months.

Although the regulatory framework for cooperatives with savings and credit as its principal activity has recently been strengthened through the creation of Resolutions 11,102 of November 19, 2013 and its modifications, the full adoption of these regulations have yet to occur in practice. INCOOP has permitted the cooperatives a two year general adaptation process starting January 2014. Adapting to liquidity requirements must be finished by June 2014 and capital adequacy must be fulfilled by January 2015. The adjustment of provision requirements is ordered with a progressive increase process of 25% every 6 months until January 2016. During this process, Resolution 499, 2004 is applicable regarding accounting rules and reporting forms.

Another important strengthening of the sector is the current project to create a deposit insurance fund for the cooperatives. With the technical assistance of the German Cooperative and Raiffeisen Confederation (DGRV)**,** INCOOP is working to establish a deposit insurance scheme to cover the cooperatives that register in the fund. The lack of protection for depositors is an urgent matter and the process of adopting a deposit insurance scheme should be completed to improve financial stability, confidence in these institutions, and financial inclusion.

Financial inclusion requires a very strong savings and credit cooperatives sector capable of providing adequate financial services to the unbanked (mainly low income populations) within a regulatory environment that allows safeguarding of public savings. Despite the strengthening measures already adopted through the new resolutions emitted by INCOOP, there are a number of measures remaining that would support a stronger legal framework governing cooperatives. A stronger cooperative framework is not only important for financial stability purposes but, also to promote responsible financial inclusion. This is particularly prominent given the important role cooperatives play in Paraguay's financial inclusion efforts, for they concentrate a significant number of members, 1,390,113, while banks have only 993,411 savings accounts. Cooperatives also have the lowest average balance in savings accounts (US$1,153 versus US$13,627 in banks)[30].

Financial activities by cooperatives should be supervised and regulated under a specialized framework and prior authorization should be required for deposit–taking activities which would be aligned with the Basel Committee on Banking Supervision's Principles [31] . The regulatory framework contained in Resolution 11,102 of November 19, 2013 and its modifications was prepared with the support of the World Council of Credit Unions (WOCCU) and the Inter-American Development Bank (IADB). Although it is a very important step towards aligning the supervision framework with the Basel Principles, it is important to point out that specialized financial activities should be performed by single-purpose institutions so cooperatives performing financial operations should be specialized and specific authorization should be required for the ability to accept deposits from its members. As multipurpose activities are prevalent in Paraguay, ideally non-financial activities should be performed through a subsidiary or holding company structure providing effective separation of accounting systems and financial statements. Efforts such as these would help streamline financial supervision and regulatory measures in order to promote a better, stronger and agile cooperative sector. There is a view that changing to a specialized supervision and regulatory process of INCOOP would be contrary to the National Constitution, Article 113 and the Cooperative Law which states that cooperatives need to fulfill an economic, social and cultural role. It is important to note, the National Constitutional definition does not necessarily imply that the fulfillment of cooperatives' role as financial intermediaries cannot be carried out by single-purpose cooperatives. Rather, specialization of regulation and supervision will help protect the financial health of the savings and credit cooperative sector in Paraguay. Furthermore, the important advances already made by Paraguay in setting the regulatory framework for the savings and credit cooperatives proves the decision of the cooperative authorities to protect and strengthen these financial intermediaries. The continuation of this strengthening process would greatly benefit from a full financial specialization requirement.

Despite the important advances, the cooperatives regulatory framework still remains lenient on risk management operating in Paraguay. As pointed out by the Basel Committee for Banking Supervision, the

[30] Supply Side Technical Note: Paraguay National Strategy for Financial Inclusion project. The World Bank, 2014.
[31] BIS. See Microfinance Activities and the Core Principles for Effective Banking Supervision

cooperative structure entails an inherent conflict of interest because the *owners are also borrowers and depositors*, which can result in "poor credit underwriting and management, inappropriate loans to related parties and frauds"[32]. Although mechanisms to prevent conflicts of interest have already been included in the regulatory framework in Paraguay, more specific provisions should be included to harmonize capital adequacy rules as well as limits to level the regulatory field with that of the rest of the financial sector. This is important to ensure at a minimum that savings and credit cooperatives are providing financial services that are prudentially regulated and supervised by a financial sector regulator.

Despite the requirement for registration with INCOOP, the lack of prior authorization for cooperatives to start operations, leaves little control over how cooperatives start providing financial services to the population. The current regulation which requires that cooperatives only register with INCOOP by informing them of the formation of the required committees that lead to the creation of the cooperative and does not require previous authorization, has led to difficulties in controlling and monitoring the number of cooperatives performing financial operations. The regulatory framework also sets the mechanisms to close cooperatives by which INCOOP has to issue a resolution cancelling the legal entity after being informed by the cooperative of the closing of operations. Despite this requirement, in practice, the cooperatives do not always inform INCOOP of this process. Thus, after two years of the cooperative not sending any information to INCOOP, it proceeds to eliminate the legal entity. These soft procedures make it difficult for INCOOP to have a complete picture of the cooperatives operating in the market.[33] Given the importance the cooperative sector plays in Paraguay and the role it can play to improve financial inclusion, further assessments of their regulatory framework should be performed building upon the already important process of regulatory strengthening.

The two different regulatory and supervisory frameworks between the banks and finance companies and the cooperatives have left financial institutions offering similar financial services to the public under varying degrees of regulations. In Paraguay, this has resulted in regulations adapted to the type of provider instead of to the type of financial operation (see Table 8). Thus, both types of institutions –both banks/finance companies and cooperatives- can be providing similar financial services to the public, such as deposit-taking or credit and loan services, under a different set of rules that affect product pricing and risk control management and could lead to inefficient allocation of credit. For example, regulatory requirements such as minimum capital requirements and capital adequacy affect the cost of providing financial services in exchange for a more reliable safeguarding framework protecting public savings; likewise, for the necessity to have risk control measures such as deposit insurance. Also important is the need for prior authorization and licensing for savings and credit cooperatives to prevent the risk of having unlicensed cooperatives mobilizing deposits without the minimum institutional, operational and financial strength. This has been a challenged faced by other countries in LAC. For example, in Colombia during the 1990s, the regulatory body began to define entry requirements and prudential regulation on savings and credit cooperatives.

[32] See BCBS, Microfinance Activities and the Core Principles for Effective Banking Supervision

[33] Sufficient supply-side information is lacking for the smaller cooperatives, for only Type A cooperatives have to send monthly financial statements to INCOOP.

Table 8. Some regulatory differences between banks/finance companies and cooperatives

	Banks and finance companies	Savings and Credit Cooperatives
Type of regulation and supervision	Specialized regulation and supervision	Specialized regulation but non-specialized supervision
Organizational format	Corporations (stock company). Single purpose	Membership-based cooperative Multipurpose
Financial activities (summary)	Performing financial activities: taking deposits to grant loans or invest. Services directed to eligible clients.	Performing financial activities: taking deposits to grant loans or invest. Only members
Licensing. Prior authorization	Required	Not required[34]
Minimum capital requirement	Banks: US$ 8.8 million Finance companies: US$ 4.4 million	Not required
Capital adequacy: Minimum effective capital versus Risk weighted assets	12%. Capital is required to be at least 12% of risk weighted assets.	**Type A (assets over US$11 million):** liquid equity[35] is required to be at least 10% of risk-weighted assets**.**
		Type B (assets between US$1 million to US$11 million): liquid equity is required to be at least 15% of risk-weighted assets
		Type C(assets under US$1 million): liquid equity is required to be at 20% to 30% of risk-weighted assets
Deposit Insurance	Up to US$30,000 per client	Not yet in place
Minimum liquidity reserve requirements	18% of liabilities	10% of deposits

Source: Based on Laws and resolutions issued by BCP and INCOOP.

[34] Although the legal status has to be granted by INCOOP, the prior authorization concept refers to the fact that they can start performing operations without requiring any authorization from INCOOP.
[35] This refers to the concept of liquid equity (in Spanish *patrimonio efectivo*). The institutions have to have to pay public liabilities in the case of asset quality deterioration.

D. PENSIONS

The pension system has a fragmented legal framework formulated by 8 pension funds regulated by their own individual laws. Initial regulations date from 1902, when the public employee pension scheme was established. The public employee pension scheme is called the *Caja Fiscal* and is operated by the Ministry of Finance. In 1943, the Social Security Institute (Instituto de Prevision Social-IPS) was created by Decree-Law 1807 to have a pension scheme for the private sector employees. Between 1924 and 2006, six other funds have been created (by law) to cover specific groups of employees as shown in Table 9. Pension contributions to these 8 different funds are mandatory for the employees of each of the institutions covered by them, as mentioned in each of the laws governing them.

The 8 regulated pension funds are overseen by the Ministry of Finance, however there is an absence of a financial regulator actively supervising the financial and operational side of the pension funds. The *Caja de Pensiones de Empleados Bancarios* is the only fund under SIB supervision. As explained by BCP, these *Cajas* are governed by their own Organic Laws that include attributions to some supervisor or control organization.

The reforms to the pension system currently in progress should consider mechanisms to widen the participation of the schemes while balancing the fact that many workers in Paraguay are prevented from participating due to the high level of work informality. From the financial inclusion perspective, it is important that these reforms include the promotion of long-term saving products for all the population, avoiding biases against informal workers. The current way in which the pension schemes are designed requires pension participants to be part of the formal salaried sector.

Table 9. Legal basis for regulated pension schemes

Institution	Regulation	Mandate	Financial supervision
Instituto de Previsión Social- IPS	Decree- Law 1,807 of 1943 Decree – Law 1,860 of 1950 Law 4,933 of 2013	Pension fund for salary workers. It also includes employees from decentralized state entities and joint ventures. With law 4933 from 2013, independent workers, employers, housewives and domestic workers can voluntarily contribute to the IPS pension scheme.	To be defined in process of pension reform
Fondo de Jubilaciones y Pensiones del Ministerio de Hacienda- Caja Fiscal	Law of public employee pension 1,902 Law 2,345 of 2003	Pension fund for the public sector employees. It was reformed in 2003.	To be defined in process of pension reform
Caja de Jubilaciones y Pensiones del Personal Municipal	Law 122 of 1993 Law 2,102 of 2003	Pension fund mandatory for employees of municipalities, of this fund and its board members. Voluntary beneficiaries are mentioned in the law.	To be defined in process of pension reform
Caja de Jubilaciones y Pensiones de Empleados Bancarios	Law 105 of 1951 Law 2,856 of 2006 Law 4,773 of 2012	Pension fund for the bank sector workers. It was reformed in 2006 and in 2012. Finance companies can be included in this pension fund as expressed by law 4,773/12.	SIB
Caja de Jubilaciones y Pensiones del Personal de la Administración Nacional de Electricidad (ANDE)	Law 71 of 1968 Law 1,042 of 1983 Law 1,300 of 1987	Pension fund mandatory for employees of ANDE and of this fund. Voluntary beneficiaries are mentioned in the law.	To be defined in process of pension reform
Caja de Jubilaciones y Pensiones del Personal de la Itaipú Binacional	Law 1,361 of 1988	Pension fund mandatory for employees of ITAIPU and of this fund. Voluntary beneficiaries are mentioned in the law.	To be defined in process of pension reform
Caja de Jubilaciones y	Law 641 of 1924	Pension fund for workers of	To be defined in process

Pensiones de Empleados y Obreros Ferroviarios	Decree 1,550 of 1940 Law 238 of 1954	railway companies and of this fund.	of pension reform
Fondo de Jubilaciones y Pensiones para miembros del Poder Legislativo de la Nación.	Law 842 of 1980 Law 2,857of 2006	Pension fund mandatory for congress members.	To be defined in process of pension reform

E. CAPITAL MARKETS

The capital market in Paraguay is based on a comprehensive regulatory framework set by Law 1284/1998 aimed at regulating the stock and securities markets. This Law orders the supervision and regulation of the market under the Securities Commission (*Comisión Nacional de Valores*-CNV) that is related to the Executive Power through the Ministry of Industry and Commerce. The CNV regulates the public securities market, issuers, the stock exchange, brokers and all participants in the stock market. Capital market activities are reserved for the subjects authorized, and public stock or securities offers are defined by the law and require previous authorization from CNV. The CNV is in charge of the public registry containing all public offers, all issuers (can be S.A. but also others authorized by CNV), stock exchanges, brokers external audits, rating agencies, and securitization companies.

From the basic financial inclusion perspective, the capital markets regulation is neutral. Current regulations do not hinder financial inclusion efforts though it is important to note that capital market products are out of the reach for the majority of the under and unbanked Paraguayans at this stage. However, as the financial market grows and deepens, considerations may be given to have both short and long-term financing options, which is one benefit of capital market participation.

F. EMPES: E- PAYMENT PROVIDERS

BCP recently issued an electronic payments resolution; thereby introducing a new regulated classification of financial service provider called E-Payment Providers (*Entidades de Medios de Pago Electronicos* -EMPES). Based on the Payments System Law 4595 of May 16, 2012 and Article 45 of BCP Organic Law 489, 1995, which regulate the payments and securities settlements in Paraguay, a resolution was passed on March 13, 2014 to regulate the electronic means of payment. The e-payments regulation states that e-payments are new financial operations that include e-money and non-bank e-transfers that are allowed by EMPEs, banks and finance companies. Table 10 summarizes the legal basis for e-payments in Paraguay.

Table 10. Regulations for e-payments

Law / regulation	Description
Law 489, of June 29,1995	Central Bank of Paraguay Organic Law (BCP)
Law 4,595 of May 16, 2012	Regulates the payment system and securities settlement
Resolution 6, Act 18, of March 13, 2014	Regulates electronic means of payments

The introduction of this regulation has legally defined a new financial operation that is different from traditional deposits. E-payments operations can be provided by an authorized legal person whose sole objective is to process, administer and/or provide services related to electronic payments through telecommunication services. They are referred to as EMPES. Authorization by BCP is necessary to operate e-money in Paraguay. The e-money regulation does not permit financial intermediation and does not allow the accrual of interest.

The regulation states that minimum entry requirements include a prior authorization by BCP for EMPES to operate but operational minimum capital requirements and capital updating are lacking while the existent fund protection mechanisms need to be refined. BCP stated that no operational minimum capital requirements were included because the regulation does not create a new license for a financial institution but rather classifies a type of financial service provider. BCP explained that e-payment providers are service companies, thus, no minimum capital requirements as well as no capital updating was defined in the regulation. Only in the case where a new financial institution is created does that necessitate the need for a new law and further requirements.

The EMPES regulation states the required technological and operational specifications needed prior to the start of operations. The technical requirements state: the operation of a platform that guarantees transactions must be made online and in real time, together with the quality, security and continuity of the services. EMPES must establish effective permanent control mechanisms and keep balances and net movements updated in real time for each client. Other rules include that the credit transfer of funds to the trust fund must be done by the end of each workday. For holidays, the transfer to the fund must occur on the following workday. Interests on trust deposits could be used to cover present and future costs and expenses related to the trust fund management.

There is a general statement [36] that instructs EMPES to comply with all regulations issued by BCP regarding interoperability, clearing and settlement of e-payments with the wider Automated Transfer System (ATS)[37] operated by the BCP. Interoperability of the system is key to determining the usage levels of e-money products among the population. However, it is important to recognize that the starting point of e-payment models can be jeopardized from reaching the breakeven point by prematurely enforcing interoperability with the ATS. This is an issue that is being carefully considered by the BCP together with CONATEL (telecommunications regulator). They are starting discussions and exploring solutions that are already in operation in other countries.

The new EMPES regulation was issued to address the control of e-payments already occurring in the market without regulation. Therefore, the current entities already providing e-wallets are required to transition as a new payment service provider (an EMPE) by creating a separate company. Three years ago Tigo, a telecommunications company, started offering a mobile wallet model. Tigo is a non-bank institution offering a payments product; thereby it is not subject to financial regulation. BCP then introduced the concept of e-payments within the broader regulation of the payments system under the Payments System Law (Law 4595/12). Attributions in this Law allowed the BCP to regulate the existing e-wallets. Until 2014, the two main telecommunications companies had been operating wallets and money orders on the mobile platform. One of these companies, Personal, was working in conjunction with a bank while the other, Tigo, was operating without a bank. As a mechanism to protect funds, money had to be kept in a trust fund before charging the wallets. From BCP's point of view, financial intermediation was not occurring as defined by the banking law in Paraguay[38]. With the new regulation it would require both Tigo and Personal to request permission from BCP with a deadline date of June 13th 2014 as they were both operating an e-wallet prior to this regulation. An extension of this deadline was requested by both providers. If Tigo and Personal are separated into two companies – telecommunications company and an EMPE - a contract binding their agreement to provide telecommunication services must be delivered together with the rest of the authorization requirements as an EMPE. BCP pointed out that those providing non-bank electronic transfers must also abide by this regulation regarding electronic transfers.

Despite BCP's efforts to regulate the e-payments occurring in the market[39], the new regulation still remains insufficient in certain areas. Even with the new regulation, it is important to consider introducing a minimum level of capital required to enter the e-payments sector. Also, no requirements were defined in the regulation to keep original capital up-to-date as e-money operations increase**.** This is important given the growing importance of this service. However, according to BCP, considering this option, the requirements would have to be introduced by law according to the traditional legal practice in Paraguay set by the Financial Sector Law and the Insurance Law that define minimum capital requirements and capital adequacy. Such requirements would deter entities from requesting authorization without the sound financial and operational requirements as well as minimum technological investments for entering into the market. As shown in Table 11, other countries in LAC with e-money regulation have also introduced capital adequacy requirements and protection mechanisms for this type of service.

[36] Art 11, Resolution 4, 2014 says: "The EMPE must comply with interoperability standards. clearing and settlement determined by the Central Bank of Paraguay through resolutions of a general nature."

[37] The ATS is the RGTS and ACH payments system operated by the BCP to clear and settle all payments made by banks and finance companies.

[38] AFI, Regulatory Approaches to Mobile Financial Services in Latin America, April 2014.

[39] Further discussion on this regulation is included in Section 4, Sub-section B.

Table 11. E-payment provider's regulation in other LAC countries.

	Paraguay	Bolivia	Colombia	México	Perú
Providers	EMPEs, banks and finance companies	Mobile Payment Service Company	Banks and Specialized Companies in Electronic Deposits	Specialized banks	E-Money Issuers
Minimum capital requirement (A)	Not required	US$ 752,000	US$ 3 Mill.	US$ 14 Mill.	US$ 806,000
Min. capital requirements (B)	Banks: US$8.8 Mill. Finance comp: US$ 4.4 Mill	Banks: US$8 Mill. Banks PYME: US$ 5 Mill.	Banks: US$40 Mill.	Banks Level I: US$ 34 Mill.	Banks: US$ 8.9 Mill
A/B	N.A.	9%	8%	40%	9%
Capital adequacy	Not required	Not required	Required according to future regulation	Same regulation for banks proportional to activities performed.	Effective capital not under 2% of e-money issued.
Protection mechanism	At least 100% to trust funds	Trust fund. Banks: 100% in Central Bank	100% deposit in banks Deposit insurance	Deposit insurance. Invested in liquid assets	Trust fund. Applies to all financial institutions with e-money operations

Source: based on AFI, Regulatory Approaches to Mobile Financial Services in Latin America, 2014. Includes final definitions for Colombia included in Law 1735, 2014 issued in October 21, 2014.

