



Financial Inclusion in Palestine

National Strategy for Financial Inclusion in Palestine



2018-2025

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الشمول المالي في فلسطين
Financial Inclusion in Palestine

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Acronyms

ABP: Association of Banks in Palestine

AFI: Alliance for Financial Inclusion

AML-CFT: Anti-Money Laundering and Countering Financing of Terrorism

DAP: Denarau Action Plan

FIEG: Financial Inclusion Experts Group

GPFI: The Global Partnership for Financial Inclusion

KYCC: Know Your Customer's Customers

MASAV: Banks Clearing Center/ automated clearinghouse

MFI: Microfinance institution

MSME: Micro, small and medium enterprises

OECD: The Organization for Economic Cooperation and Development

PCMA: Palestine Capital Market Authority

PEX: Palestine Exchange

PIF: Palestinian Insurance Federation

PMA: Palestine Monetary Authority

Sharakeh: Palestinian Network for Small and Microfinance

SME: Small and medium enterprises

USSD: Unstructured Supplementary Service Data

1. Introduction

Financial inclusion has come to the forefront of the development policy and reform agenda in Palestine since recently. A number of reforms introduced in the financial sector with a view to increasing financial inclusion reflect this emphasis. Such measures have embraced financial awareness and education, improvements in financial infrastructure and the legal and regulatory framework, financial consumer protection as well as the reform of the microfinance sector. Palestine represented by Palestine Monetary Authority (PMA) became a member of the Alliance for Financial Inclusion (AFI) in 2010 recognizing the importance of advancing financial inclusion and the deriving benefits from global experience. PMA made a commitment under the Maya Declaration¹ to formulate a National Financial Inclusion Strategy (NFIS). Subsequent to the Maya Declaration, PMA signed an agreement for joint leadership with the Palestine Capital Markets Authority (PCMA) for the formulation of the proposed NFIS, which will cover the period 2018 - 2025, and created a National Steering Committee (NSC) to oversee the formulation of the strategy.² The NFIS presented in this document not only fulfils PMA's Maya commitment but also demonstrates the firm and increased determination of Palestine's financial sector policymakers and stakeholders to approach the issues of financial inclusion in a more systematic manner.

The policymakers' strong emphasis on financial inclusion reflects primarily two interrelated factors: increased understanding of the gravity of the financial exclusion problem in Palestine with greater availability of data, and greater recognition of the potentially transformative power of financial inclusion to address a number of pressing development needs of the majority of the people in Palestine. However, it is widely agreed that to realize the transformative power of financial inclusion, the level and the quality of financial inclusion must be substantially increased particularly among the low income people including women in particular and for the micro, small and medium enterprises (MSMEs).

¹ The Maya Declaration was launched at the 2011 AFI Global Policy Forum held at Riviera Maya, Mexico by the members of the AFI. Since its launching over 60 member institutions have made commitments.

² The Steering Committee was established in 2014 and chaired by the PMA and the PCMA. The membership includes the Palestine Banking Association, the Ministry of Education and Higher Education, the Banking Services Consumer Society, the Palestinian Network for Small and Microfinance "Sharakeh", the United Nations Relief and Works Agency, Palestine Exchange, The Palestine Union of Securities Trading Companies, the Palestinian Insurance Federation and Ministry of Social Development.

Rationale

Palestine's economy operates under severe external constraints. Israel-imposed economic and social restrictions continue to constrain sustainable and inclusive economic growth. The limitations imposed by Israel on physical movement of people and other resources such as water and capital have a profound adverse impact on economic growth. However, internal factors also contribute to poor economic growth, high incidence of poverty and unemployment and reduced prospects for equitable growth and development. In 2016, for example, the unemployment rate in Palestine reached 26.9% while poverty rate was as high as 25.8% in 2011. These averages mask regional disparities. For example, the unemployment rate in the Gaza strip was estimated to reach 41.7%.³

Relatively low access to and use of financial products and services figure prominently among the internal factors that depress inclusive economic growth and development and lead to high rates of poverty, unemployment and inequity. A substantial proportion of adults that includes a large number of women, remain excluded from the formal financial system while many with access to the formal financial system are underserved. For example, while 60 percent of adults in the territory have bank accounts, only 10% of the adults use credit products⁴ due to a range of factors including poor financial awareness and literacy, limited supply of appropriate financial products and services and their high cost. Only 8.6% of adults have an insurance policy.⁵ Data indicates that women suffer disproportionately from financial exclusion. A low level of trust in the formal financial service providers and lack of financial awareness and literacy among a large proportion of adults further aggravate the problems.