Other regulatory shortcomings include the fact that specific rules applied to e-payment operations are not clearly applicable to all possible providers. Resolution 6, 2014 Act 18, of March 13, 2014 from BCP does not address the way e-payment operations should be treated when performed by banks or finance companies. Thus, depending on whether the banks, finance companies or EMPES provide the financial service, the e-money funds can be intermediated and accrue interest. This is due to the fact that the current regulation is designed based on the provider performing the service rather than on the financial service itself. Other countries have addressed the issue differently by setting the same requirements for the operation regardless of the type of institution providing the service. For example, in Peru, both banks and other financial institutions providing the service are also required to keep the funds in a trust fund held by another financial institution[40].

Although Paraguay's regulation has a fund protection measure for the e-payment funds, the regulation still lacks a pass-through mechanism for the trust's money deposited in bank accounts. According to Resolution 6, Act 18, of March 13, 2014 from BCP, 100% of the total amount of each client, agent or point of sale´s funds must be kept in several trust funds. Balances must be individualized so that each client's balance can be identified properly and the sole beneficiaries of these trust funds are the clients, agents or points of sale. In the case of agents or points of sale, it is assumed they will work under prepaid agreements with EMPES. This means that agents and point of sale agents will "buy" a line of credit from the EMPE that will be used for withdrawals and deposits from clients. Before the credit lines are utilized, they are liabilities that the EMPE owes to the agent or point of sale agents and as such should have the same protection as funds deposited by clients. According to the current regulation, funds are protected by being deposited into a trust separate from the financial institution managing the trust. However, in practice, the trust will most likely deposit the funds in another financial institution as an institutional lump-sum deposit versus individual deposits. For example, Bank A has its e-payment funds deposited into a trust. This protects the e-payment funds from Bank A's financial troubles. Subsequently, the trust will most likely deposit the funds into another bank, Bank B, as a lump-sum institutional deposit by the trust. At this point, funds are deposited into Bank B as any other deposit. If Bank B goes bankrupt, there is not a pass-through mechanism protecting the individual deposits; that would allow the bank's deposit insurance to cover each one of the individual deposits included in the trust whose money is deposited in a bank account. Nonetheless, in this event, insurance will only cover one individual deposit up to US$30,000. This leaves

[40] Law 29985, 2012.Resolution 6283, 2013, SBS. Peru

the e-payment funds stored in banks, vulnerable to losses and could potentially affect depositors if a bank becomes bankrupt. Future measures to ensure protection of e-payment funds should include the design of a broader fund protection mechanism for e-payments where trusts must be held in several banks or finance companies and a pass-through mechanism has to be introduced for the deposit insurance to recognize individualized accounts within one deposit.

Despite these remaining regulatory challenges, the new EMPES regulation has eased the way for the development of e-money issuers to support wider financial inclusion efforts in Paraguay. According to Resolution 6 from BCP, the main driver to design a legal framework for e-payments (e-money and non-bank electronic transfers) is its importance for increasing financial inclusion. As such, e-payments mechanisms are considered an entry point to a broader range of financial services for the entire population, particularly the un/under-served financial clients in Paraguay.

G. CONCLUSION

From the financial inclusion perspective, the financial service providers in Paraguay are providing similar financial services with varying degrees of regulations, resulting in constraints for access to financial services. Overall in Paraguay, financial regulation is determined according to the financial service provider and not based on the financial service/product provided to the market. The financial regulatory framework governing the commercial banks, finance companies, EMPES and insurance companies refers only to those under BCP's regulation and supervision by SIB and SIS. For SIB, there is a strict interpretation that regulation and supervision is limited to those institutions providing financial intermediation. Savings and credit cooperatives are governed by a different set of financial rules derived from the general cooperative regulatory framework. For example, minimum capital adequacy is applied differently to banks and finance companies from cooperatives. Savings and credit cooperatives are allowed to perform basically the same activities as finance companies but do not have minimum capital requirements nor the need for prior authorization to operate in the market. In general, the regulations applied to savings and credit cooperatives are not as stringent compared to bank and finance companies. Cooperatives have lenient requirement regarding market entry barriers, capital adequacy, and specialization of operations and deposit insurance. Such legal differences influence credit risk policies, the efficient rationing of credit allocations and pricing of credit offered to the market as well as access to its services and potential market outreach of its services and products. In Paraguay, these legal framework differences have resulted in some financial services being offered outside the scope of the financial regulations and supervision; particularly regarding the enforcement of non-prudential regulations such as transparency and credit information reporting.

The adoption of an EMPES regulation is an important step towards promoting financial inclusion in Paraguay; however, refinement of the regulation could better safeguard the provisioning of this service. The lack of minimum capital and capital adequacy requirements for e-payment providers may allow market players to enter the market with minimum technological investments and a minimum capital base that supports e-money operations. With minimum investments and safeguards of the service, it could potentially jeopardize the concept of e-payments and thereby diminish the public's trust of such financial services. Furthermore, fund protection mechanisms normally designed through regulations that consider separating e-money funds into a trust fund via pass-through mechanisms is currently absent in Paraguay. These pass through mechanisms are to ensure the protection of the trust funds deposits in the event of a business' liquidation. The inclusion of such provisions in the regulation would allow the provision of e-money products under a better regulatory environment both for the providers and the general public utilizing this financial service.

Capital markets regulation is neutral from the basic financial inclusion perspective, but promotion of long-term savings products for low income population will relay on the pension system reform in progress. It is important to note that capital market products are out of the reach for the majority of the under and unbanked Paraguayans at this stage. However, in the future as financial inclusion of low-income population deepens, capital markets may be an important source of long term savings products for the entire population.

3. Partially Regulated or Non-Regulated financial service providers in Paraguay

Currently, there are a number of partially and non-regulated financial services being offered in Paraguay. This section will describe these financial service providers operating in the market.

A. PAWN SHOPS

Pawnshops are regulated in Paraguay by Law 2,283 of November 10, 2003 and are not under the supervision of any financial regulatory body but rather under the local municipality's control. The law defines a minimum capital requirement of US$20,000 for pawnshops to start operations and establishes that these entities have to comply with requirements set by the Ministry of Finance and the local municipality. In practice, the municipality's control over pawnshops seems to rely only on the commercial license process rather than on the compliance and supervision of their operations. The Law also defines important aspects such as the setting of interest rates by pawnshops in relation with the maximum interest rate defined by BCP. The pawnshop's interest rates must abide by the maximum interest rate according to the usury regulation included in Law 489, of June 29 1994, the Organic Law of BCP. However, pawnshops can charge in addition to the interest rate the appraisal costs and expenses, costs related to conservation, maintenance and the safe keeping of pledged goods. The costs related to conservation, maintenance and keeping of the pledged goods cannot be over 50% of the total interest rate.

The Law defines the set of consumer protection requirements that the pawnshops should follow. Among these, pawnshops are required to give the client a contract clearly stating the terms and conditions of the pledge and providing full identification of the client and the pawnshop. They are required to provide receipts of payment operations, allow pre-payments at any time, formally cancel the obligation and return the pledge to the client. Identification of the client requires a photocopy of the national ID. Pledges not claimed within the defined term, are to be auctioned off through a public auctioneer chosen by the pawnshop. The pledge has to be published in the newspaper three times during a period of not more than 5 days.

B. CAJAS MUTUALES

Cajas Mutuales are regulated by Law 3,472 of 2009 but supervision has not been implemented. *Cajas mutuales* are similar to a cooperative in that they provide services to members, but the capital is owned by the institution and not by the members. In Paraguay, the Law defines them as types of associations to provide pension, health, education and other services financed by the contributions of its members. The majority of *Cajas mutuales* focus on pensions. These schemes are offered by the private sector and are optional to join. Even though a supervisory body was included in the Law of 2009 it has not yet been implemented.

C. NON- REGULATED PROVIDERS

In Paraguay, there are a number of non-regulated, non-supervised financial services providers operating in the market; these are considered semi-formal for they are registered and have a commercial license but are not financially supervised. Despite the fact that the laws and regulations state that financial and insurance activities are under the State's supervision, some financial providers are able to provide a number of financial services to the general public without any regulation or supervision. There are a number of different entities in Paraguay that operate financial services and work with the public without financial regulation, supervision or oversight. This group of entities include: non-profit MFIs/NGOs, *casas de credito, casas comerciales*, and international and domestic money transfer service providers and payment processing companies. There are also insurance products that are under the oversight of a public authority (i.e Ministry of Health) but the financial aspect of their operations are not being supervised. This is the case of the pre-paid medicine companies –*medicina prepaga*- operating in Paraguay. *Medicina prepaga* is a private health insurance scheme offered to the public. The Superintendency of Health oversees the quality of health services offered to the market but does not have the specialized skill set to focus on the actuarial aspects of the health insurance product. Thus, the financial insurance aspect of it is not overseen by any specialized financial regulatory body (Table 12).

Table 12. Non-regulated, non-supervised financial services offered in Paraguay

Provider	Description
Non-profit MFIs/NGOs	Non-profit organizations or foundations that collect donations to grant loans.
Casas de credito	Companies that do not take public deposits, but lend to the public with its proprietary funds.
Casas comerciales	Stores that sell goods and services using credit.
Medicina prepaga	Type of health scheme by which people pay a premium to cover for future health issues. This is a typical case of an operation very similar to insurance for a premium is paid to cover a risk that may or may not happen. The Superintendence of Health monitors the quality of health services offered to the public, but not the financial aspect of offering an insurance product.
Prepaid funeral schemes	This scheme is set as an advanced payment for a funeral that may occur or not within the term of the contract. Also similar to insurance, for it is designed to cover a risk and if the event doesn't occur within the term of the contract, money is not returned.
Payment service providers	Provide payment collection services. They have to comply with AML rules set by SEPRELAD in Resolution 218 of 2011.
Remittances providers	Receive and send international remittances without any specific regulation. They have to comply with AML rules set by SEPRELAD in Resolution 333 of December 27, 2010.

Regulations define SIB's supervisory powers over entities that conduct the complete cycle of financial intermediation and within this group, financial entities authorized to take deposits. SIB and SIS supervision scope is limited to banks, finance companies and insurance companies. For example, granting loans using proprietary funds in the case of *casa de creditos* are excluded from prudential regulation and supervision due to BCP's law which states that regulation and supervision are for financial entities conducting the entire financial intermediation process from deposit to lending or investment of its funds. This same principle is applied to all non-regulated, non-supervised financial services providers mentioned in Table 12. Due to the fact that they do not take public deposits and do not conduct a complete cycle of financial intermediation, they fall outside of regulatory or supervision scope of BCP and/ or any other regulatory bodies.

The application of non-prudential regulations in the areas such as the usury regulation, general business conduct, credit information circulation and transparency standards are absent from an enforcement body. The exception to this is the AML/CFT regulations by SEPRELAD and the consumer protection issues by SEDECO which apply to all financial service providers operating in Paraguay. As for the other issues such as usury regulation, credit information circulation and transparency norms, there is absence of an enforcement body for all entities that provide financial services in the Paraguayan market. For example, if a credit provider does not respect the usury limit there are no clear attributions to stop the non-compliant behavior (a formal complaint must be filed in a civil court on case-by-case basis). So despite the fact that the usury limits apply to *all* credit operations as it is part of BCP's general attributions over the economy and the monetary authority, the enforcement only occurs over those supervised by BCP, for no-one else is explicitly empowered to enforce the usury limits over those non- deposit-taking institutions (see Section 4, subsection C). The result is that only the regulated institutions have enforcement to comply with the usury law. This situation defeats the very purpose of defining a usury limit, which is intended to protect the public from abusive behaviors from the non-supervised agents.

Some financial insurance products are also left in a financial supervision vacuum. The Insurance Law is precise in defining the characteristics of an insurance product. However, the narrow scope of supervision of the SIS has not been able to prevent the development of initiatives outside the insurance sector. This is evident through the pre-paid funeral or medicine schemes operating in the market without SIS supervision. An attempt for SIS to regulate the financial aspects of the pre-paid medicine market was made in 1999, but it was legally challenged and suspended leaving the discussion open until today.

Overall, the absence of a regulatory framework governing certain financial products that might be highly utilized by low income segments of the population is a risky and potentially detrimental situation for financial consumers and the sector as a whole. This is particularly true in populations with lower financial literacy levels and awareness. Though this situation has allowed the development of market innovations that have turned out to be important for financial inclusion like mobile wallets, the lack of specific rules on lending by non-supervised by BCP poses a challenge to contain initiatives that could put consumers at risk and could ultimately pose financial sector challenges should their activities level increase in these areas. For example, the absence of monitoring could also be encouraging consumer over-indebtedness as lenient credit risk assessments may contribute to excessive credit to the same clients. In summary, the best way to deter such practices would be to define clear and specific standards or norms on non-prudential issues such as transparency, general business conduct, and credit information reporting for *all* lenders but limiting

prudential regulation to all deposit-taking activities alone or together with the whole intermediation process.

There are two main areas of improvement that would address the current regulatory gaps under which the non-regulated financial entities are operating: 1) ensuring that non-prudential regulations are being enforced to *all* financial entities operating in the market and 2) standardize financial regulations applicable according to the financial service being provided and not designed according to the financial entity offering the service; proportionality of regulations must also be maintained.

i) An enforcement agent, regarding non-prudential matters such as the usury limit, credit information circulation, general business conduct to all financial entities operating in Paraguay should be developed. Currently, prudential regulations are applied to deposit-taking institutions. Non-prudential regulations, with the exception of the AML-CFT and consumer protection enforcement bodies, SEPRELAD and SEDECO, are not applied to those financial entities that are outside of BCP's oversight scope. Thus, despite a number of financial entities operating in the market, there is absence of an enforcement body for non-prudential norms for the general financial sector in Paraguay. Furthermore, the non-regulated financial entities should be monitored for activities that would place consumers at risk and/or could ultimately pose financial sector challenges should their activities level increase in these areas.

ii) Similar to the difference mention in the aforementioned section between banks/finance companies and cooperatives, it is important to note that these recommendations refer to the regulated financial institutions, insurance companies and cooperatives providing financial services. In the case of the financial sector, this would imply that all deposit taking institutions should be subject to similar regulation and supervision but proportional to the risks and outreach of its respective operations as institutions conducting only financial intermediation. For example in the case of e-money operations, they typically[41] do not entail lending thus have less minimum capital requirements because they are not subject to credit risk. They also have different capital adequacy rules considering the amount of funds received as opposed to the required level of risk-weighted assets that is often required by banks. Within the insurance sector, the SIS, should supervise all technical and financial aspects of those providing insurance products whether they are insurance companies or other companies allowed to provide insurance products (for example, *Medicina Prepaga* companies). An example of the said concept – the equal application of regulations centered upon the financial service and not based on the provider of the financial service– is evident in the case of Peru's e-money regulation. In Peru, under the principle that e-money cannot be intermediated neither by banks nor by EEDES (*Empresas Emisoras de Dinero* Electrónico in Spanish). The regulatory framework should be proportionate to the type and size of their operations. In doing so, it would level the playing field by removing potential biases that may be introducing artificial distortions into the market in product pricing and credit risk management. The suggested recommendation is aligned with the international standards in this area – the Basel Core Principles.[42]

D. CONCLUSION

The scope of regulated financial activities refers to the *complete* cycle of financial intermediation; as a result, several financial service providers are operating in Paraguay under minimal regulation and supervision and the enforcement of non-prudential regulations is absent. It is defined as regular deposit taking in any form that entails repayment of obligations, to provide credit or investments regardless of the legal form or denomination used by the companies or subjects developing these activities. The narrow definition of financial intermediation activities in Paraguay has limited the scope of both the regulation and supervision by BCP over deposit-taking institutions. The Financial Sector Law (861/1996) states that BCP's scope of supervision authority is only in relation to institutions conducting financial intermediation as defined by the same law (in short, taking deposits to grant loans).Thus, when financial entities enter the market conducting just a part of these activities such as only taking deposits BCP's supervision powers are restricted and would not apply to those market players. As a result, non-regulated providers that perform one part of financial activity but not the whole intermediation process are operating in

[41] This is the case of almost all e-money regulatory frameworks in LAC except for Colombia and Mexico. In these two cases e-money or electronic deposits are operations allowed only to deposit taking institutions that perform financial intermediation activities.

42 As the Basel Core Principles tailored approach suggest, both Principle 2 (Permissible activities) and Principle 3 (Licensing criteria), should be applied to financial institutions in proportion to type and size of their operations. These operations include also insurance activities that should be clearly defined in laws or regulations and tied to the size of the institution and its ability to manage risks inherent with such products and clients. "Permission to engage in sophisticated activities should be substantiated by management's experience and ability to identify, control and mitigate more complex risks. Also, the supervisory or licensing authority should maintain and publish a current list of licensed/supervised ODTIs, and remain alert to and have the authority to deal with the illicit provision of financial services." (Microfinance activities and the Core Principles for Effective Banking Supervision, Basel Committee for Banking Supervision, 2010.)

Paraguay with minimal or little monitoring, including the application of non-prudential regulations. For example, financial service providers that mainly focus on providing credit include: microcredit MFIs/NGOs, *casas de crédito*, and *casas comerciales*.

Although the regulatory framework in Paraguay applies to all those performing financial activities and providing insurance, in practice financial supervision only reaches those institutions specifically authorized to perform financial activities leaving regulatory gaps. The legal financial framework sets the financial sector's structure by defining the different types of institutions allowed to perform financial activities but falls short in clearly defining the regulatory consequences for those providing financial services without being any of the institutions specifically defined in the legal framework. For example, insurance schemes are being provided by pre-paid medicine companies and prepaid funeral companies in which the financial service aspect is not being regulated or supervision by any financial authority. Likewise, payments and transfers are also being provided by payment service providers and remittances providers that are apart from the regulated financial institutions. There are also pawn shops and *cajas mutuales* which have regulation but are not under supervision.

4. Products for financial inclusion

This section will focus on the regulation of financial products available in Paraguay and the role of the current regulation on financial inclusion. As pointed out in Sections 1, 2 and 3, regulation and supervision on financial products in Paraguay is uneven for it is designed based on the type of financial provider rather than on the financial product. This section describes the regulation or lack of regulation that sets the framework for the main financial products provided in the market and relevant to financial inclusion: deposits, payments, loans and insurance.

A. DEPOSITS

Deposit-taking is only allowed by financial institutions – banks and finance companies- (Financial Sector Law 861 of 1996) and the cooperatives. Banks and finance companies can accept deposits in local and foreign currency, while banks are the only ones allowed to provide current accounts. Both of these institutions can also issue bonds and securities. In the case of cooperatives, Resolution 11,102 of November 19, 2013 issued by INCOOP allows taking demand deposits (savings accounts) only from their members and other cooperatives. Financial regulation specific to deposits is very general allowing each financial institution to design and develop different products tailored to their target market.

Deposits taken by banks and finance companies are covered by the deposit insurance fund while savings taken by cooperatives are not yet covered by any deposit insurance. The deposit insurance for banks and finance companies was defined by Law 2,334 of 2003 and by Resolution 10, Act 75 of August 23 of 2004 from BCP to partially protect public savings deposited in the institutions under the supervision of SIB operating within the national financial system (Table 13). This guarantee covers all liabilities up to 75 monthly minimum wages [43] - US$30,000 per person per financial institution. As mentioned in Section 2, in the case of cooperatives' savings, INCOOP is working to establish a deposit insurance scheme covering the cooperatives that register in the fund. This is being completed with the technical assistance of the DGRV**.** However, it is important to note that before creating deposit insurance for cooperatives, cooperatives should be required to meet prudential norms, and be prudentially supervised to avoid creating moral hazard.

[43] Monthly minimum wage, starting from March 2014, was set at Gs. 1,824,055, US$ 405

Table 13. Basic regulation for deposit insurance for banks and finance companies.

Regulation	Description
Law 2,334 of 2003	Defines the general regime for the deposit insurance guarantee for those institutions governed by the Financial Sector Law (Law 861 of 1996)
Resolution 10, Act 75 of August 23 of 2004, BCP	Sets rules for the deposit insurance

From the regulation point of view, there are no legal thresholds that limit financial inclusion for general deposits other than those general rules defined for the purposes of Money Laundering (ML) risk prevention by the Paraguayan Anti-Money Laundering Authority (SEPRELAD, Spanish Acronym). The results from Paraguay Financial Inclusion Survey 2013 noted that most people reported lack of money as the most important barrier for not having saving accounts. From the regulatory point of view, this could imply that the minimum deposit or balance requirements of traditional saving products are too high as a result of high costs to comply with the regulation that require the providers to charge high commissions and/or require high minimum balances or high minimum deposits to recuperate costs induced by regulation compliance. Usually, this type of cost is fixed and relatively high for financial products of low amounts. However, it is important to point out that regulation does not include this kind of requirements for traditional saving products. However, the associated regulations causing this could be the general requirements for client due diligence (CDD) applied to banks and finance companies affecting account opening and thus limiting access to financial products especially for those whose economic activities are informal or lack the specific documentation detailed in Table 27.These rules are applied differently in the case of cooperatives. This will be further described in detail in Section 5.

BASIC SAVINGS ACCOUNTS BY BANKS AND FINANCE COMPANIES

BCP issued a basic account regulation in 2013 - Resolution 25, Act 51 of July 18, 2013 from BCP - reducing CDD costs for financial institutions and access barriers for the clients. The basic bank account is a savings account that permits deposits and a limited number of free withdrawals. It is an account designed with simplified, minimum opening requirements and is limited to the maintenance of low balances, as a mechanism to control ML risk. The regulation was designed to reduce entry barriers encouraging low-risk clients to open formal bank accounts without too many requirements and costs.

The basic account regulation applies to those financial institutions operating under BCP's supervision. This implies that basic accounts can be opened at banks and finance companies operating in Paraguay. This resolution does not apply to cooperatives, though they are free to tailor savings products using the same characteristics of the basic savings accounts. As of September 2014, two financial entities–Vision Banco and Financiera Interfisa – report offering this type of account in Paraguay. Vision Banco was already offering a similar type of account before the regulation was emitted and much of the regulation's characteristics were adopted from the Vision Banco model. Four other institutions have received approval from SIB to operate the basic account; however, they have not yet implemented the product.

Opening a basic savings account requires filling out an application form and relies upon simplified CDD procedures for low risk clients. A basic application form is required to be filled and signed simultaneously. According to SEPRELAD, this basic application must be completed and signed in-person as digital signatures for opening basic accounts are not allowed. Although Law 4017, of December 23, 2010 recognizes the legal validity of digital signatures, SMS, and electronic files, the digital signature has not been implemented yet and SEPRELAD does not recognize the possibility of using digital signatures. The only exception is when mobiles are used to open accounts and the acceptance is provided using an SMS. The simplified CDD procedures were defined by SEPRELAD as those conducting transactions for less than US$2,430 monthly (six monthly minimum wages). [44] However, SEPRELAD's Resolution 349 Article 26, also defines a low risk client with monthly transactions under three minimum wages to include CCTs beneficiaries. Thus a clarification between the references of using three or six monthly minimum wages for a low-risk client opening a basic account would be useful. The simplified procedures allow account opening to be completed by only presenting a national ID. In the future, for the opening of accounts both via mobile applications and non-mobile applications, digital signature regulations should be considered in SEPRELAD's CDD procedures to avoid the need for paper formats and physical signatures.

Basic savings accounts can be opened through mobile phones or other electronic mechanisms called "over the air" (OTA)[45] accounts. The basic savings accounts resolution states that when these opening mechanisms are used, the customer's ID document requirement has to be collected by the telecommunications company or the person hired for that effect. Opening accounts via agents and other self-opening mechanisms requires in practice, linking the client's name, the ID number, mobile number, or other identification number related to the activation procedure used by telecommunications companies to a system which could validate the client's information.

According to the regulation, a maximum of 2 basic accounts per client are permitted in the whole financial system. Financial institutions are responsible for ensuring that the maximum of 2 basic accounts per person is honored. Currently, the only way to verify compliance with this is through BCP. The BCP currently does not monitor savings accounts by individual IDs as it does with loans. To be able to enforce the limit on the number of basic accounts per person, BCP plans to begin monitoring these simplified accounts. It is important to monitor the number of basic accounts opened by individuals to have a clear idea of the client's savings and payment behavior and the possible ML risks that might arise from accounts that may be opened with very little information.

Table 14 details the main characteristics of the basic savings account as stated by Resolution 25, Act 51, 2013 from BCP. This account has neither opening nor minimum balance amount and has a mandatory cost reduction. Financial entities offering basic accounts should offer a minimum of 3 free consultations and 4 free withdrawals monthly. Transactions over these limits can be charged but using lower fees when compared to traditional accounts.

[44] SEPRELAD's Resolution 349, 2013 defines low risk clients performing transactions below six monthly minimum wages in general, but also sets a limit of 3 minimum wages for clients including CCTs beneficiaries. The basic savings account regulation refers to the more general limit of six minimum wages as pointed out in the interviews during the mission and AFI's published documents on mobile financial services in Latin America.

[45] Opening accounts without having the client in front of a bank officer or agent.

Table 14. Basic accounts regulation: Resolution 25, Act 51 of July 18, 2013 from BCP

Characteristics	Requirements
Type of client	Only for individuals categorized as low risk clients as defined by SEPRELAD: transactions below US$2,430 monthly
Opening amount or balance	No minimum required. (Saving accounts other than the "basic account" still require a minimum balance.)
Currency	Only local currency
Cost reduction	Minimum of 3 free consultations and 4 free withdrawals monthly
Delivery channels	ATM, agents or other branchless banking mechanisms authorized by the BCP (mobiles, Internet) for transactions
Interests	Agreed between the parties
Usage instruments	Mobiles Debit card provided upon client's request, in which case it must be provided free of charge
Risk limits	One account per client in each financial institution and up to 2 accounts in the whole financial system
Operational limits	Transactions below US$2,430 monthly. If the client wishes to operate over this limit he/she will have to comply with KYC procedures defined for clients of that risk level
Opening procedures	Physical presence in agents or over the air (OTA) using mobiles or other technological means
Opening requirements	Simplified procedure: ID provided by the client Client identification form filled in with client's information

Source: Resolution 25, Act 51 of July 18, 2013 from BCP

The creation of the basic savings account regulation is an excellent step towards designing risk proportionate regulations to promote financial inclusion in Paraguay. One of the typical limitations to access to financial products (especially savings and other deposit products) is the documentation requirements posed by CDD requirements. In Paraguay, CDD requirements are set by SEPRELAD according to general international AML rules. These general rules include requirements that may not be proportional to the risk posed by the type of financial service being offered. Some countries in the region facing the same constraints have developed simplified CDD requirements that comply with the Financial Action Task Force (FATF) recommendations and do not limit financial inclusion. In order to take advantage of the flexibility allowed by FATF standards regarding risk-proportional CDD recommendations[46], countries must conduct a risk assessment to justify the simplified measures for certain products.

Thus, the fact that BCP has adapted the legal requirements to encourage formal financial inclusion for the lower economic segments of Paraguay is a positive step. Other regulatory agencies in Latin America have also designed similar regulatory frameworks in order to increase financial inclusion within their markets. The lesson learned from the design and application of this is simplified opening procedures are more effective than mandatory cost reduction, which tends to limit the potential development of new products. Reference to the experiences in other countries is included in Box 1.

[46] FATF, Anti-money Laundering and Terrorist Financing Measures and Financial Inclusion. 2013.

Box 1. Savings accounts regulation in LAC

A study by the Inter-American Development Bank (IADB)/the Multilateral Investment Fund (MIF) collected examples of regulations of basic saving accounts from 6 Latin American countries: Brazil, Colombia, Ecuador, Guatemala, Mexico, and Peru.

Country	Name of account	Regulation	Limits
Brazil	Simple account	Resolution 3,881 from 2010, which modifies Resolution 3,211 from 2002. Central Bank of Brazil.	Balance (US$ 993) Monthly Deposits (US$ 993)
Colombia	Savings account with simplified opening procedure (CATS, for its acronym in Spanish)	Chapter IV, Title II of the Basic Legal Circular includes External Circular 053 from 2009 and External Circular 013 from 2013, Financial Superintendence.	Balance (US$ 2,573) Monthly Deposits (US$ 643)
Ecuador	Basic account	Chapter XI from Title IV from the Book of General Norms for the Application of the General Law of Financial Institutions	Balance: US$ 3,000
Guatemala	Accounts opened through simplified procedure	IVE 721 from 2011 IVE IRS 01 from 2011 Superintendence of Banks of Guatemala	Monthly Deposits (US$ 642) Yearly Deposits (US$ 2,570)
Mexico	Basic account	Circular 03/2012 from Banxico which modifies Circular 2,019/95. Article 115 from Law of Credit institutions, and its General Dispositions. Chapter X for the Circular Unica de Bancos Circular 22/2010 Banxico from 2010.	**Level 1**: Balance: US$441 Monthly deposits: US$306 **Level 2**: Monthly Deposits: US$ 1,234 **Level 3:** Monthly Deposits: US$ 4,114
Peru	Basic account	Resolution 2,108/2011. Superintendencia de Banca, Seguros y AFP (SBS)	Balance (US$ 769) Monthly Deposits (US$ 1,539)

There are significant differences regarding the regulation for simplified accounts. The definition of a simplified account in the various countries has had an impact on product implementation. For example, Peru does not allow remote enrollment, Guatemala requires a detailed format to open the simplified account, and Brazil as well as Peru limit the number of accounts a client can hold in the financial system, which represents operative challenges to verify it. Effective control requires the knowledge of the types and numbers of accounts each person has in the financial sector. Verification of such information requires access to important databases capturing this information. In order to simplify opening procedures with less requirements, these accounts generally limit transactions and balance amounts to prevent ML risk, but the legal framework does not stipulate a required number of free transactions. In the case of Mexico, there is a robust and sufficient framework to adequately face the market requirements. The Mexican regulation has an array of simplified products for different markets and clients. The regulation permits electronic format, filing, remote opening, and adequate limits according to the market and the ML and operational risk requirements. Both Mexico and Colombia have several simplified financial products. Mexico has simplified products like *Cuenta Express* from BBVA, Transfer Banamex and MiFonBanorte. Colombia has *Cuenta de Ahorro a la Mano* from Bancolombia, *Transfer* in Citibank, and *Daviplata* in Davivienda. Ecuador has a simplified account called *Cuenta Amiga* in Banco Guayaquil Ecuador and Banco Industrial of Guatemala offers *Tu Billetera*.

This study raises important policy considerations in order to allow a successful implementation of these products. Among them the most relevant is the importance of ensuring that regulations adequately address the most representative situations of the market, assuring the products are really simple and that the simplified enrollment procedures can be carried out using non-traditional channels like agents or mobile phones. In cases where there are high document and information requirements it hinders the agile and efficient enrollment to the financially marginalized segments of the society.

Source: Agents and Financial Inclusion: Regulatory Frameworks in Latin America, Technologies for Financial Inclusion (TEC-IN), IDB/MIF-CAF.

Public information on the results of these regulations is not available in all cases and when it is, it often refers to the number of accounts as opposed to the number of people with accounts. Table 15 includes some results on the number of basic accounts available in Mexico, Peru and Colombia as of 2013. The specific results in the case of Colombia are influenced by the CCT program payments that opened an account of this type for almost 2 million beneficiaries.

Table 15. Number of savings accounts in other countries. 2013

COUNTRY	NAME/TYPE OF SAVINGS ACCOUNT	TOTAL NUMBER OF ACCOUNTS	# OF ACCOUNT / 10,000 ADULTS
Mexico	Traditional	70,028,289	8,400
	Level 1	11,059,849	1,327
	Level 2	2,426,830	291
Colombia	Traditional	51,222,608	16,226
	Simplified procedure accounts (CATS)	102,000	32.3
	Electronic savings accounts	3,180,000	1,007
	Electronic deposit	1,889,000	598
Peru	Traditional	26,810,000	300

Source: Colombia, Financial Inclusion Report 2013, México, Comisión Nacional de Bancos y Valores (CNBV), and Perú SBS.

In light of the regulatory advance in this area, the application of the relatively new basic account regulation has highlighted a number of market challenges in implementing the basic savings account in the Paraguay financial market:

-Verification of the client's ID information is proving to be difficult due to the inability to connect to a national identification database. There is no official, national identification database that financial institutions can access in order to verify the authenticity of the presented client identification. As such, currently, the only way both financial institutions and authorities meet this requirement is by requiring a copy (paper or electronic) of the ID presented by the customer[47]. Requiring a copy of the ID is particularly cumbersome for people in rural areas due to the limited access to photocopy machines. Even with the copies of the ID documentation, there is no means to verify the document's authenticity. In the case of OTA or using mobiles, information validation is only done against the telecommunications company's database, without a third-party confirmation of document authenticity.

-The responsibility of fulfilling the CDD requirements is still a matter of discussion between financial institutions and telecommunication companies. According to SEPRELAD, CDD activities are the responsibility of the financial institutions including account opening using mobiles or other electronic instruments. However, depending on the method, the basic savings account is opened –via financial institutions or through mobile channels - supporting documents have to be required ex-post by the financial institutions to the telecommunications company. In any case, the ex-post control required to complete the KYC process has not been relaxed, thus financial institutions are still responsible for implementing internal procedures and controls to guarantee that the account's movements stay within the limits defined by the regulation. Also alternative mechanisms regarding the process for product acceptance and the requirement for a signature can be alleviated through the implementation of the digital signature; thereby, eliminating the need for physical presence to open accounts and to fulfill CDD requirements.

-General rules for operational risk control are applied to basic accounts, with no specific requirements for electronic instruments. Operational risk regulation in Paraguay has only set principles and responsibilities without yet defining specific rules and minimum requirements [48] . The regulation requires printed or electronic documents be kept for at least five years. Financial institutions have to set security mechanisms that guarantee authenticity, identification and safeguard of the client's data. In Paraguay, there are no further rules and minimum requirements regarding operational risk requirements such as minimum security requirements for electronic instruments related to clients' verification. For example, there is no requirement on the usage of PINs and the use of cards (debit/credit) containing information on the client and the account using a chip or a magnetic band[49].This is particularly important because the level of public confidence regarding the security in using the electronic instruments influences the usage rate of electronic

[47] It was reported that almost all adults have IDs.

[48] Res. 37, Act 72, 2011 from BCP.

[49] See for example, Circular 7 of 1996, Financial Superintence of Colombia.

services. The specific electronic requirements must be balanced by applying the proportional risk entailed by low-value products.

-The mandatory cost reduction associated with operating the basic savings account has made the banks and finance companies reconsider the business case for widely offering this product. According to the banks, formal business models are yet to be developed for the wide implementation of this product. They consider it difficult to comply with the regulations to provide free transactions and operations on a product with a high volume of transactions and very low balances. Low balance products need a way to recuperate fixed operational costs; this is often done through charging per transaction. Many banks commented during the mission that the business case is not clear for them to allow free transactions and recover their operational costs. Moreover, while they can charge when clients exceed the limits of free transactions, the charges must be lower than those charged on the traditional deposit accounts. Thus price discrimination is arbitrary depending on the type of account utilized and not necessarily based on the service provided. Therefore, the basic saving accounts implementation could benefit from a review of the effects of the mandatory free transactions requirement on the viability of business models being developed by financial institutions. Having in mind the experience in other countries mentioned in Box 1 it is important to closely follow the process to identify possible difficulties in developing a viable business model for basic savings accounts.

-**The financial entities have also been hesitant to provide the public with full cost transparency related to transactions associated with this type of account.** Typically unit costs related to information disclosure are important in providing low-amount financial services for they increase operational costs on a business model sensitive to volume and value of transactions. In Paraguay, the introduction of basic accounts by Resolution 25, Act 51 of July 18, 2013 from BCP has lowered CDD requirements as shown in Table 14 and has also lowered the costs related to paper based account movements. For example, now banks allow consultations using ATMs, Internet, mobiles and other available mechanisms, while providing printed abstracts only upon request and charging the client. In any case, the conditions for accessing accounts transaction information must be included in the contract.

B. PAYMENTS

PAYMENT SYSTEM

The payments system is governed by Law 4,595 of May 16, 2012, which sets the framework for the payment system and securities settlement. This law defines the rights and obligations of operators, participants and regulators of the national payments system in Paraguay. It provides the legal foundation to regulate the validity of clearing and settling for payments and securities operations. This Law appoints BCP as the regulatory authority while the CNV is the authority to regulate payment issues related to the stock market. The attributions of BCP as regulator and supervisor of payments also allowed the issuance of a regulation on e-payments (Resolution 6, Act 18, of March 13, 2014 from BCP).

BCP undertook a significant reform to support the environment for conducting electronic payments by implementing a national payments system in Paraguay. The national electronic payments system in Paraguay (SIPAP-Spanish acronym) consists of a real time gross settlement system (RTGS), an automated clearing-house (ACH), and a Central Securities Depository (CSD) operated by BCP. The SIPAP supports the transfer, clearance, and settlement of electronic payments for the financial sector versus the manual, paper-based payments prior to the development of SIPAP. Resolution 1, Act 67 from 2012 from BCP defines the general rules governing the payment system after Law 4,595 of May 16, 2012 was issued. Since the issuance of these regulations, great progress and payment system efficiency has been accomplished. Compared to paper-based payment instruments such as checks, payments conducted by the financial institutions connected to the SIPAP are now settled in real-time, reducing credit, liquidity and settlement clearance risks of payments. For example, in terms of retail payments, merchants are able to receive payments conducted on credit or debit cards on the following business day as opposed to eight days later, as was the case before SIPAP. In terms of inter-bank transfers, placing the ACH in the Central Bank has contributed to the reduction of inter-bank transfer costs. This is because BCP does not charge accrued interests on the remaining deposits at the end of the day.

The payment system further reform is still in progress. In the future, as they meet system requirements, the BCP is contemplating adding e-payment providers and cooperatives as direct participants of the SIPAP system. This would thereby allow more payments to shift from cash to electronic, like payrolls. As of now, only banks and finance companies manage accounts in the BCP as part of the payment system and cooperatives as well as other relevant players in the market, are indirect participants of SIPAP as they have access to the system through a commercial bank or finance company.