Financial exclusion is not confined to individuals. Micro, small and medium enterprises (MSMEs) also suffer severely from financial exclusion. A majority of MSMEs, as a result, are compelled to rely on self-finance⁶ or informal sources to meet their requirements. However, neither self-finance nor informal sources enable them to fully harness their growth potential; hence their overall contribution to economic growth and employment generation remains limited. A high unemployment rate in general and among youth reflects this to a large extent.

³ According to Palestinian Central Bureau for Statistics (PCBS)

⁴ According to PMA data, 2013

⁵ "The Study of Financial inclusion in Palestine", 2016.

⁶ Self-finance has serious disadvantages as a method of financing enterprises. A main disadvantage is that an enterprise's resources may not match those required to harness an investment opportunity within a reasonable time frame. As a result, an enterprise may not be able to take advantage of a high-productivity investment opportunity. The scale of the enterprise will have to be limited by the amount of self-finance. In general, self-finance limits specialization, adoption of better technology, growth in productivity, and thus inclusive economic growth and development.

Policymakers have recognized the transformative power of financial inclusion for some time and have been active in promoting financial inclusion through a range of measures. Such measures include the introduction of a basic banking account campaign in 2012, financial awareness campaigns that included both banking and non-banking sectors, in addition to efforts to promote financial access for SMEs. Another important measure is the improvements in the regulatory and supervisory framework for microfinance. A number of measures were also introduced to improve the financial infrastructure, particularly the credit information system. However, there has been no overall framework to ensure that these measures are well-designed and implemented in a coordinated manner. Moreover, these measures have often been introduced based on inadequate diagnostics of the underlying factors for the low level of financial inclusion.

It is in the above context that the NFIS assumes an important place within the development policy. The overall rationale for the NFIS stems from a combination of two major factors: unacceptably low use level of formal financial products and services by a majority of the people and enterprises, and the need to fully harness the transformative power of financial inclusion to address the high level of poverty and unemployment, the low rate of economic growth and the high degree of socio-economic inequalities in a systematic manner^{7 8} Policymakers also agree that the potential contribution of financial inclusion to the improvement of financial stability also justifies the need for formulating the NFIS⁹.

Vision and Definition

The vision of the NFIS is to achieve **“a developed financial sector that fully meets the financial needs of all segments of the Palestinian society to improve their welfare”**.

For the purpose of the NFIS, financial inclusion is defined as **“Enhancing access to, and use of, financial products and services by all segments of the society via formal channels, while meeting their needs in a timely and affordable manner, protecting their rights and promoting their financial knowledge to enable them to make well-informed financial decisions.”**

This definition encompasses access, use and quality dimensions of financial inclusion while assigning a central importance to financial consumer protection, which is critically important in the local context to ensure sustainability and quality of financial inclusion.

⁷ As noted in the World Bank’s Global Financial Development Report 2014, “new evidence demonstrates that financial inclusion can significantly reduce poverty and boost shared prosperity, but underscores that efforts to foster inclusion must be well designed.” (World Bank. 2015. p.xi).

⁸ As clearly pointed out in the Annual Report 2013 of PMA (p.79).

⁹ Morgan, P., and V. Pontines. 2014. Financial Stability and Financial Inclusion. ADBI Working Paper 488. Tokyo: Asian Development Bank Institute. Also, African Development Bank. 2013. Financial Inclusion in Africa, Chapter 9: The Trade-off Between Financial Inclusion and Financial Stability.

Financial Inclusion: Global Perspectives

In recent years financial inclusion has gained a great deal of traction as an important development pillar. This process began with the work carried out by the United Nations. The importance of access to financial services was recognized by the world leaders in the outcome document adopted at the 2005 World Summit at the United Nations. In 2006, based on a year-long international consultative process on inclusive finance, the United Nations released the publication, *Building Inclusive Financial Sectors for Development*, to provide a reference point for policy makers to collectively discuss strategies, share best practices and improve processes with respect to inclusive finance. The book offered a vision of what inclusive finance could be and suggested that individual countries need to design their own national strategies for financial inclusion. Continuing its emphasis, the UN established the UN Advisors Group on Inclusive Financial Sectors in 2006 to advise the UN system and member states on global issues relating to inclusive finance. In 2009, UN-Secretary General also appointed her Royal Highness Princess Maxima as his Special Advocate for Inclusive Finance for Development. The Sustainable Development Goals adopted by the UN in 2015 also highlight the importance of financial inclusion to achieve a number of the goals.