PAYMENT PRODUCTS

Payment products available in Paraguay include bill collection and payment services, remittances and electronic payments (e-money and non-bank

electronic transfers). Bill collection and payment services [50] are provided by private payment processing companies while international remittances are provided by remittance companies. Furthermore, in Paraguay, the post office has not been an active participant in the financial service space, neither as a payment service provider nor as a remission channel for payment services. There are no specific regulations for these services although according to BCP non-bank electronic transfers have to abide by the regulation issued on e-payments (see next section).

SEPRELAD also has AML rules applicable to remittance companies and payment service companies contained in Resolutions 333 of 2010 and 218 of 2011. Remittance companies are required to keep records and monitor operations, but they only have to individualize operations over US$10,000. They are required to record names, place and date of birth, ID, and economic activity of each client. However they only have to require the physical ID and a copy of it for operations between USS$1,000 and US$9,999, while operations over US$10,000 need the filing of a Statement of Operations Form. According to Resolution 218 of 2011, payment companies and other non-supervised subjects need to register at SEPRELAD.

As of July 2014, there are no regulatory limitations for the development of non-electronic payment products like non-electronic money transfers and remittances. However, given the importance of these types of products for the unbanked it is relevant to monitor the growth and behavior of these service providers to prevent future losses of public funds.

E-PAYMENTS

The definition of electronic money (e-money) and its issuance by regulated non-banks is a very significant step towards financial inclusion in Paraguay. This is particularly important considering the recent increase in penetration rates of e-payment products as reported by the demand-side results[51]. According to the e-money regulation, Resolution 6, Act 18, of March 13, 2014 from BCP, e-money does not accrue interest.[52] It is stored on par with value received after fees, in an electronic device or a computer system and may be used through telecommunications services (mobile, Internet, and other access devices including debit cards). It is accepted as a means of payment by people and companies other than EMPES. It is convertible into cash by the EMPES on par with the balance of value stored. BCP allows e-money to make purchases. Thus in this manner, e-money is defined and treated differently from traditional bank deposits.

Basic operations of cash-in, cash-out transfers and purchases are allowed. E-money operations currently authorized include: conversion of cash into e-money and in reverse as well, payments, and non-bank electronic transfers. E-money operations are defined as operations by which a client or sender transfers funds in real time, through an EMPE, to a beneficiary into an e-money account, or a traditional bank account or to be cashed-out. E-money is stored into one e-money account per client per EMPE. Its monetary value *may* be expressed in local currency (foreign currency also possible).

Risk control limits are set to provide a proportional regulatory framework. E-money account balances cannot be over 40 minimum daily wages (US$ 540 approx.; Gs. 2,800,000), while monthly cash debits and credits must remain below US$ 2,027[53]. Accounts are considered dormant after 90 days of no transactions[54], and balances have to be transferred to a deposit in a financial institution previously defined by the client or a basic savings account opened by the EMPE under the individual's name. This raises a number of challenges. If the balance is transferred successfully, the individual may not longer have access to his/her funds after 90 days of inactivity (e.g., if the bank only has branches in a town different than that where the person lives). It also opens the possibility for banks to set conditions that are difficult to meet (or charge high fees) and, as a result, non-banks have a high cost to comply with or simply do not comply at all with the regulation (since the regulation does not specify the terms under which banks enable the transfer of dormant balances). If the client is corporate, it must have defined a deposit account to which balances can be transferred. No further details are provided in the regulation regarding the implementation of this.

Specific requirements and limits are set for non-bank electronic transfers by EMPES in order to reduce risk. Maximum limits set per EMPE refer to each sender's *monthly* transfers which cannot exceed the equivalent of 40 daily minimum wages (US$540), the same amount set for balances in e-money. The amount of transfers received *monthly* by a beneficiary cannot exceed 40 daily minimum wages (US$540). Partial withdrawals of transfers are not allowed and transfers must be processed and registered in real time only within the national territory. Transfers must be returned to the sender after 4 days from sending if the beneficiary does not withdraw them. Nevertheless, if the beneficiary has an e-money account once the funds are credited into his account

[50] These are similar to those provided by the postal system in developed countries

[51] For more details please refer to The World Bank, Paraguay's 2013 Financial Inclusion Survey, 2014.

[52] Some other countries like Colombia and Mexico have decided to frame e-money within the traditional deposit concept, thus solving the issue on deposit insurance and overall application of proportional financial regulation.

[53] According to SEPRELAD or low risk clients: as of 2014, 5 monthly minimum wages, US$ 2,027.

[54] Though this might seem a short period of time, it was required in this case for mobile money providers were already accumulating large amounts of money in the e-wallets.

the transfer is considered withdrawn. Operations that exceed limits both for e-money and non-bank e-transfers must be made using bank accounts.

The e-money regulation (Resolution 6, Act 18, of March 13, 2014 from BCP) allows EMPES to apply the abbreviated CDD procedures. Abbreviated CDD procedures include filling the client identification form with basic information required and a copy of the ID and other documents that SEPRELAD may define for this type of client. Despite the abbreviated information and process for account opening, the latter requirements (e.g., physical copies of documentation) may make it unviable for providers to promote account opening in remote areas, where the control of physical documents and the equipment required to make copies may demand high investments. This is due to the fact that electronic signatures are not yet in place in Paraguay, requiring paper signed forms when not using mobiles to open accounts. Also when needed, EMPES have to adopt procedures to identify final wire transfers beneficiaries according to SEPRELAD's Resolution 266 of August 27, 2013. Specific FATF recommendations for wire transfers (Recommendation 16) determine that all wire transfers should be traceable, and more so, small wire transfers that can potentially be used for terrorist financing. However, FATF also recognizes the importance of not affecting the payment system. Tracing transfers in countries where most small payments are made in cash has served as an argument for issuing e-payments, and the e-money regulation allows more transfers to be made using the financial system.

Regulations require that EMPES pass on the float revenue to financial institutions. According to the EMPE regulation, interest accrued on the pooled account should be exclusively used to pay the cost of trust fund administration (either for present or future expenses). Financial institutions who manage the EMPE trust funds are therefore entitled to an important revenue stream that may be significantly higher than the actual costs of managing such trust fund. This may reduce incentives for banks to proactively seek the development of new businesses that leverage the payments infrastructure, since holding the pooled account may already provide an important source of revenue.

Delivery channels regulations for e-money set less restrictive requirements for EMPES. EMPES are allowed to use agents and points of sale as delivery channels and, as such, they can use them to operate but cannot delegate their responsibilities. EMPES, as well as banks and finance companies, are liable for all their operations performed using the different delivery channels. These delivery channels can use other payment systems or instruments allowed by BCP, and can also be used by several EMPES. This is contrary to the procedures that apply for commercial banks and finance companies that need prior authorization from BCP to extend their physical infrastructure presence of branches and ATMs (see Section 5, Subsection B).

C. CREDIT

Loan products available in Paraguay are provided by banks, finance companies, cooperatives, regulated but un-supervised providers and non-regulated & non supervised credit providers[55]. Table 16 summarizes the products available by type of provider.

[55] From the financial regulation perspective, regulated but un-supervised and non-regulated and non-supervised are those credit providers that abide to the general regulation but do not have specialized financial regulation.

Table 16. Credit products available in Paraguay according to regulation status

Financial provider	Types of loans	Regulation
Banks and finance companies	Loans: commercial, consumer, housing, and microcredit. Leasing and factoring	See Tables 17 to 20
Savings and credit cooperatives, only to members	Loans: housing, commercial, and consumer. Leasing and factoring	See Tables 22 to 24
Non-profit microfinance institutions (MFIs)/NGOs	Microcredit	No regulation
Casas de Credito	Consumer loans	No regulation
Casas Comerciales	Consumer loans: selling goods and services on credit	No regulation

REGULATED CREDIT

The combination of credit definitions for credit risk assessment and the disproportional requirements of documentation can be a barrier to formal financing for the low income/ informal population. As part of the credit risk assessment processes and as a result of the credit risk management rules defined by BCP, regulated institutions require formal documentation [56] and collateral[57] to determine a debtor's credit worthiness. Understandably this is an important process in general credit risk management. However an unintended consequence of this is that low-income individual and the informal business segments such as micro-entrepreneurs are unable to meet these requirements. As such they are often financially excluded, but credit risk management rules and minimum requirements posed by regulation can be adapted to meet the realities of this circumstance and correctly assess the real credit risk they entail. For example, the credit methodologies used by microcredit lenders for this segment are often based on a deep knowledge of the client's financial and economic conditions and require a closer monitoring of the client to guarantee loan repayment. Thus financial inclusion of these markets requires adapting regulation to recognize the special characteristics of the credit risk control methodologies and also requires adequate supervision of these market participants as well, based on monitoring the credit risk control process.

Credit Offered by Private Banks, Finance Companies and Public Sector Banks

Credit products available in the financial sector provided by banks and finance companies are defined by Resolution 1, Act 60, of September 28, 2007 and Resolution 37, Act 72 of November 29, 2011 from BCP (Table 17). The resolutions govern the credit risk assessment rules, provisioning requirements, and the permitted interest accrual that commercial and public banks as well as finance companies must abide to issue credit. Typical credit products for low-income populations and financial inclusion are mostly consumer credit and microcredit that can be used to finance needs from consumption to productive activities to housing improvements. Table 18 lists the types of credit offered to the market as well as the types of debtors in Paraguay.

Credit risk categories are defined according to the type of borrower; in which microcredit has a more stringent standard than other types of borrowers. The risk categories are not differentiated by the type of credit. Rather, the risk category is defined by the number of days past due and provision requirements are subsequently set accordingly. Microcredits in Paraguay are classified at higher risk categories within a strict timeframe to be considered past due in comparison to individual, small and medium size debtors. This requires higher provision requirements within a short timeframe for microcredits (Table 19). It is important to note that although loans are considered past due from the first day of missed payment, they remain in the lowest risk category (and with 0% provisioning requirement) up to 60 days past due. Only after the loan is 60 days past due, the provision requirements starts. This delayed provisioning effect until 60 days hides the real credit risk situation for two months. Instead of a 60 day provisioning delay, a risk classification beginning at least with a 30 day delay across all types of loans would support more vigilant credit risk assessment policies.

[56] Business registration in the case of companies, record of tax payment, income receipts for individuals. In the case of microcredit only ID and loan request form and agreement are required by the regulation.
[57] Though regulation not always requires collateral, it is part of the credit risk management rules and minimum requirements and affect provisioning.

Table 17. Credit risk regulation for banks and finance companies

Regulation	Description
Resolution 1, Act 60, of September 28, 2007 from BCP	Sets rules for credit risk assessment, provisioning requirements and interest accrual.
Resolution 37, Act 72 of November 29, 2011 from BCP	Modifies Resolution 1, Act 60, of September 28, 2007 from BCP regarding provisioning requirements.

Table 18: Classification of credit types and debtors for banks and finance companies

Type of credit	Definition
Consumer	Loans to individuals aimed at financing consumption goods and services, including credit cards.
Housing	Loans to individuals aimed at financing housing acquisition, enlargement, repair and building as well as land buying for housing
Microcredit	Loans to companies, economic units or individuals performing small-scale productive, commercial or services business whose main payment source are productive activities for an amount not exceeding 25 minimum monthly wages (US$10,125).
Type of debtor	**Definition**
Large debtors	Companies, economic units or individuals performing a productive, commercial or service business with loan balances over 3% of the minimum capital requirements for banks.
Medium and small debtors	Companies, economic units or individuals performing a productive, commercial or service business with balances below the amount for being a large debtor.
Individual debtors	Individuals not included in any other definition.

Source: Resolution 1, Act 60, of September 28, 2007 from BCP

Table 19. Credit risk category and provisioning requirements for banks and finance companies

Risk Category	Medium and small debtors (days past due)	Individual debtors: consumer credit and housing (days past due)	Microcredit (days past due)	Provisioning requirements
1	0 – 60	0 - 60	0 - 60	0%
2	60 – 90	60 - 90	60 - 90	5%
3	90 – 150	90 - 150	90 - 120	25%
4	150 – 180	150 - 180	120 - 150	50%
5	180 – 270	180 - 270	150 - 180	75%
6	Over 270	Over 270	Over 180	100%

Source: Resolution 37, Act 72 of November 29, 2011 from BCP.

BCP outlines in Resolution 1, Act 60, of September 28, 2007, the criteria for guarantees that are taken into account for provisioning requirement calculations. The guarantees must comply with the following criteria:

- Effectiveness: as an alternative source of repayment so they have to be first or second rank, underlying assets must have market acceptance and be insured together with timely, sufficient and up-to-date information for proof.
- Registry: must be formalized and registered according to legal framework and tax rules.
- Coverage: estimated value has enough coverage.

The type of collateral affects the provisioning requirements for banks and finance companies, as regulation uses collateral as an credit risk assessment criteria. Of the total provisioning requirements, 50% is applied over the total debt balance and the other 50% over the debt balance minus first provisions and acceptable collateral. Despite the fact that it is common to grant loans on the "debtor's signature," the kind of guarantee is important for provision requirements and credit risk assessment for all loan definitions. Currently, Paraguay's collateral rules are framed within the traditional legal framework for movable guarantees used in Latin America that limits the types of assets that can be used as collateral as well as the process of getting hold of the collateral. Though no detailed diagnostic has been made yet on the specific case of Paraguay, the authorities are considering starting the process of reforming the secured transactions general framework to allow new kinds of assets as collateral and implement the registry for movable collateral. With IFC's support, this reform would allow the use of more type of assets as collateral, which is especially important for micro and small businesses. Table 20 defines BCP's guarantee computable values.

Table 20.Collateral computable values for provisioning requirements for banks and finance companies

Type of collateral	Computable value
Mortgage	70% of estimated value
Pledge on industrial or agricultural machinery and vehicles	50% of estimated value
Pledge on cattle	50% of estimated value
Warrants on grains or cereals	80% of document value
Warrants on cotton fiber	70% of document value
Warrants on other products	50% of document value
Bank guarantee	100% of document value
Trust guarantees	According to underlying asset
Pledge on goods without possession	Up to 40% of verifiable value

Source: Resolution 1, Act 60, of September 28, 2007 from BCP.

Microcredit by banks and finance companies

BCP has defined microcredit and the credit risk control regulation. Through Resolution 1, Act 60, of September 28, 2007, microcredit is defined as a loan granted to companies, economic units or individuals performing small-scale productive, commercial or service businesses whose main payment sources are productive activities for an amount not exceeding 25 minimum monthly wages (US$10,125). The SIB is currently working to improve the definition of microcredit applicable to banks and finance companies with the support of IADB.

Microcredit provisioning and risk rating is defined by number of days past due. According to Resolution 37, Act 72 of November 29, 2011 from BCP, 100% microcredit provisions are reached by 180 days past due. However, the microcredit practice applied in mature microfinance markets like Bolivia reach 100% provisions by 90 days past due[58]. In Paraguay, classification to a higher risk category starts after 60 days past due regardless of the type of loan or the client's risk characteristics. This treatment is not consistent with the short-term nature of these loans, where the higher risk nature of these types of loans, due to the debtor's informality, requires closer monitoring to prevent credit loss. Although the current regulatory minimum rules for microcredit provisioning are applied by all banks and finance companies, the result is that they prevent a sound credit risk assessment both for the industry and the supervisors. This is because the universal application of the microcredit provision minimum rules allows a lenient treatment of loans[59], where in contrary the debtors' characteristics require a close monitoring and supervision to keep portfolio at risk (PAR) value under control. Even though finance companies with a special focus on microcredits are aware of the need to provision more quickly, regulation prevents them from having accurate provisions as it would make their balance sheet look less sound versus other competitors.

Microcredit supervision in-situ is based on the same principles of traditional loan supervision. A sample from the clients' files is randomly selected and the assessment is based on the documentation adequacy as required by regulation. The focus of the random assessment is on document compliance versus the loan management process. This traditional supervision mechanisms results in an insufficient qualification process for informal micro-entrepreneurs who do not tend to have the proper documentation. Given the importance of the microcredit technology to identify, assess, grant, monitor and recuperate loans from informal clients, a different set of supervisory practices is lacking. The supervisory process for microcredit would allow the dynamic development of microcredit within risk control limits by reviewing the procedures in place to manage the specific nuances of microcredit risk and the use of best practices illustrated in Box 2. Traditional supervision techniques fail to recognize the risk control mechanisms provided by microcredit's best practices which are tailored to assess informal clients' payment capacity.

The current supervision of microcredit in banks and finance companies set by Resolution 1, Act 60, of September 28, 2007 and Resolution 37, Act 72 of November 29, 2011 from BCP could benefit from a closer monitoring of the portfolio and its clients. The current supervision method falls short on the best practices of supervising microcredit, which requires the lender to have a deep knowledge of the client and its productive activity, supported mainly by a cash-flow analysis. Development of microcredit in financial institutions requires special supervisory practices based on overseeing that microlenders base their lending and risk management on microcredit best practices, ensuring that financial institutions have the adequate lending processes and procedures in place, as well as a close knowledge of the clients' economic situation and a close monitoring of the repayment schedule before the first day past due. In this case, loans need to be considered past due from the first day, and not the current 60 day standard. Subsequently, adequate collection procedures also need to be required by the regulation. Box 2 summarizes the best practices for microcredit risk control.

[58] Rosales R., Janson T., Westley G., Principles and practices for regulation and supervision of microfinance, IADB 2003.
[59] Though these lenient rules may allow for more access to microcredit, they also lead to higher credit risk.

Box 2. Microcredit best practices.

Best practices for credit risk control in microcredit are based on recognizing that the risk profile of the client is different from corporate or consumer loans. Indeed, the traditional key elements (formal information on the economic activity and collaterals) are not present in micro-entrepreneurs. The use of adequate credit methodologies has proven to be successful in making microcredit profitable for Latin-American MFIs since the 1980s, by using another set of procedures designed to control credit risk. Based on the "best practices" described by Rosales (2006), these are the basic elements to be considered in microcredit risk control methodologies:

1. Evaluation of a client's repayment capacity using simplified financial statements built upon information collected by the financial institution when visiting the client's premises. In this phase the client´s character can also be assessed through his credit history or references from neighbors and suppliers.
2. Scaling–up loans starting from an initial test loan to assess the repayment capacity, willingness to pay and payment habits thus increasing loan sizes according to the client's performance.
3. Decentralized operations where decisions are made by small credit committees including loan officers and branch managers.
4. Close follow-up starting before payment days and frequent visits to the debtor's premises.

Source: Based on Rosales R., Regulation and Supervision of Microcredit in Latin America, An Inside View of Latin American Microfinance, 2006.

Based on the best practices mentioned in Box 2 and the basic regulation parameters for microcredit as defined by CGAP [60], some countries in LAC have introduced microcredit definitions in their regulation to provide an adequate framework to assess and control credit risk. Box 3 contains examples of microcredit definitions in other regional countries. Countries like Bolivia, Colombia, Mexico, Nicaragua, Panama, and Peru have used this kind of definition and it has been proven to be adequate to assess credit risk without limiting the development of the product in regulated financial institutions. The regulatory definition of microcredit is what allows the supervision to take place and defines its basic parameters. It sets the basic rules to assess credit risk and sets the basis for financial supervision. For example, if the regulation does not require short term provisioning, the supervisor will not be able to require short term provisioning, thereby the market will be reluctant to apply the provisioning process if it makes their financial statements look fragile. The regulatory definition can also limit the development of microcredit. For example, if microcredits are defined with very low limits for the lending amounts and microentrepreneurs exceed that limit, then there is a chance the credit could be misclassified as commercial credit and supervised under different regulations, despite the specific characteristic of the loan.