A multitude of factors seem to have reinforced the continuing interest in financial inclusion over time. One factor is the increased recognition that a financial system that serves only a minority of a country's population represents a fundamental flaw and cannot be accepted as development oriented. Following this line of thinking, the global development community has concluded that building inclusive financial systems that serve a majority should be made a central goal of every developing and emerging countries. Second, factor is the greater availability of research and data on the extent of financial exclusion and its adverse impact on inclusive growth and development. The World Bank's studies on access to finance (A2F) in India, Brazil, Nepal, Bangladesh, Pakistan and Indonesia, for example, shed light on many negative effects of widespread financial exclusion of people and MSMEs. The findings of these studies were further reinforced by financial inclusion surveys carried out in a number of Sub-Saharan African countries. In the meantime, the World Bank in 2008 published an authoritative and influential book, *Finance for All?*¹⁰ The book reviewed and synthesized a large body of research and concluded that financial inclusion is central not only to stability but also to growth, poverty reduction, and more equitable distribution of resources and capacities. The book also included a basis for sound policy advice in the area of financial access.

¹⁰ Asli, Demirguc-Kunt et al. 2008. *Finance for All? Policies and Pitfalls in Expanding Access*. World Bank.

A watershed in the growing global interest on financial inclusion was the establishment in September 2008 of the Alliance for Financial Inclusion (AFI), the first global knowledge sharing member-based network of financial sector regulators and policymakers designed exclusively for advancement of financial inclusion through better policies and approaches. Funded by the Bill and Melinda Gates Foundation and managed by the German International Corporation, AFI began to grow rapidly into a truly global organization of developing and emerging countries after its first Global Policy Forum held in Nairobi, Kenya in September 2009¹¹. With the growth of AFI and its worldwide policy programs, many developing and emerging countries gained membership of AFI and accorded high priority to improving financial inclusion in the respective countries. AFI became an independent global institution in January 2016 and showed its robustness as a member-based institution. At the end of March 2016, AFI membership covered 117 institutions from 93 countries¹². PMA became a principal member of AFI in 2010.

AFI has made a tremendous contribution to promote sustainable financial inclusion across the globe. The Maya Declaration of AFI is an innovative instrument introduced by AFI members at the Global Policy Forum of 2011 held in Riviera Maya, Mexico. The Maya Declaration is universally accepted as the “first global set of specific, measurable commitments made by policy makers from developing and emerging countries to unlock the economic and social potential of the poor through greater financial inclusion.” Recognizing its value for the country, PMA made its commitments under the Maya Declaration at the Global Policy Forum held in Cape Town, South Africa in September 2012. One of the commitments was to formulate a national strategy for financial inclusion in cooperation with other stakeholders. The Maya Declaration was further expanded by the AFI membership through Sasana Accord in 2013 and Maputo Accord in 2015. At the Global Policy Forum 2016 held in Nadi, Fiji, the AFI members strengthen their determination and affirmed their commitment to close the gender gap in financial inclusion with the endorsement of Denarau Action Plan (DAP): The AFI Network Commitment to Gender and Women’s Financial Inclusion.

¹¹ Since then AFI has held a Global Policy Forum every year. The most recent GPF was held in September 2016 in Fiji.

¹² The 2015 Annual Report (p.3) of AFI describes the organizations as “a member-owned network with a vision of making financial services more accessible to the world’s unbanked. To make this vision a reality, AFI has adopted a unique cooperative approach and bottom-up model that allows AFI members to set their own agenda and harness the power of peer learning and peer pressure to develop practical and tested policy reforms that enhance financial inclusion.”

These additions have provided further guidance and incentives for the members in their work towards comprehensive strategies for financial inclusion. The DAP in particular strongly recommended AFI members to “consider and implement best practices for women’s financial inclusion and gender considerations within national financial inclusion strategies” and collaborate with other key stakeholders, including government agencies, development partners and civil society to create, among other things an “enabling and supportive environment to accelerate women’s financial inclusion.”¹³

AFI has not been alone in its efforts to advance financial inclusion. The number of other organizations such as the World Bank and G20 also joined the bandwagon of financial inclusion and further strengthened its importance at global and national levels. The G20 began to discuss financial inclusion as an agenda item first in 2009 at its Pittsburgh Summit. Thereafter G20 launched a Financial Inclusion Expert Group (FIEG) and released the Principles for Innovative Financial Inclusion developed by the Access Through Innovation Sub-Group of the FIEG. The Principles were endorsed at the Toronto Summit in May 2010. Moving forward and elevating its importance further, G20 recognized financial inclusion as one of the main pillars of the global development agenda and endorsed a Financial Inclusion Action Plan at the Seoul Summit in November 2010¹⁴. At the same Summit, G20 also established a Global Partnership for Financial Inclusion (GPFI)¹⁵ which continues to make a significant contribution to promote financial inclusion in a sustainable manner. In 2016, G20 endorsed and released the High-level Principles for Digital Financial Inclusion, underscoring the critical importance of developing sustainable and efficient digital financial services to accelerate financial inclusion across the globe.

These very positive global developments suggests the urgent need to advance financial inclusion and ensure that unserved and underserved people as well as firms are given adequate opportunities to participate in the formal financial system on a continuing basis. They also suggest that countries have to organize themselves and develop sound strategies to achieve desired results. More importantly, all global stakeholders agree and emphasize that financial inclusion is a means to an end; not an end in itself. The global data confirm the shared recognition of the value proposition of NFIS. According to latest data from the AFI, 29 countries had NFIS at the end of August 2016. Of these, 11 were in the Asia and Pacific region, eight in the Sub-Saharan Africa, three in Europe and Central Asia and seven in Latin America and the Caribbean region.

¹³ AFI. 2016. DENARAU ACTION PLAN: The AFI Network Commitment to Gender and Women’s financial Inclusion. Kuala Lumpur, Malaysia.

¹⁴ In November 2014, G20 leaders accepted an updated version of the Action Plan.

¹⁵ GPFI is an inclusive platform for all G20 countries, interested non-G20 countries and relevant stakeholders to carry forward work on financial inclusion, including implementation of the G20 Financial Inclusion Action Plan, endorsed at the G20 Summit in Seoul in 2010. GPFI has established a number of working groups to implement its work program on a systematic basis.

And another 28 countries were at various stages of developing a NFIS. These 28 included four countries from the Middle East and North Africa region. The organized efforts to advance financial inclusion at national levels had produced encouraging results. Global Findex data showed that between 2011 and 2014, some 700 million new accounts had been opened across the globe. According to the World Bank, over 200 million of the new accounts have resulted from national strategy implementation. The World Bank also points out that those countries with national strategies have done much better in increasing financial inclusion than those without national strategies.

It is in this context that the PMA and PCMA have taken this initiative to develop a NFIS in line with international best practices including the G20 Principles for Innovative Financial Inclusion and good practices emphasized by AFI including in particular the Denarau Action Plan.

2. Landscape of Financial Inclusion

Palestine established a formal financial system 22 years ago, after the signing of Oslo Accords in 1993 and the Paris Protocol in 1994. The formal financial sector consists of banks, microfinance institutions (MFIs), moneychangers, insurance, securities, mortgage finance, and financial leasing companies. The Palestine Monetary Authority (PMA) was established in 1994 to oversee and regulate the banking system. The PMA is also responsible for regulating MFIs and moneychangers. The Palestine Capital Market Authority (PCMA) was established in 2004 as a part of the formal financial system to oversee and regulate the insurance, securities, mortgage finance and financial leasing sectors.

The legal framework for the operations of PMA is provided by the PMA law issued in 1997, while that for the PCMA is provided by the PCMA law issued in 2004. The legal framework for the financial system has been further developed since then.^{16,17}

The total Palestinian population worldwide is roughly 12.37 million¹⁸, 4.8 millions of whom reside in the West Bank and the Gaza Strip (2.9 million in the West Bank and 1.9 million in the Gaza Strip), the rest are in diaspora. The adults (18 years of age or older) living in Palestine constitute 51.3%, while this ratio for the West Bank is 53.4% and for the Gaza Strip 47.5%.¹⁹

Despite a number of measures and procedures undertaken by governmental agencies, regulatory bodies and other stakeholders to increase financial inclusion in Palestine, high levels of financial exclusion persist.

¹⁶ Palestine Capital Market Authority law number (13) of 2004.

¹⁷ Palestine Monetary Authority law number (2) of 1997.

¹⁸ The number of Palestinians around the world according to the estimations of the Palestinian Central Bureau of Statistics, 2015.

¹⁹ The Palestinian Central Bureau of Statistics, 2016.