[60] The Consultative Group to Assist the Poor (CGAP) has produced guidelines for regulating and supervising microfinance institutions.

Box 3. Examples of microcredit definitions for credit risk purposes

Nicaragua: Small value credit is considered a value up to ten times the country's GDP per capita, destined to finance small scale productive, commercial, housing or services activity, given to a natural person or legal entity who acts individually or as a group, who owns a business or wishes to start one. The repayment source should be the earnings from the sales of goods and services of the business. The credits are disbursed using specialized credit methodologies to evaluate and determine the client's willingness and capacity to pay back.

Law 769, 2011. Promotes and regulates microfinance.

Mexico: Credits whose repayment source is a commercial, industrial, agricultural, livestock or services activity including professional services as well as the credits disbursed to small entrepreneurs, natural persons or legal entities, owners of microenterprises or groups of solidary people. It excludes credits to the salaried, unless their repayment source is an additional productive activity, different from which they receive the salary.

General dispositions for popular savings and credit institutions, community financial societies and rural financial integration organisms regulated by the Law of Popular Savings and Loans. December 2012.

Colombia: Microcredit is comprised by credit operations granted to microentrepreneurs or microenterprises in which the sources of repayment are the funds provided by the productive activity. Outstanding indebtedness of the debtor cannot surpass 120 legal minimum wages (currently US$ 39,153) upon the approval of the respective credit disbursement. Balance is understood as the sum of the new loan and the outstanding loans with the financial and other sectors, according to the credit bureaus registries, excluding mortgages or housing loans. The financial institution must use a methodology that adequately reflects the debtor's risk using elements that compensate information deficiencies according to the debtor's characteristics and informality. Information required can be obtained and documented in the place where the debtor performs his economic activities.

Basic Financial and Accounting Circular, Financial Superintendence.

Panama: Low-amount loan granted to a debtor, individual or corporate, whose main source of income comes from production, commerce and services activities, and that doesn't necessarily have documents or formal registries to back-up income statements nor has registered collateral.

Law 130, 2013.

Peru: Direct or indirect credits disbursed to a natural person or legal entity to finance its productive, commercial or services activity, if its indebtedness level with the financial system in the previous six months, excluding mortgages and housing loans, does not exceed 20,000 Soles (USD 7,128). If the loan outstanding balance at any point surpasses the S/ 20,000 limit for six consecutive months, the credit has to be reclassified to the corresponding type.

Resolution 11,356, 2008. Banks and Insurance Superintendence

Bolivia: Credit granted to a debtor, individual or corporate, or a group of debtors, to finance production, commerce or services activities, whose main source of payment is the product or income generated by these activities. According to the credit methodology microcredits can be classified as:

- **Individual**: granted to one debtor with or without collateral.
- **Solidarity**: granted to a group of individual debtors with joint or solidarity collateral.
- **Village banking**: successive and phased loans granted to group of people organized in solidarity groups, with joint and indivisible collateral, to obtain together with the microcredit human and economic development services from the other associates.

Financial Services Regulations Code. Financial Sector Supervision Authority.

In the case of Paraguay, the analysis of microcredit regulation in comparison to the regulation in other countries and the best practices recommendations gathered by CGAP (Table 21) and Rosales (2006) point out some aspects of the regulation in Paraguay that need revision in order to increase microcredit outreach. Table 21 highlights the situation of microcredit regulation in Paraguay in comparison with international recommendations on key issues like: scope of definition, provisioning, credit risk assessment, and supervision.

Table 21. Microcredit regulation in Paraguay vs. Best Practices

	Paraguay	Best Practices Recommendations[61]
Scope of definition	Limited to loans granted to companies, economic units or individuals performing small-scale productive, commercial or services business whose main payment source are these productive activities. Does not reach all the loans granted to these debtors, for example to finance household needs.	Definition should not regulate over use of funds for money is fungible, while analyses of the actual use of microcredit indicate that not all the money is invested in a microenterprise but some goes to financing household's needs.
Loan amount	Amount not exceeding 25 minimum monthly wages (US$10,125).	Include a maximum loan amount in regulation, but this maximum needs to balance the low-income target without excluding microcredit successful clients wanting loans that sometimes exceed the low-income target. A two-sided approach is suggested including a maximum average outstanding loan balance for the entire microcredit portfolio and a maximum initial amount for any microloan.
Provisioning	Starts after 60 days past due, reaching 100% after 180 days.	In mature microfinance markets like Bolivia, provisions reach 100% by 90 days past due[62]. The general prudential recommendation is that provisioning should consider the risk specifics of microlending, including the risk of default given the characteristics of the debtors. In the case of microcredit, terms and informality require a quick response from the financial institution and an adequate disclosure of credit risk by starting provisions at least after 30 days past due.
Credit risk assessment	Not required	Without limiting the development of different types of credit risk assessment and management methodologies, an indication that financial institutions should have such practices adequate to the market should be included.
Supervision of microcredit	Random selection of loans and assessment based on the completeness of the documentation required by regulation. Current use of same methodology applied to the rest of the loans.	Apply specific supervision methodology according to the best practices of microcredit risk management. The CGAP Guide points out that: - Assessing microcredit risk requires specialized examiner skills and techniques, different from conventional retail bank portfolios. - Relying supervision on close review of the institution's systems and policies for

[61]Christen R., Lauer K., Lyman T., and Rosenberg R., A Guide to Regulation and Supervision of Microfinance, Microfinance Consensus Guidelines, CGAP, 2011.
[62]Rosales R., Janson T., Westley G., Principles and practices for regulation and supervision of microfinance, IDB 2003.

	lending, collection, credit risk management, and internal controls, as well as the actual performance of its portfolio.

Following this analysis, microcredit market could benefit from applying the general principles set in the best practices in Table 21. The following regulatory improvements could allow further development of microcredit products by the banks, finance companies, and cooperatives:

- **Definition of microcredit for credit risk assessment purposes**: Increase the scope of the definition to include all loans granted to a micro-entrepreneur based on the source of the debtor's payment capacity[63], and explore the possibility of increasing the total debt limit to allow higher amount of microcredits to develop within the same definition. This would avoid having to classify microcredit's best clients as commercial clients, which is currently happening in the market.
- **Credit risk assessment**: Require institutions to develop adequate evaluation (including credit bureau consulting and reporting[64]), monitoring and recuperation methodologies adapted to the economic and informal conditions of the clients. Credit risk assessment should be based on cash-flow analysis rather than on collateral and this should be recognized in the provisioning requirements for microcredit[65].
- **Accelerate provisioning conditions**: Consider applying microcredit provisioning practices such as considering loans past due from the first day of missed payment and 100% provisioning to be reached after 90 days.
- **Adapt microcredit supervision practices**: Supervision for microcredit should focus on assessing the soundness of these methodologies rather than the traditional in-situ supervision practice.

Credit offered by cooperatives

Savings and credit cooperatives provide various types of loans; microcredits are not separately defined nor are they regulated or supervised differently from other loans. Normal credits that cooperatives provide are used for consumption, working capital, and investments. Cooperatives also issue credit cards and provide mortgages. Credit risk regulations of cooperatives are defined by Resolution 11,102 of November 19, 2013 and Resolution 11,481 of February 6, 2014, both from INCOOP. INCOOP does not have microcredit defined as a separate type of loan. Thus, despite the particularities of microcredit, the special microcredit risk characteristics are not being considered in INCOOP's credit risk regulations (Table 22).

[63] Definitions of microcredit and even consumer credit in other countries like Peru and Colombia refer to the source of payment and payment capacity not only for policy purposes but for credit risk purposes.
[64] Currently reporting is not mandatory.
[65] Often regulation includes less provisions depending on the type of collateral affecting also the risk classification of a loan, but in the case of microcredit as they don't usually offer any collateral rules should allow just the cash flow analysis.

Table 22. Credit definitions for credit risk purposes for cooperatives

Type of credit	Definition
Normal credits	Loans used for consumption, working capital, investments
Credit cards	Loans used for purchases using credit cards
Housing	Mortgages

Source: Resolution 11,102 of November 19, 2013 from INCOOP

A specific credit risk regulation[66] for cooperatives requires them to start provisioning after 90 days past-due and provision 100% after 360 days regardless of the type of loan. According to the regulatory framework for cooperatives set by Resolution 11,102 of November 19, 2013 and Resolution 11,481 of February 6, 2014 from INCOOP, loans can be short term (12 months) or long term (over 12 months). The repayment risk categories and the associated lenient provisioning requirements allowed for cooperatives may introduce financial risk for both the cooperatives themselves and system wide, given the important role cooperatives play in Paraguay. Table 23 outlines the provision requirements according to the repayment risk categories set by INCOOP.

[66] Resolution 11,102 of November 19, 2013 and Resolution 11,481 of February 6, 2014 from INCOOP.

Table 23.Loan provisioning requirements for cooperatives

Risk category	Days past due	Provisioning requirements
A: Zero past due	0	0%
B: Normal	0-30	0%
C: Acceptable	31 - 60	0%
D: Potential	61 - 90	5%
E: Significant	91 - 150	30%
F: Real	151 - 240	50%
G: High risk	241 - 360	80%
H: Unrecoverable	Over 360	100%

Source: Resolution 11,102 of November 19, 2013 and Resolution 11,481 of February 6, 2014 from INCOOP.

The standard for credit risk assessment is more lenient for cooperatives compared to banks and finance companies. Table 24 compares the different provisioning standards between cooperatives and banks/finance companies. For example, initially both cooperatives and banks/finance companies require 0% provisioning for loans past due between 0-60 days, however the requirements are progressively more lenient for cooperatives. Cooperative loans overdue between 151-240 days require 50% provisioning while for banks this is shortened to 150-180 days overdue. For cooperatives, only loans over 360 days overdue require 100% provision, while for banks this same requirement is at 270 days overdue and for microcredits it is for 180 days overdue. Aligning the provision structure and definition of credit between cooperatives and banks/finance companies would provide a common regulatory framework for the financial market in this area reducing pricing distortions and creating an equivalent basis for credit risk assessment and financial health disclosure. For example, this would mean that all loans should be considered late passed 30 days.

Table 24. Credit risk rules comparison

Cooperatives			Banks and finance companies				
Risk category	Days past due	Provision requirements	**Risk category**	Medium and small debtors (days past due)	Individual debtors: consumer credit and housing (days past due)	Microcredit (days past due)	Provision requirements
A	0	0%	**1**	0 - 60	0 - 60	0 - 60	0%
B	0-30	0%	**2**	60 - 90	60 - 90	60 - 90	5%
C	31 - 60	0%	**3**	90 - 150	90 - 150	90 - 120	25%
D	61 - 90	5%	**4**	150 - 180	150 - 180	120 - 150	50%
E	91 - 150	30%	**5**	180 - 270	180 - 270	150 - 180	75%
F	151 - 240	50%	**6**	Over 270	Over 270	Over 180	100%
G	241 - 360	80%					
H	Over 360	100%					

Source: Resolution 11,102 of November 19, 2013 and Resolution 11,481 of February 6, 2014 from INCOOP and Resolution 37, Act 72 of November 29, 2011 from BCP.

Credit risk assessments for cooperatives can be refined to more accurately reflect repayment risks -such as the case for microcredits- as well as to better align the credit risk assessments between cooperatives, banks and finance companies. Currently, though cooperatives provide loans to microenterprises, their supervision framework does not take into account the nuances of microcredit. Risk assessment frameworks that reflect the particularities of the portfolio´s characteristics, as earlier mentioned by the best practices of microcredit, allow the regulators and supervisors to better monitor financial risks. Also presently, the different regulatory standards between the more lenient cooperative credit risk framework compared to the more stringent bank and finance companies credit risk framework could possibly be introducing risk into the financial system. This is due to lack of accurate disclosure of credit risk and it could be affecting the pricing of financial services for the public as a result of lenient provisioning standards to the same degree of credit risk regarding days past due.

INTEREST RATES

According to the Organic Law of BCP (Law 489, of June 29 1995), interest rates are to be determined by the market with certain limitations. The parameters framing interest rates are defined by Law 2,339 of December 26, 2003 that modified Article 44 of Law 489, of June 29 1994 (Table 25). These parameters are:

- Default interest: Once the loan is past due, the normal interest rate turns into a default interest. The default interest rate is not above the original interest rate. Default interests are calculated in

relation to the debt balance past due without interest capitalization. However, creditors are allowed to receive penalty interests at a rate not over 30% of the default rate applied to the debt balance past due.

- Usury interest: Normal and penalty interest rates cannot be over 30% of the average annual interest rates charged by banks and finance companies on consumer credit according to terms and currency.
- Usury reference interest rates: Usury interests are based on reference interest rates calculated by BCP using the observed rates in the market. Usury rate is calculated as 30% over the market rate, leading to a maximum absolute usury limit. These usury interest rates are published monthly by BCP who also determines the consumer credits rate, terms and currencies (local and foreign currency).

Table 25. Laws governing interest rates limits

Law	Description
Law 489, of June 29, 1994	Organic law of the Central Bank of Paraguay (BCP). Article 44 sets interest rate regime.
Law 2,339 of December 26, 2003	Modifies Article 44 of the Organic Law of BCP to introduce usury limits to interest rates.

As of September 2013, BCP, through SIB, updated the methodology to calculate two interest rate limits; one for local currency and one for foreign currency. The limits are calculated over the resulting rate of the moving weighted average of effective interest rates and disbursements for the last 24 months for consumer credit operations of banks and finance companies in the financial sector. These rates are calculated and published on a monthly basis. Usury interest rates for June 2014 were set at 56.16% in local currency and 16.15% in foreign currency. According to financial institutions, the rates are enough to cover loan operational costs even for products like village banking.[67]

The application of the interest and usury laws is narrowed to the BCP supervised entities and the cooperatives; the application of the law to other credit providers operating in the market remains ambiguous. The Laws described in Table 25 set the usury limits on interest rates to be calculated by BCP, but the enforcement of the law remains vague. Although Article 44, in the Monetary Regime Section of the Organic Law of BCP, refers the application of this Article to the entire economy, the narrow interpretation of BCP's supervision has led to difficulties in enforcing the limits throughout the economy. For example, when a non-supervised credit provider does not respect the usury limit set by BCP there are no legal regulations supporting the intervention of BCP to stop the non-compliant behavior. More importantly, outside of BCP, there is no other authority empowered to control usury limits compliance by all loan providers (ie. other legal enforcement agencies like the consumer protection agency). Due to the absence of legal enforcement, a formal complaint must be filed by the customer in a civil court on case-by-case basis. This practice may result in having only the supervised institutions respect the usury limit. This situation defeats the very purpose of defining a usury limit intended to protect the public from abusive behaviors that are more frequent in the non-supervised agent lending. So, in order to level the playing field, it should be important to broaden the enforcement scope of control over caps on interest rates beyond those already supervised by the SIB. This could possibly imply the usury regulation to be enforced by entities other than SIB.

It should also be noted that capping market interest rates could limit institutions from accurately reflecting the risks that financial entities must undertake to properly service the more challenging financial market segments to reach. Among many other indications, interest rates reflect the operational costs that financial entities must undertake to service the loan. By placing stringent regulatory ceilings on interest rates versus market determined rates, it could potentially deter financial markets from taking risks to service difficult-to-reach financial segments which are also more costly to service. To avoid this risk, BCP should closely monitor its usury cap to ensure that it is high enough not to exclude lenders, especially microlenders, from reaching otherwise excluded clients.

The market would also benefit from promoting information transparency. This could be achieved through the implementation of regulations aimed at preventing anti-transparency practices to avoid the usury limit, like charging commissions and other costs together with bundling other products like insurances. This practice was reported by financial institutions and the SIB in Paraguay. To prevent this, regulations on exactly what should be included in the interest rate need to be issued, together with the various commissions, fees, and costs that are allowed and the manner in which charges should be expressed. For example, Peru has a set of regulations to tackle this issue. Peru requires interest rates to be expressed as effective annual rates for all financial operations.

PUBLIC CREDIT INFORMATION

Currently there are two main sources for credit information operating in Paraguay, a public registry in BCP and a private credit bureau called Informconf-Equifax. BCP's public credit registry collects negative and positive information from the institutions under its regulation and supervision

[67] Village banking is a type of microcredit were a financial institution or a MFI provides credit to a group of people collectively responsible for the loan, in charge of managing the funds, collect payments, savings as collateral and distribute loans among the participants.

according to Law 861, of June 24 1996 (banks and finance companies). The regulation states that financial institutions must provide BCP's public registry credit information on a daily basis. However, in practice, this information is supplied on a 10 day delay basis to BCP. The regulation states that the credit information supplied to BCP is classified and filed by debtor rather than by loan operation. Improvements are in progress to file information by loan operation but information is not being classified according to credit risk definitions. This currently causes short-term loans to be mistaken for long-term fully paid loans.

The private credit bureau contains credit information on a broad universe of credit providers (including cooperatives, casas de credito, casas comerciales). The credit information is limited to negative information [68] and it is not integrated with the information of any other registry. A legal limitation on sharing positive information was reported based on a banking secrecy clause identified in the Financial Sector Law. [69] This includes the prohibition to publish positive credit information or even show it to third parties that are not financial institutions.

INCOOP is developing a credit bureau based on the cooperative's credit information that started operations on June 1st, 2014. The bureau is based on the legal framework outlined in Resolution 11,859 of May 2, 2014 from INCOOP. This resolution requires Type A cooperatives to report information monthly starting June 1, 2014 while Type B cooperatives are required to start sending information by December 31, 2014. According to INCOOP, at the beginning, their credit registry is active only for cooperatives and information is planned to be updated only on a monthly basis. There are neither specific legal obligations nor other plans to share their credit bureau information with BCP's credit registry though conversations have been held. The anticipated cooperatives' credit bureau should maintain accurate and updated credit information. It is important to consider updating information on a daily basis to prevent excessive credit risk and over-indebtedness of the cooperatives' clients.

Market practices were identified as leading to the loss of important credit information history. The limited scope of financial regulation outreach has allowed the growth of non-financial companies willing to buy NPLs from the financial sector. Financial institutions reported selling NPLs to un-supervised companies to eliminate the loans from their financial statements. Mission interviews mentioned that in some cases once loans are sold to unsupervised companies, the credit information disappears from the credit bureau erasing the credit history. Such practices encourage the circulation of inaccurate credit information within the credit reporting information system and prevent sound credit risk assessments by the sector. Furthermore, financial institutions should be required to keep records of loans sold to unsupervised companies.

The current practices of the credit reporting industry can be improved to facilitate more accurate credit reporting history. Credit reporting information enables the entities to rapidly access accurate and reliable standardized information on potential borrowers. Credit reporting can also play a key role in improving the efficiency of financial institutions, by reducing the processing costs of loans as well as the time required to process loan applications. Lenders may also use credit data to better monitor their existing portfolios. Standardized data enables the development of sound internal models to measure credit risk and allocate the necessary capital and/or provisions, identify potential problems, and develop and sell enhanced products. Financial lenders are able to sell enhanced products via more accurate pricing and targeting, thereby contributing to their profitability.

Since credit registries and bureaus promote transparency and reduce the information disadvantage that institutions have over their existing clients, they can also encourage greater competition, which can lead to lower prices and greater access to credit. In Paraguay, the credit information reporting is fragmented between the public credit registries of BCP and INCOOP, the private bureaus, and other credit information providers. Due to the information segmentation, it is difficult for credit providers to capture an accurate, holistic picture of a potential creditor's payment history. Thus, this credit information fragmentation is creating inefficiencies for financial entities and can be avoided if the credit registries and bureaus share their information. Moreover, BCP's public credit registry can also improve accuracy by updating the information on a daily basis and including information by type of credit according to the credit risk definitions so that each kind of loan can be easily identified for credit risk. Negative information should include loans past due from 30 days onwards.

The limitations of Law 861 should be addressed to allow the collection and circulation of positive public credit information. Credit reporting addresses a fundamental problem of credit markets: asymmetric information between borrowers and lenders which leads to adverse selection and moral hazard. The heart of a credit report is the record it provides of a consumer's or firm's payment history. Since one of the best predictors of future behavior is past behavior, the data on how a potential borrower has met obligations in the past enables lenders to

[68] Equifax also collects positive information but it is not widely circulated. The positive information is based on reciprocity of information provided based on an agreement.

[69] Article 84, Financial Sector Law 861, June 24, 1996.- Operations secrecy. Financial Institutions and their directors, administrations and control organs and workers are forbidden to provide any information on their client's operations unless there is a written authorization from the client or it pertains to the specific aspects contained in the following articles. The prohibition does not apply to cases in which the disclosure of the amounts received from the clients is mandatory for the purposes of resolving banks or finance companies.

more accurately evaluate credit risk, easing adverse selection problems. At the same time, credit reports strengthen borrower discipline and reduce moral hazard, since late or non-payment with one institution can result in sanctions in many others. Thus in Paraguay, circulating only negative credit history is leading to a partial picture of a borrower's credit history.

The credit information system in Paraguay can benefit from a wider collection of payment information. The information from public financial institutions providing loans should be reported to BCP´s credit bureau, and regulations should be issued to prevent financial institutions from eliminating the negative reports on clients whose debts have been sold to unsupervised loan collection companies. Moreover, positive information should also be considered to be legally required to share amongst the credit information registries and unregulated lenders (e.g., store credit and others) should also report credit data to the credit bureau as well as the payment of utilities (e.g., electricity bills, phone bills, etc.).

Credit information veracity can benefit from a stronger exercise of consumer rights by defining the mechanisms for the public to correct erroneous credit information in the systems. The National Constitution of Paraguay sets the right for people to correct false, distorted or ambiguous public information disseminated. The public right to correct the false information is applicable to the habeas data provisions. People have the constitutional right to access information and data filed in public or private registries and request through the judiciary, an update, correction or destruction of wrong data. However, no law has further developed these principles and there is little awareness of consumer rights and the exercise mechanisms. For example, rules for expediting procedures to allow timely updating, correction or destruction of wrong information are not in place in Paraguay.

NON-REGULATED / NON-SUPERVISED CREDIT

As mentioned before, in Paraguay there are loans being provided by non-regulated or semi-regulated providers that may be distorting the provision of credit. These products are mostly microcredit provided by non- profit MFI/NGOs, loans provided by *casas de credito*, consumer loans provided by private companies, selling on credit, or even credits with pledges on movable assets in the case of pawnshops. This is partially due to the fact that the financial regulations in Paraguay focus on the financial service providers instead of the financial products being offered in the market, where prudential regulation should fall on all those taking deposits while the same general rules on transparency, information reporting, and consumer protection should apply to all lenders. Prudential regulation aside, one result is that similar credit products are developed under different rules depending on the financial service provider. This situation not only introduces distortions in the financial activities but also entails a risk as segmented, non-regulated/non-supervised credit providers can contribute to over-indebtedness. The most vulnerable clients in this situation are those obtaining non-supervised financial services for they seldom are able to comply with the whole set of documentary information required from the formal financial service sector and their assets are often not eligible for collateral by the regulated financial sector. Thus the only option for many are to obtain credit from the non-supervised financial service provider, who do not have to comply with the regulations sets on interest rates and transparency norms. The application of uniform basic rules can be applied by increasing the scope of BCP's outreach in controlling usury interest rates in the absence of another enforcement authority, information provision to credit bureaus, and the enforcement of consumer protection rules. Such practices could help the low income population that utilize non-regulated/non-supervised credit as well as help deter practices that contribute to over indebtedness to the users of such financial services.

D. LEASING AND FACTORING

Leasing and factoring operations are both legally permissible by banks and finance companies; however, both products are not readily being offered by the market. Regarding leasing operations, Law 1295, 1998 created leasing societies as part of the financial system and defined minimum capital requirements for its operations. Decree 6,060 of 2005 regulates financial and commercial leasing operations. According to BCP, this was an initiative to broaden the market scope but no leasing company was ever created and banks and finance companies have not implemented any leasing products. During this time, BCP has not issued any further regulation to implement the leasing law and decree from Table 26. Factoring operations are legally authorized by banks and finance companies. The financial sector (Law 861, 1996) and rules were defined by BCP's Resolution 1, Act 38, 2009 for factoring operations. This resolution defined factoring operations in terms of the transfer of invoice rights of collection from the owner to a financial institution in exchange for funds. According to the regulation, invoices have to be signed by the debtor. BCP's resolution also defines the general characteristics of the contracts and the invoices. The factoring operations' credit risk is ruled by the general credit risk regulation contained in Resolution 1 Act 60, 2007 from BCP and its modifications. Provisions are defined according to the type of debtor (see Table 19). In practice, factoring is not readily exercised by the market as there are no rules in practice allowing the use of invoices as executory instruments.

Table 26. Basic regulation on leasing and factoring operations

Regulation	Description
Leasing	
Law 861, of June 24,1996	Financial Sector Law: Regulates banks, finance companies and other loan companies. Creates Superintendence of Banks (SIB)
Law 1,295 of August 6, 1998	General framework for leasing operations (financial and commercial)
Decree 6,060 of March 4, 2005	Regulates leasing operations (financial and commercial)
Factoring	
Law 861, of June 24,1996	Financial Sector Law: Regulates banks, finance companies and other loan companies. Creates Superintendence of Banks (SIB)
Resolution 1, Act 38, July 1, 2009 from BCP	Regulates factoring operations performed by the financial system.

From the financial inclusion perspective, the need to provide adequate financial instruments for small and medium enterprises requires the active development of leasing and factoring operations in the financial sector. To this end, further market diagnostics are required to determine exactly the main obstacles limiting these products and to identify the regulatory adjustments needed.

E. INSURANCE

Insurance has an important role in people's lives for it is a financial product specially tailored for recovering the economic situation of an individual or family when an unexpected but yet insurable event happens. For instance, the loss of the life of the primary worker or the loss of productive assets can hardly be recovered by fully using savings. This is even more difficult to overcome with the sole reliance on credit. The former are rarely enough to completely overcome the situation, while the latter requires the generation of new income to honor the debt.

Insurance products available in Paraguay are basically those allowed by the Insurance Law (Law 827 of 1996): life insurance and asset insurance. Life insurance may include accidents, sickness, or death. Asset insurance may include products like car insurance, fire and natural disasters, damaged to goods, and also civil liabilities from vehicle accidents. Regulations on specific insurance products have not been issued in Paraguay, though an attempt was made to introduce universal/mandatory civil liability insurance for car accidents. The law that established this mandatory insurance was repealed by Congress after being sanctioned, due to questionings in its regulations.

Insurance companies are not allowed to operate any other kind of insurance from those specifically authorized and all the insurance plans have to be registered with the SIS including all technical and contractual elements. These elements include: specific text of the insurance description and policy; premiums and parameters of calculation. In the case of life insurance, they must also provide the questionnaire to be used, and the basis for the calculation of redemption values.

Insurance companies are required to build mathematical reserves and technical provisions to cover their risks. The Insurance Law requires them to have provisions to cover current risks; for claims pending to settle and those not yet declared; and mathematical reserves to cover life insurance risk according to mortality tables. These provisions and reserves have to be invested according to the rules defined by the Insurance Law.

When buying life and asset insurance, according to SEPRELAD's Resolution 26, of November 26, 2009, CDD procedures are not required when the clients have already been through a KYC process by other supervised financial institutions, other insurance companies, or the CNV. CDD procedures are neither required regarding insurance mass-marketing; as long as premium payments are debited from existing financial products, and the insurance is held on behalf of employees.

As reported during the mission, insurance companies do not find regulations as a limitation to reach low income markets. Despite no legal barriers, the insurance industry has not permeated the low income populations. There are no formal micro-insurance products offered in Paraguay or other formal insurance products specifically targeting the low income populations. The development of micro-insurance has not been considered by the insurance companies as a business model or by the SIS for their long term strategy for the insurance market.

Although insurance regulation seems to be precise, the scope of supervision has limited the outreach of the SIS. Funeral and health insurance products have developed in the market outside the specialized financial regulation. Health insurance is being provided by *medicina prepaga* companies that are supervised by the Health Superintendence regarding the health services provided but, not regarding the financial aspects of insurance. Thus, the product has developed under a different set of rules setting an unleveled field and a potential risk

that may affect the customers. It is important to insist in adequately supervising the financial aspects of these health insurance providers and applying the same rules on reserves, provisions, and investments as the other insurance companies. Funeral pre-paid products are also available in the Paraguayan market; however, these entities also remain out of the regulatory and supervisory scope of the SIS.

The development of micro-insurance products and the associated need to develop a regulatory framework should be considered. According to the Paraguay Financial Inclusion Survey 2013, micro-insurance is a product that is sought by the population but is not widely available. Currently, there are no legal barriers preventing the development of this market. Rather with foresight, the authorities could consider working with the private sector to start developing an appropriate legal framework for this future market. As a note of caution in this area, when trying to develop micro-insurance mass products, defining the parameters of micro-insurance to set the boundaries for premiums and coverage is important for the industry, as well as verifying each claim is required, which is one of the difficulties faced by other micro-insurance companies in other countries. For example, in the case of Peru a definition was included in the regulation (Box 4), while in the case of Colombia the approach used was to induce a market-tailored product by developing a group policy for beneficiaries of *Red Unidos*, the program aimed at eliminating extreme poverty. The micro-insurance program was financed using public funds through the financial inclusion program, *Banca de las Oportunidades*[70]. Other regulatory considerations for micro-insurance products are the challenges posed by the low-cost and simplified delivery of the service. The balance between low-cost and simplified collection channel and wide outreach via agents and mobiles will need to be considered in the regulation. These channels to collect premiums and pay claims for micro-insurance will be critical for the wide adoption of the product. Until now, this kind of authorization has not been found. Currently, banks and finance companies often act as insurance brokers selling insurance products to their clients, frequently bundled with loans (see consumer protection section below).

[70] www.bancadelasoportunidades.gov.co

Box 4. Microinsurance definition in Peru

Resolution S.B.S. N° 14283 -2009 (which modifies Resolution Banks and Insurance Superintendence N 215-2007) set the basic rules for micro-insurance provision according to the following:

Concept: Micro-insurance is an insurance that protects low-income population from losses derived from human and patrimonial risks that may affect them. Coverage is provided by an insurance company, authorized by the Superintendence, hired under the modality of individual or group insurance, for which a simplified policy is issued.

Characteristics of the micro-insurance: The micro-insurance products should comply with the following characteristics:

a) Respond to the risk profile and protection needs of the specific insurable group identified.
b) Coverage should be adequate for the characteristic of the sector to which they are addressed and consider the real and immediate protection needs.
c) The simplified policy should be in a simple language and contain the minimum requirements established in this resolution.
d) The policy of the group insurance should be written in an easily comprehensible language according to the characteristics of the micro-insurance, contain the minimum information stated in numeral 6 and it should not include conditions that affect its characteristics of contractual simplicity, clarity, and ease.
e) It cannot include previous verifications with the insured person or asset, unless the nature of the insurance requires it, being the subscription of the simplified policy enough to operate the coverage of the subscription. If verifications are necessary, they should be according to the coverage of the micro-insurance.
f) No exclusions should be established and if required, this should be minimum and according to the micro-insurance coverage.
g) The premium payment should be made in the form and term established in the simplified policy. Non-compliance with the payment can result in the suspension of the coverage or resolution of the contract, situation that should be clearly stated in the policy.
h) Deductible and co-payment do not apply.
i) Expenses related to issuing the policy should be included in the value of the premium.
j) In case of a sinister, the claim should be presented to the insurance seller who will process the corresponding compensation payment with the insurance company
k) The compensation payment should be made within 10 days after receiving the corresponding documents

Source: Resolution Banks and Insurance Superintendence No. 14,283, 2009.

F. CONCLUSION

Financial regulation sets the general rules and requirements to provide financial services by those authorized, leaving enough space for each provider to design and develop different types of products according to its target market and its business model. In this sense, financial regulation does not introduce direct limits to the basic characteristics of financial products such as pricing or minimum amounts which may directly limit financial inclusion. However, specific regulations aimed at controlling risks such as: AML/CFT compliance, credit risk, operational risk, and usury prevention has influenced costs for the providers that indirectly contribute to increasing the costs for the clients. This is the case for traditional deposits and credit products limiting the ability of financial institutions to develop viable business models to provide services to low income population (these products tend to have very low amounts and high levels of transactions).

Specific product regulation for banks, finance companies, and EMPES recently issued has been an important step towards financial inclusion in Paraguay. Regulations on basic savings accounts and e-money have allowed the use of simplified CDD procedures to open accounts, reduced the costs for the providers as well as the barriers faced by the population when opening accounts. In both cases, simplified CDD procedures have been authorized with limits on balances and deposits to enhance AML/CFT risk control. As for the basic savings accounts, mandatory reduced transaction costs are required although the implementation of the product is not mandatory for the banks. Though few basic accounts have been opened to date, this kind of regulation is promising for increasing financial inclusion of the unbanked. In terms of electronic payments, an e-money regulation was issued allowing banks, finance companies, and EMPES to conduct e-money and non-bank electronic transfers. This regulation sets risk control limits according to a regulatory proportional framework where simplified CDD procedures are allowed and limits are set to monthly transfers, balances, debits and credits. These regulations are important advances for increasing financial inclusion, although further refinements to the regulations, such as the recommended pass-through mechanism for the e-money regulation, could strengthen the overall legal framework.

The national electronic payment environment has also taken a significant step forward with the adoption of the Payments System Law passed in 2012 and the implementation of the missing national financial infrastructure of an ATS and

CSD system. Though further reforms are still in progress, should e-payment providers and cooperatives be able to meet the ATS system's operational requirements as either indirect or direct participants of the system; this will enable a further shift from cash to electronic payments.

Regulated credit is being provided by banks, finance companies, and savings and credit cooperatives under two different sets of regulatory framework. Banks and finance companies have to apply the credit risk management regulation issued by BCP in which credits are classified by debtor and type of credit, including microcredit. This regulation sets minimum provisioning requirements and risk classification rules according to days past due for each credit type. Provisioning starts in all credit types after 60 days past due, while sound financial practices applied in several countries in the region suggest provisions start when credit risk increases mostly after 30 days; or in more stringent conditions in which the regulation considers a credit is at risk as soon as it is disbursed. For banks and finance companies in Paraguay, a microcredit definition and classification exists although it has room for improvements according to microcredit best practices. Financial credit by savings and credit cooperatives is regulated by INCOOP with a different set of rules regarding credit types, classification, and provisioning that need to be harmonized with those of the banks and finance companies. For cooperatives, the microcredit definition and classification do not exist and thus cooperatives do not separately regulate and supervise it as a unique type of credit.

The fragmentation of the credit information system hampers accurate credit risk assessments. Paraguay has three main registries: BCP's public credit registry, a private credit bureau, and the cooperative credit bureau. BCP's registry has negative and positive information from entities under its supervision and the credit information is received on a 10 day delay basis. The private credit bureau is limited to negative information and it is not integrated with BCP's public credit registry. The cooperatives' credit information has been reporting to INCOOP since June 2014 but on a monthly basis. INCOOP's credit registry is not integrated to BCP's nor to the private bureau. The fragmentation has made it difficult to obtain an accurate assessment of credit risk.

The further development of leasing and factoring regulations could potentially improve financing options for SMEs. Though the legal basis for both products have been developed for banks and finance companies, leasing regulations by BCP have not been issued and for factoring there are serious limitations on the accounts receivables legal framework.

Insurance products for financial inclusion are non-existent in Paraguay. Regulations on micro-insurance are not in place. In addition, the absence of the private sector's interest to develop adequate business models to provide the much desired products for the low income population merits further attention.

5. Cross-cutting regulation

This section contains general laws and regulations that are applicable across all financial products and thus may affect access and usage of financial products from the financial inclusion perspective. This includes the general AML minimum requirements applicable to all financial products, delivery channels, operational risk requirements, consumer protection and information disclosure, and the competition law in Paraguay. General risk management regulation (AML and operational risk) can affect financial inclusion for compliance may be costly for financial institutions thus limiting access to low-amount products and/or imposing high transactional costs to the clients. Delivery channels regulations can be limiting the financial sector outreach as a necessary, but not a sufficient, condition for financial inclusion. While regulations on transparency, consumer protection, and information reporting is key to allowing consumers appropriate decision-making regarding the financial products which are more suitable to their needs. Finally, competition regulation sets the framework for restricting abusive conducts and market concentration rules that can be limiting financial inclusion. For example, if there are a few large financial institutions in the market with little interest in low-income markets due to collusive business practices. Also, product pricing can become obscured in the absence of adequate competition regulations.

A. AML REGULATION

General AML regulatory framework is set by the Law 1,015 of January 10, 1996 and modified by Law 3,783 of July 20, 2009; it defines and punishes money laundering as a felony and creates the Anti-Money Laundering Authority (SEPRELAD) under the President of Paraguay. The Law is applicable to banks, finance companies, insurance companies, foreign exchange houses, brokers, stock exchange, cooperatives, NGO's and pawnshops. This Law defines the obligations of all these institutions to identify their clients by registering and verifying the information provided regarding identity, residency, and economic activity. Also, they are required to identify and register all the operations performed by their clients; to keep records for at least 5 years after the last operation has been performed; to report suspicious operations; to maintain client confidentiality of their actions; and to have internal control procedures. SEPRELAD is defined by the Law as the enforcement authority for AML measures and to that end it is authorized to issue laws and regulations by which all subjects must abide (Table 27).

Table 27. Regulation on AML

Regulation	Description
Law 1,015 of January 10, 1996 and Law 3783 of July 20, 2009.	Prevents and suppresses illegal acts aimed at legitimizing goods or assets using the financial system and other economic sectors. Creates the Anti-Money Laundering Authority (SEPRELAD) under the Presidency.
Resolution 349 of November 1, 2013 from SEPRELAD.	Approves the regulation on AML, terrorism financing (TF) and mass weapons proliferation (MWP) for all those under SIB's supervision.
Resolution 370 of November 7, 2011 from SEPRELAD.	Approves the regulation on AML, TF and MWP for all cooperatives supervised by INCOOP.
Resolution 454 of November 30, 2011 from SEPRELAD	Sets the obligation for supervisors to control compliance with SEPRELAD's regulations by the institutions under their supervision.

The general AML regulations apply to all clients and potential clients in the financial sector; cooperatives, capital markets and the financial entities are responsible to set their internal policies and procedures to adhere to the AML regulations. Given that ML risk is present in financial services, the regulation has stated that the financial institutions are responsible to set internal policies and procedures to prevent ML and terrorism financing (TF) and weapons of mass destruction (WMD). AML-CFT policies are defined by: (i) KYC procedures to which the minimum obligations are the CDD (ii) risk level classification according to the client's background, behavior, and economic activities (iii) product, services and delivery channels related risks: according to complexity or specific characteristics and geographical areas related risks: place of residence as well as the country's location. The internal procedures of the financial entities should include registering and monitoring, keeping records, and reporting suspicious transactions. The financial entities must bear the cost for all these activities within their normal operations.

SEPRELAD's regulations set the principles, rules, and minimum requirements that have to be applied ex-ante and ex-post by all those required to comply. Regulations issued by SEPRELAD are based on the Financial Action Task Force (FATF) recommendations for all financial products under regulatory supervision. These recommendations allow simplified CDD procedures in cases of low risk ML products (which must be justified by a risk

assessment), such as with basic accounts and e-money products.

As set by Resolution 349 of November 1 2013 from SEPRELAD, financial institutions under SIB's supervision are required to identify their clients at the beginning of the relationship using reliable verification means and the required documents according to the client's risk level. According to this resolution, as a general practice, financial institutions must require from their first time clients the original documents or authenticated copies of their identification. Verification of information is often done by requiring and keeping paper copies of documents sometimes with certified authenticity, which can be costly for both the financial entity and the customer. The financial entities can also request authorization to verify the information provided by the client by using public or private databases and the client has to commit to update all the information every time the financial institution requires it. In Paraguay, technology-based verification mechanisms are allowed when mobiles are used to open accounts, fully complying with the international requirements. In practice, what occurs in Paraguay is that information validation is only done by comparing the paper copies with the original document presented by the client, without a third-party confirmation of the document's authenticity. Also, the documentation required by the client depends on their level of risk. Table 28 includes the minimum client identification requirements set by SEPRELAD, which must be verified and backed-up with adequate documentation.

Table 28. Minimum (but not simplified) identification requirements for banks, finance companies and cooperatives.

	Banks and finance companies		Cooperatives
	Permanent[71] clients (individuals)	Occasional[72] clients (individuals)	Cooperatives members (individuals)
Name and surname	X	X	X
ID number	X	X	X
Place and date of birth	X	X	X
Home and work address	X	X	X
Marital status	X		
Phone number (home and work)	X		X
E-mail (if applicable)	X		X
Tax sworn statement or evidence of non- contributor	X		X
Statement to money and assets origin	X		X
Main economic activity description	X	X	X
Income and expenditures	X		X
Total assets and liabilities	X		X
Purpose of commercial relationship			
Personal, bank or commercial references	X		X
Public facility's payment receipt			X
Name and surname of spouse (if applicable)	X		X
Main economic activity description of spouse (if applicable)	X		
Name and surname of beneficiaries (if applicable)	X		
Authorization to consult information from other sources	X		

Source: Resolution 349 of November 1, 2013 and Resolution 370 of November 7, 2011 from SEPRELAD

[71] According to SEPRELAD, permanent clients are those with established contractual relations by virtue of financial products.
[72] According to SEPRELAD these are people using some financial services sometimes.

Simplified KYC procedures were approved by SEPRELAD's Resolution 349 of November 1, 2013 for all those under SIB supervision. This set of procedures can be applied to low-risk clients (transactions for less than US$2,430 monthly), and those using savings accounts in local currency, credit cards, remittances or CCTs with transactions under three minimum wages (US$1,215). The simplified KYC procedures still require the client's identification form together with a copy of the national ID. In the case of savings accounts in local currency, credit cards, and remittances with transactions for less than 3 minimum wages (US$1,215) a simplified procedure can be used: the identification form has to be completed; a copy of the ID has to be provided[73], together with a formal income statement or proof of salary. For business credit applications, the client's ID and evidence of income or commercial activities such as payroll receipts, commercial registry or VAT sworn statement is required. These abbreviated procedures, already approved as a general practice, are an important step forward in the development of inclusive financial products business models for they do not require any mandatory cost reduction as is the case of the basic savings accounts regime (refer to Section 4 Sub-section A for a discussion on this matter). The CDD activities are also a cost for financial institutions and require an effort on the client's side, which sometimes results in moving clients away from the financial system. This effort is more costly for low-income clients and in some cases it is even impossible to comply with.

In the case of cooperatives, AML regulations are set by Resolution 370 of November 7, 2011 from SEPRELAD. Similar to SIB supervised entities, the cooperatives are required to set policies and procedures to prevent ML. They are required to comply with the same basic principles based on KYC to which the minimum obligations are the same as other financial institutions (CDD, registration and reporting of suspicious transactions). Regarding CDD towards their members, compliance with their internal cooperative procedures is allowed, but the information included in Table 27 *can be collected ex-post* the development of a client relationship. Please note that in the case of banks and finance companies this information has to be collected *before* the commercial relationship is established. The same set of rules should be applied to both banks and finance companies as well as cooperatives. The recommended process would be conducting CDD requirement *prior* to engaging in a business relationship with the customer. This would allow a more sound AML/CFT risk control system over all financial transactions. Simplified CDD procedures have not been set in this regulation for cooperatives. The simplified CDD procedures can benefit from leveraging the E-Signature Law (Law 4,017, Law 4,610 from 2012 and Decree 7,369 from 2011). When the e-signature law is applied to the CDD process it facilitates documentation compliance because e-signatures can replace the necessity for physical signatures required as part for the CDD process. Such simplified procedures can facilitate account openings for the populations outside of Asuncion.

[73] According to the authorities everyone has ID in Paraguay. The problem is that financial institutions do not have access to the national ID database to verify authenticity.

B. DELIVERY CHANNELS FOR BANKS, FINANCE COMPANIES AND COOPERATIVES

Delivery channels have often been cited as an important issue to analyze in order to expand financial sector outreach. Onerous delivery channel requirements have been found to limit financial inclusion for several reasons: the associated costs to expand physical infrastructure to remote areas where often the related financial transactions cannot offset the cost of physically expanding to these areas. An alternative common challenge is that traditional financial regulations impose heavy requirements on financial institutions to prevent the expansion of delivery channels beyond the operational and financial capability of the financial institutions. Though these requirements are fair, implementation should be proportionate. For example, requiring annual plans of expansion rather than authorizing each branch expansion separately. Often regulatory challenges remain that are not as important for traditional financial services, but become important for the business case of low-amount transactional products.

Branches for banks and finance companies

BCP's regulation states that branches can provide a wide range of financial services but the closure or moving of these branches requires prior authorization. Resolution 2, Act 70 of November 22, 2011, defines branches as facilities or establishments open to the public by financial institutions to provide access and usage of all services and products, managed and operated by the institutions' employees. These branches can be fixed or mobile, permanent or temporary. Facility sharing is allowed as long as it is clearly published where the financial branch is located within the establishment. However, Article 6 of Law 861 of June 24, 1996 states that should banks or finance companies decide to close or move the business location of certain branches/agencies, they need prior authorization from BCP on a case-by-case basis. Branch authorization requires documents such as a feasibility study, and to be in-compliance with current information requirements, demonstration of manager's probity, competence and experience, among others.

The requirement of requesting BCP's permission to change branch locations and establish new branches is a major constraint to expand the delivery channels to clients. Financial institutions are mandated to request for authorization every time a branch is opened or closed, burdening the financial product provisioning process. This could also inaccurately reflect the ebbs and flows of financial services in certain geographic areas. Rather a

consideration, permitting branch expansion based on previous annual planning authorization, ex-post supervision or exploring the possibility of introducing some flexibility for branch expansion within the general framework of the current redrafting of the Financial Sector Law (Law 861, June 24, 1996) should be explored. Also, general requirements can be set to allow a bank/finance company to open a branch as long as it follows the requirements. In this case, the regulator would be in charge of determining if the requirements are not met issuing a directive to upgrade or close the branch.

There are no restrictions regarding business opening hours for banks and finance companies as long as their operating hours coincide with the same operational hours as BCP's clearing house. Banks and finance companies can freely define opening hours and can include being open during weekends and holidays. Despite this liberty, some banks such as BNF are open to the public only during workdays from 8 am to 1 pm, due to high operational costs and security issues as reported during the mission. In practice, finance companies attend to its clientele until the afternoon.

Agents for banks and finance companies

Paraguay has recently adopted a regulation to promote branchless banking. Resolution 1, Act 70 of November 22, 2011 from BCP has allowed a wider scope of delivery channels in the financial sector mostly aiming at promoting branchless banking through agents, as a means to reduce low-value product delivery costs for the financial entities. This regulation defined agents' basic characteristics as individuals or corporations with no dependent relationship to the financial institution, with commercial activities of their own on their own premises or those of third parties. These agents are allowed to carry out financial services on behalf of and under the exclusive responsibility of the financial institutions in addition to their main commercial activity, under contract with one or several financial institutions. They can operate directly with the financial institutions on a one-by-one basis, or through an agent manager hired by the financial institution.

The Resolution also explicitly defines both permissible and non-permissible activities of the agents. Basic operations allowed through agents include: loan disbursement and collection, transfers, deposits and withdrawals, consultations, transaction summary delivery, payments and collections, and low risk account opening. The regulation specifically forbids agents to reassign these contracts to third parties, except when working under an agent manager. It does not allow agents to charge any kind of financial services related fee to the clients, provide any kind of guarantees to the clients, operate if there is a communication failure, or provide financial services on their own. Security requirements are provided together with consumer protection information. For example, the regulation requires the full identification of the agent with the financial institution, phone numbers of other communication channels and address of the nearest branch, fees charged by the financial institution to the client, and the opening hours.

The regulation requirement for using agents is a general pre-authorization. This means financial institutions can request authorization for using the channel but not on a case-by-case basis, as is the case with traditional branches. Detailed requirements are set including a contract form with general minimum characteristics defined. Also, Resolution 1, Act 70 of November 22, 2011 from BCP, requires that activities as agents must be secondary to the main commercial activity. Banking agents are required to use only electronic terminals with online connection to the financial institution's technological platform, receipts produced by the electronic terminal to verify the transaction, date, type and amount, as well as an identification of the agent and the financial institution. Also, the measures to control operational risk are applicable to agents, like limits per individual and transaction according to the agent's cash flow.

ATMs/ POS

Opening ATMs does not require previous authorization from BCP. ATMs are defined in Paraguay's regulation by Resolution 1, Act 70 of November 22, 2011 from BCP as electronic devices connected to the financial institution to provide clients services using debit or credit cards or other instruments using a PIN, electronic signature or others. Security requirements include closed circuit television (CCTV) in high and medium high risk ATM locations. High risk areas are considered those ATMs in low density areas with easy access and criminal events; medium-high risk areas are those in low density areas with easy access and low police coverage; medium-low risk in low-density areas but with a regular flow of people, police presence and private surveillance; and low risk areas as ATMs located inside places with regulated access, high flow of people and surveillance. A sign posted inside the ATM with minimum-security procedures to be applied by the user is also required by Circular SB SG 55, of January 30, 2013.

There is no specific regulation on Point of Sale (POS) Terminals.

Electronic Channels for Delivery: Mobile banking

Mobile phones are being used as delivery channel by banks and finance companies even though no specific regulation has been identified. Financial institutions use the channel to serve their clients and there is a general authorization for opening basic accounts using mobiles.

A regulation regarding security requirements to maintain information integrity through electronic channels was issued by SIB through Circular SB SG No. 55/2013, and Circular SB SG 474/2013.

These regulations refer to electronic channels as all delivery channels like Internet, electronic banking, and any other electronic device. Transactions using ATMs also have to comply with this regulation. These regulations set minimum requirements to guarantee information integrity and authenticity, like the use of authentication and encryption algorithms for information transmission, sound technological architecture, and constant network monitoring. The regulation requires redundant channels and automatic traffic re-directioning, as well as strong firewall rules. Regular security tests and controls must be performed. Transactions between financial and non-financial institutions must comply with the same security integrity requirements.

Delivery channels for cooperatives

The cooperative's regulation allows the use of all delivery channels with prior authorization from INCOOP. Through Resolution 11,102 of November 19, 2013 and Resolution 11,481 of February 6, 2014, the cooperatives are allowed to use any delivery channel -branches, agents, Internet and mobiles - with previous authorization from INCOOP on a case-by-case basis. This is in order to keep excessive growth over the institution's operational and financial capacity in check.

C. OPERATIONAL RISK REQUIREMENTS

Principles for operational risk management by banks and finance companies were issued on December 2012 by BCP to be applied by all financial institutions. Resolution 4, Act 67/2012 defines operational risk as the possibility of losses due to inadequacy or failure of internal processes, persons, systems or external events. As a general principle set by regulation, financial institutions are required to design a risk management process that allows the identification, assessment, monitoring, control and mitigation of operational risks occurring in the performance of businesses and operations. Vulnerability must also be assessed.

Minimum requirements to mitigate operational risk have not been included in the regulation issued by BCP yet; but as they are defined in the future, the requirements should be designed proportionately to the risks of the model. This is an important issue for financial inclusion especially regarding specific information technology-related aspects like security characteristics for electronic instruments (chip versus magnetic band) that contribute to protect customer's trust and confidence in the financial and payment's system. Also lacking is the resolution mechanisms for claims originated in fraudulent, inaccurate or mistaken transactions using usage instruments of financial services (checks, credit or debit cards, mobiles, Internet). However, for financial inclusion purposes the management and control of operational risk of products like e-payments needs to be proportional to the risk entailed by very low value transactions to avoid overloading a very sensitive business model. In strong traditional regulation environments, specific characteristics and security features of the payment / usage instruments are required; as regulations are adapted to high amount products that entail also high risk. However, these risks change in the case of low-amount financial products allowing the regulation to be proportional to the risk of specific markets.

In rural areas, cellular phones are often used by multiple people as determined in the Supply side Technical Note. From the financial regulation point of view, cellphones are instruments to use financial products, owned by one person responsible for their usage, which should only be by the owner. However, if these findings are widespread, operational risk provisions and consumer protection rules for mobile wallets should warn consumers of their responsibilities in letting someone else use their mobile wallet. The opening of accounts only allows one mobile to one account to one client and from the regulation point of view all transactions made with that cellphone are of the owner's responsibility.

D. CONSUMER PROTECTION, INFORMATION DISCLOSURE AND TRANSPARENCY[74]

Paraguay has a consumer protection law that covers the financial sector. Consumer protection is regulated by the General Consumer Protection Law 1,334 of 1998. This framework includes rules applicable to all sectors including the financial sector. In 2013, Law 4,974 created an autonomous government body, the National Secretary of Consumer Protection (Secretaria Nacional de Defensa al Consumidor-SEDECO), to implement the consumer protection law. BCP has adopted some rules to protect financial consumers, but its role and SEDECO's are not yet clear regarding the general consumer protection law and financial consumer rights. The financial regulators, BCP and INCOOP, have issued regulations on consumer protection but they are not yet uniform between the banks & finance companies and cooperatives. In this regard, it would be important to consider including specific attributions on financial consumer protection to BCP and INCOOP. This would allow a better fit of requirements to financial services and expedite protection of consumers fostering public's trust in the financial sector.

All financial institutions supervised by BCP must disclose relevant transparency information to their clients according to specific regulation issued by BCP. BCP has issued regulations on information disclosure since 2001 when Resolution 2, Act 123 of November 15, 2001 was issued then modified by Resolution 2, Act 73, on November 7, 2003 that set a methodology to calculate and publish interest rates including commissions that should be considered part of the interest rate. The interest rates

[74] More details can be found in the Consumer Protection & Financial Literacy diagnostic made by the World Bank as of June 2014.

are required to be published in newspapers and displayed in branches. Credit card information transparency provisions were included in 2007 by Resolution 5, Act 13, of May 3 by BCP limiting some commissions to 15% of the loan disbursed for loans up to 5 minimum wages. The bundling of insurance products into loans (life insurance linked to credit) led SIS to issue Resolution SS.SG 45 of August 8, 2013 limiting the insurance sales commission to 30% of the premium as a measure to protect consumers. No other regulation exists defining specifics for publicly disclosing information specific costs, commissions, fees, and costs applied to all products of financial institutions. The only exception is the e-payment regulation that requires EMPES to disclose applicable costs and commissions.

Despite the information transparency regulation, a lack of price transparency and market misconduct was observed during the mission. Due to the nuances of terminology, financial institutions have set different kinds of fees and commissions with similar names for the same service. For example, SIB found around 250 different types of commissions. This makes it impossible for consumers to assess the real total cost of the services provided, let alone compare with other financial institutions. Cross-selling is a common practice together with product and price bundling preventing consumers to have a clear notion of the real price of financial products. Also, the use by financial institutions of a unique contract-form[75] including the acceptance of all financial traditional products [76] regardless of the products effectively requested by the consumer was observed in the market. Also noted were abusive loan collection practices after loans are sold to non-supervised companies. In the case of cooperatives, information disclosure requirements are stated in Resolution 11,102 of November 19, 2013. The rules include requirements for publishing costs and interest rates at their branches, together with information on terms and conditions of savings and credit products.

It could be helpful to consider issuing specific rules to improve information disclosure and transparency. Refining information disclosure requirements for consumer protection purposes is key to promote a more active competitive financial market for the benefit of the financial customers. However, some proportionality has to be considered in order to avoid cost overloading on financial institutions and limiting the expansion of low-value product business models. Also, a consideration could be that financial institutions and cooperatives should send and publish regularly statistics regarding coverage and usage of financial services together with the costs, fees and commissions to the respective regulators.

Peru's Superintendency of Banks (SBS) has put in place a set of regulations that is applicable to all supervised financial entities, which clarifies the transparency requirements that could be taken as a helpful example to improve the current market practice in Paraguay. Peru's SBS requires interest rates to be expressed as effective annual rates for all financial operations. SBS defined "commissions" as the value returned from the consumers for the provision of the financial service by the institution; this included a non-exhaustive classification of all types of commissions. The SBS also defined "costs" as all those related to services really received from third parties to comply with the operations requirements, like insurance premiums. More details can be found in the Paraguay Consumer Protection & Financial Literacy diagnostic made by the World Bank as of June 2014.

E. COMPETITION

The legal and regulatory framework to promote competition is contained in Law 4,956 of May 29, 2013 and Decree 1,490 of April 14, 2014. This law regulates competition, market concentration, and behavior in all markets including financial markets. The Law created the *Comisión Nacional de la Competencia* (CONACOM) in 2013, but the Commission is not operational yet as reported during the mission. Decree 1,490 regulates Law 4,956 regarding aspects on forbidden agreements that limit competition, abusive conducts related to predatory prices, market concentration rules and evaluation. All these activities have to be assessed and controlled by CONACOM. The Decree also defines the organizational structure for CONACOM, its activities and responsibilities. Due to the fact that CONACOM has yet to be operational and effective, the implementation of competition policy laws and regulations have yet to be defined and determined in the area of financial inclusion.

F. CONCLUSION

Cross cutting regulation affecting financial inclusion in Paraguay basically refers to general AML minimum requirements applicable to all financial products, delivery channels, operational risk requirements, consumer protection and information disclosure, and the competition law.

General AML risk control requirements issued by SEPRELAD apply to a wide range of financial service providers in Paraguay. The AML risk control requirements apply to: all entities under SIB, SIS and INCOOP's supervision as well as foreign exchange houses, brokers, stock exchange, NGO's and pawnshops. The general AML regulation is based on FATF recommendations and CDD procedures must be followed including client identification, basic form filling, and information verification. These rules are more lenient for cooperatives for they can perform CDD procedures after clients have been enrolled as a cooperative member while other financial institutions have to perform these checks before undertaking a financial service.

[75] In Paraguay, each financial institution has one contract model that includes all financial products rather than one contract for each product.
[76] This practice is not allowed for basic accounts.

Paraguay's delivery channel regulations are improving but still face limitations for increasing financial inclusion. In Paraguay, branch regulations as defined by the Financial Sector Law for banks and finance companies is limiting due to the fact that prior authorization is required for branch expansion on a case-by-case basis. Cooperatives also need prior authorization for branch expansion, but not on a case-by-case basis. Thus the necessity for the approval of branch expansion by the regulatory bodies can impede the expansion rates of financial sector outreach. Agent regulation for banks and finance companies was issued in 2011 as an important step for financial coverage expansion. The agent regulation contains all the basic rules to control the associated risks of using agent banking. The use of ATMs or POS does not require previous authorization.

Regarding operational risk, regulation in Paraguay is not limiting due to excessive requirements. On the contrary, the regulation only defines general principles but rules and minimum requirements are lacking. Further improvement of this regulation is relevant for financial inclusion to safeguard transactions and the public's trust of the financial services.

Consumer protection, information disclosure and transparency still need improvement. A consumer protection legal framework is in place but implementation is still in process. BCP has adopted rules to protect financial consumers, but the division of responsibility and the respective scope of the role between BCP and SEDECO is not yet clear regarding the general consumer protection law and financial consumer rights. The financial regulators, BCP and INCOOP, have issued regulations on consumer protection but they are not yet uniform between the banks/finance companies and the cooperatives. In light of a recent legal and regulatory framework on competition issued in 2013 and 2014, more financial information disclosure and transparency policies would help promote a more active competitive financial market for the benefit of the financial customers.

6. Summary of Legal and Regulatory Policy Recommendations

Recommendation:	Priority: High, Medium or Low	Timeframe Immediate (within 6 months), Mid-term (6-24 months) or Long-term	Responsible party
Broaden the scope of financial activity's definition and supervision to effectively reach all deposit taking activities and improve enforcement of non-prudential regulation over financial activities that do not entail deposit taking.	High	Immediate (Amendments to the Financial Sector Law - Law 861, of June 24 1996 is currently in progress)	Congress / BCP
The regulation for savings and credit cooperatives should be modified to be aligned with the banks and finance companies. See Section 4, Sub-section C.	High	Mid-term	INCOOP
Define capital requirements and capital adequacy for EMPEs. See Section 2, Sub-section F.	High	Immediate (When defining the requirements, proportionality should be considered as well as the revised Financial Sector Law and attributions from the Payment System Law which was referenced to issue the EMPEs regulation.)	BCP
Include alternative mechanisms of product acceptance/signature in CDD procedures including the simplified procedure. See Section 4, Sub-section A, and Section 5, Sub-section A.	High	Immediate	SEPRELAD
Clearly specify the maximum amount of transactions for low-risk clients regarding basic savings accounts. See Section 5, Sub-section A.	High	Immediate	SEPRELAD
Allow the use of electronic signature in CDD process. See Section 4, Sub-section A, and Section 5, Sub-section A.	High	Immediate	SEPRELAD
Allow access to national ID database for financial institutions to verify ID's authenticity. See Section 4, Sub-section A, and Section 5, Sub-section A.	High	Immediate	MINISTERIO DEL INTERIOR BCP/SEPRELAD
All loans from banks, finance companies and cooperatives should shorten the first credit risk category period to 30 days. See Section 4, Sub-section C.	High	Mid- term	BCP, INCOOP
Apply same credit definitions and provisioning structure between banks, finance companies, and cooperatives. See Section 4, Sub-section C.	High	Mid- term	INCOOP
Refine the microcredit definition for banks and finance companies. Also, apply the same definition to cooperatives as well. See Section 4, Sub-section C.	High	Mid- term	INCOOP / BCP
Improve regulation on transparency on interest rates and financial product costs for banks, finance companies, and cooperatives. See Section 5, subsection D.	High	Immediate	BCP/ INCOOP

Enforcement of non-prudential rules such as the usury regulation, information disclosure, transparency norms, general business conduct for all financial service providers; including the non-regulated and non-supervised sector (ie. casas de creditos, casas comerciales, etc.) Refine scope of interest rates cap enforcement. See Section 3, Sub-section C.	High	Mid-term	BCP/INCOOP/SEDECO
Implement mechanisms for credit registry information sharing/integration between BCP and INCOOP. See Section 4, Sub-section C.	High	Long-term	BCP/INCOOP
Promote accurate and updated credit information at both the BCP and INCOOP credit registry. See Section 4, Sub-section C.	High	Mid-term	BCP/INCOOP
Require banks and finance companies to keep records of loans sold to unsupervised companies. See Section 4, Sub-section C.	High	Immediate	BCP
SIS could consider to develop a regulatory definition for micro-insurance. See Section 4, Sub-section E.	High	Mid-term	BCP/SIS
Apply the same set of CDD rules applied to banks and finance companies to cooperative as well. See Section 5, Sub-section A.	High	Mid-term	SEPRELAD
Allow branch expansion for banks and finance companies based on a previous general authorization of annual plans of expansion. See Section 5, Sub-section B.	High	Mid-term	BCP
Continue progress towards a new secured transactions regime. See Section 4, Sub-section C.	High	Lon-term	MINISTRY OF FINANCE/ BCP
Improve fund protection for e-money products. See Section 2, Sub-section F and Section 4, Sub-section B.	Medium	Mid-term	BCP
Continue pension reform to promote long-term savings products. See Section 2, Sub-section D.	Medium	Long-term	MINISTRY OF FINANCE
Consider allowing a wider range of delivery channels for insurance companies. See Section 5, Sub-section B.	Medium	Long-term	BCP
Issue rules and minimum requirements for operational risk management, keeping proportionality to financial inclusion products. See Section 5, Sub-section C.	Medium	Mid-term	BCP / INCOOP
Include specific attributions on financial consumer protection to the BCP (SIB and SIS) and INCOOP. See Section 5, Sub-section D.	Medium	Mid-tern	BCP / INCOOP / SEDECO
Apply specialized financial regulation and supervision to insurance products developed outside the regulated market. (ie. funeral and pre-paid medicine, etc.) See Section 3, Sub-section C.	Medium	Mid-term	BCP
Issue adequate rules to allow the performing of leasing and factoring operations by banks and finance companies. (The issuing of adequate rules could imply understanding the market limitations to provide leasing and factoring; such as the use of invoices as executory instruments.) See Section 4, Sub-section D.	Medium	Mid-term	BCP

References

AFI, Regulatory Approaches to Mobile Financial Services in Latin America, April 2014.
Banco Central del Paraguay, Informe de Estabilidad Financiera, Junio 2013.

International Association of Insurance Supervisors-IAIS, " Application Paper on Regulation and Supervision supporting Inclusive Insurance Markets" , October 2012

ASBA, Guía de Principios para una Efeciva Regulación y Supervisión de las Operaciones de Microfinanzas, 2010.

Basel Committee on Banking Supervision, Microfinance activities and the Core Principles for Effective Banking Supervision, August 2010.

BFA, Assessment for E-money Regulatory Framework, SBS Peru, 2013.

BID/ FOMIN, El Panorama de los Microseguros en América Latina y EL Caribe, 2013.

BID/FOMIN-CAF, Agents and Financial Inclusion: Regulatory Frameworks in Latin America, Technologies for Financial Inclusion (TEC-IN). September 2013

CEMLA, Sistemas de reporte de préstamos bancarios y créditos en Paraguay, August 2011, World Bank, FirstInitiative.

Christen R., Lauer K., Lyman T., and Rosenberg R., A Guide to Regulation and Supervision of Microfinance, Microfinance Consensus Guidelines, CGAP, 2011.

FATF, Anti-money Laundering and Terrorist Financing Measures and Financial Inclusion. 2013.

FATF, International Standards on Combating Money Laundering and Financing Terrorism & Proliferation, FATF Recommendations, 2012.

GSMA, Dinero Móvil en Paraguay: Un estudio de caso de Tigo Paraguay.

Marulanda B., Paredes M., Fajury L., Assessment and regulation of financial products, payment instruments and delivery channels for financial inclusion in Uruguay, CAF, 2013.

Marulanda Consultores, Access to Finance in Colombia, USAID, 2005.

Marulanda Consultores, Access to Finance in Colombia, challenges for the next four years, CAF 2010.

Marulanda Consultores, Assessment of Access to Financial Services in Honduras, 2011.

Marulanda Consultores, Financial Inclusion Strategy for the Ministry for Development and Social Inclusion in Peru, 2012.

Marulanda Consultores, Assessment of Access to Financial Services in Panama, GIZ IDB, 2012.

Marulanda Consultores, USAID's support to Financial Inclusion Policy in Colombia 2006-2013, USAID, November 2013.

Marulanda Consultores, Estrategia de Inclusión Financiera para Colombia 2014- 2018, Ministry of Finance, February 2014.

Ministry of Finance Paraguay, Financial Leasing an Un-explored Market in Paraguay, December 2007.

Rosales R., Regulation and Supervision of Microcredit in Latin America, An Inside View of Latin American Microfinance, 2006.

Red de Microfinanzas, Oferta y Demanda de Microfinanzas con Alcance Rural en el Paraguay, 2013.

World Bank, Financial Inclusion Global Financial Development Report, 2014.

World Bank, Supply-Side Assessment of Financial Inclusion in Paraguay, 2014.

World Bank, Paraguay's 2013 Financial Inclusion Survey, 2014.

Annex 1. Regulation Reviewed

Regulation	Authority	Contents
National Constitution, 1992		
Law 238, 1954	Congress	Pension Fund for Railway workers
Law 281, 1961	Congress	Creates the BNF
Law 438, 1994.	Congress	Sets the general regulatory framework for the constitution, organization and operation of all cooperatives.
Law 489, 1995	Congress	BCP Organic Law
Law 551, 1995	Congress	General regulation framework for Crédito Agrícola de Habilitación
Law 642, 1995	Congress	General legal framework for telecommunications services
Law 827, 1996	Congress	General legal framework for insurance and creates the SIS
Law 861, 1996	Congress	General legal framework for banks, finance companies and other credit institutions and creates the SIB
Law 1015, 1997	Congress	Prevents and controls illegal actions aimed at legitimizing illegal money or assets.
Law 1183, 1985	Congress	Civil Code of Paraguay
Law 1284, 1998	Congress	Capital markets general framework
Law 1295, 1998	Congress	General framework for leasing operations (financial and commercial)
Law 1300, 1987	Congress	Pension Fund for ANDE workers
Law 1361, 1988	Congress	Itaipu Pension Fund
Law 2100, 2003	Congress	Sets restructuration measures for BNF
Law 2102, 2003	Congress	Law of Retirement Pension and Municipal Pensions
Law 2157, 2003	Congress	General legal framework for INCOOP.
Law 2334, 2003	Congress	Sets the deposit insurance for financial institutions.
Law 2339, 2003	Congress	Modifies usury limits set by Law 489, 1995
Law 2345, 2003	Congress	Reforms the Caja Fiscal
Law 2283, 2003	Congress	Regulated pawnshops
Law 2502, 2004	Congress	Modifies Law 2100, 2003 and limits scope of deposit insurance regarding BNF.
Law 2640, 2005	Congress	Creates the AFD
Law 2857, 2006	Congress	Pension Fund for Congress Workers
Law 3330, 2007	Congress	Modifies Law 2640, 2005
Law 3655, 2008	Congress	Modifies Law 2640, 2005.
Law 3783, 2009	Congress	Modifies Law 1015, 1997
Law 4017, 2010	Congress	Recognizes the legal validity of digital signatures, SMS, and electronic files
Law 4595, 2012	Congress	General framework for the payment system
Law 4457, 2012	Congress	General framework for micro, small and medium enterprises
Law 4843, 2012	Congress	Reforms BNF operations to allow all financial operations but limits loan amount to US$2 million per debtor.
Law 4610, 2012	Congress	Modifies Law 4017, 2010.
Law 4733, 2012	Congress	Banking Sector Pension Workers
Law 4933, 2013	Congress	IPS Law
Decree 14052, 1996	Ministry of Agriculture	Regulates Law 438, 1994.
Decree 6060, 2005	Ministry of Finance	Regulates leasing operations (financial and commercial)
Decree 7395, 2006	Ministry of Finance	Regulates Law 2540, 2005
Decree 7369, 2011	Ministry of Industry and Commerce	Regulates Law 4017, 2010.
Res. 1 Act 192, 1997.	BCP	Minimum requirements for opening or closing of branches of banks and finance companies
Res. 10, Act 75, 2004.	BCP	Sets rules for the deposit insurance
Res. 499, 2004	INCOOP	Sets the general regulatory framework for cooperatives.
Res. 1, Act 60, 2007.	BCP	Credit risk management rules for banks and finance companies

Res. 2, Act 123, 2007.	BCP	Transparency on information disclosure regarding interest rates.
Res. 262, 2007.	SEPRELAD	Rules for AML risk management for cooperatives
Resolution 1, Act 38, 2009.	BCP	Rules for factoring operations performed by the financial system.
Res. 263, 2009.	SEPRELAD	Rules for AML risk management for insurance companies
Res. 333, 2010.	SEPRELAD	Rules for AML risk management for remittances companies.
Res. 218 of 2011.	SEPRELAD	Rules for AML risk applicable to remittances companies, pawn shops, NGO's and others not supervised subjects.
Res. 1, Act 70, 2011.	BCP	Regulation and rules for the use of agents by banks and finance companies
Res 1. Act 44, 2011.	BCP	Sets minimum capital adequacy for banks and finance companies
Res. 2, Act 70, 2011.	BCP	Regulation on delivery channels for banks and finance companies
Res. 37, Act 72, 2011.	BCP	Rules for operational risk management for banks and finance companies
Resolution SS.SG 45, 2013	BCP	Sets limits to commissions on insurance intermediation
Res. 3, Act 4, 2012.	BCP	Introduces changes on general capital adequacy rules for banks and finance companies.
Res. 4, Act 67, 2012.	BCP	General rules for operational risk management for banks and finance companies
Res. 30, Act 44 2012,	BCP	Sets liquidity reserve requirements for banks and finance companies.
Res. SB SG 211, 2012.	BCP	General rules for AML risk management for banks and finance companies
Res. 349, 2013.	SEPRELAD	Rules for AML risk management for banks and finance companies
Res. 20, Act 65, 2013.	BCP	Allows payment providers to participate in the payments system as technical counterparts.
Res. 25, Act 51, 2013.	BCP	Regulation on basic savings accounts for banks and finance companies.
Res. 11,102 2013,	INCOOP	Approves the regulatory framework for saving and loans cooperatives.
Res, 11,343, 2013	INCOOP	Partially modifies the regulatory framework for saving and credit cooperatives.
Res. 11,481, 2014	INCOOP	Partially modifies the regulatory framework for saving and loans cooperatives.
Res. 370 of Nov 7, 2011	INCOOP	AML, CTF and WP for all cooperatives
Res. 454 of Nov 30, 2011	BCP	Obliges supervisor to control compliance with SEPRELAD's regulation by the institutions under their supervision.
Circular SB SG 55, 2013.	BCP	Security rules for ATMs for banks and finance companies
Circular SB SG 474, 2013.	BCP	Security rules for ATMs for banks and finance companies
Circular SB SG 555, 2013.	BCP	Sets the calculation methodology for usury interest rates
Res. 6, Act 18, 2014,	BCP	Regulation on e-payments
Circular SB SG 12, 2014	BCP	Updates minimum capital requirements for financial institutions

Annex 2. List of Interviews

Institution	Area	Name and position
BCP	Board members	Santiago Peña, Rafael Lara
BCP – SIB	Intendencia de Inclusión Financiera (Bancarización, Protección al Consumidor, Educacion Financiera)	Hernán Colman (Superintendente de Bancos) - Zulma Espinola (Intendente de IF) - Elizabeth Guerrero (Protección al Consumidor) - Paola Gimenez (Educacion Financiera) - Isidro Chavez (Bancarización) – Angel Gonzalez
SEPRELAD	General Direction	Oscar Boidanich Ministry-Secretary. Alejandro Dávalos Salomón, Director General de Asesoría Jurídica. Gregorio Mayor O., Director de Normas
BCP	Deposit Insurance	José A. Meza
BCP-SIS	Superintendent and Division Directors	Bernardo Navarro, Superintendente. Germán González, Derlis Pelayo, Pedro Gonzalez, Roberto Dominguez
BCP – SIB	Intendencia de Inspección (Gerencia de Supervisión In-Situ -GSIS)	Patricia Capurro - Nicolasa Vera
BCP – SIB	Intendencia de Riesgo Operacional y Tecnologico + Intendencia de Riesgo de Lavado de Dinero y Financiamiento al Terrorismo (Gerencia de Supervisión in situ)	Gustavo González, Juan Gustale
BCP – SIB	Credit Registry	Yolanda Bejarano
BCP – SIB	Intendencia de Estabilidad Financiera	Raúl Alderete
IDB	Financial Markets Senior Specialist.	Francisco Demichelis
Red de Microfinanzas Paraguay	General Direction	Laura Lesme, Gerente General. Edith Perez Gauto, Presidente. Luis Echarte, Consultor
TIGO	General Direction	Guillermo García, Comliance Officer. Gabriel Cosp, Gerente de Unidad de Negocios. Javier Irala, Gerente de Mercados
Financiera El Comercio	Management	Carolina Cabrera Gerente de Calidad y Procesos. Silvia Franco Gerente de Corresponsales no Bancarios. Silvia Caballero Gerente de Marketing y Productos. Renato Bogado Banca Seguros.
BCP-SIB	Intendencia de Estudios y Normas (GSES)	Hernán Colman (Superintendente de Bancos)
BCP	Payments system	Maria Epifania Gonzalez
BCP	Payment system oversight	Maria Epifania Gonzalez
INCOOP	President of the Board	Valentín Galeano, Former Presidente INCOOP
BCP Credit registry	Central de riesgos	Yolanda Bejarano

BNF	Management	Miguel Angel Rodriguez, Executive Director. Aldo Darío Rojas, Banking Services Director. Víctor Hugo Dejesús, Trust fund Director
Vision Banco	Management	Luz María Gómez, Banca Emprendedor. Diego Barreto, Inclusive Business, Rubén Mendoza, Business and Marketing Manager.
Cooperativa Universitaria	CEO	Lic Herbe Chaparro, Gerente General. Lic Pablo Cespedes, Gerente Financiero
Asociación de Entidades Financieras del Paraguay (ADEFI)	CEO	Manuel Caballero, Advisor. Silvia Murto de Mendez, Board member. Cristian Heisecke, Board Member.