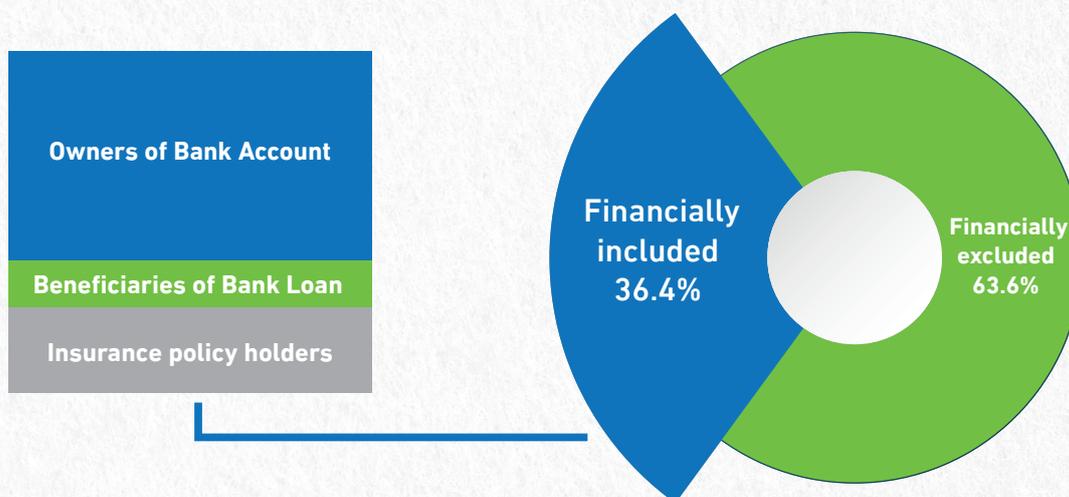
In order to assess the state of financial inclusion, a comprehensive study was carried out in 2016 based on demand and supply side survey data²⁰. Findings of the study revealed that financial inclusion was low at 36.4% for the total adult population, which is equivalent to 898,732 financially included adults.²¹ Thus a vast majority remain financially excluded.

Figure 1: Financial inclusion Strands among adults.



Owning a bank account is considered the first step towards financial inclusion, as banking services is one of the main pathways to the formal financial sector. This is particularly true for Palestine given that there is no mobile financial services operated by a mobile network operator or banks. Generally, opening a current or savings account is often the starting point for participating in the formal financial system.

Figure 2: Financial inclusion composition among adults.



²⁰ "The Study of Financial inclusion in Palestine ", 2016. The data for this study was gathered through surveys on the demand and supply sides; the demand- side data collected based on region/adult demographic survey (18 years and above) in order to obtain accurate data on the access to and usage of financial products and services. The supply-side data (banking and non-banking financial products and service providers) were collected through a survey, which provided a second source of valuable information and data for the study. The supply-side survey was aimed at gathering information on the evolution of the internal environment of banking and non-banking financial products and service providers.

²¹ Owners of current accounts in banks, borrowers from banks, and insurance policy holders were considered when calculating the level of financial inclusion.

Although there have been some improvements in the financial service access points over the past few years, they continue to remain low. The number of banking branches reached 11 per 100,000 adults, 4.5 branches for every 100 km² and 22.2 ATM for every 100,000 adults at the end of 2015.

Table 1: The geographical spread of financial access points (as of end of 2015)

The Area	Number of Adults (above 18)	Area (km ²)	Number of branches and offices		Number of branches per 100,000 adults		Number of branches and offices/100 km ²		Number of ATM	Number of insurance company agents	Number of ATMs per 100,000 adults	Number of insurance company agents per 100,000 adults	Number of insurance company agents/100 km ²
			Banks	Insurance companies	Banks	Insurance	Banks	Insurance					
Palestine	2,469,045	6,020.0	272.0	111	11.0	4.5	4.5	1.8	548	215	22.2	8.7	3.6
West Bank	1,575,295	5,655.0	221	104	42	6.6	12	1.8	473	210	91	13.3	3.7
North of the West Bank	645,145	2,206.0	88.0	51	13.6	7.9	4.0	2.3	171	69	26.5	10.7	3.1
Middle of the West Bank	522,276	1,793.0	75.0	26	14.4	5.0	4.2	1.5	186	84	35.6	16.1	4.7
South of the West Bank	407,875	1,656.0	58.0	27	14.2	6.6	3.5	1.6	116	57	28.4	14.0	3.4
Gaza Strip	893,750	365.0	51.0	7	5.7	0.8	14.0	1.9	75	5	8.4	0.6	1.4

Source:

- PMA and PCMA
- Financial Inclusion study in Palestine, 2016.

The financial inclusion study referred to earlier estimated the percentage of adults having a current account at 22.7%, the bank checks users at 7.8%, and saving account owners at 9.2%. The same study estimated the percentage of adults with an outstanding bank loan at 5.1%, bank deposit owners at 1.1%, credit cards owners at 4.4% and adults who received funding in the form of Murabaha or Mudarabah at about 0.5%. The percentage of adults with an outstanding loan from MFI is estimated at 2.9%, suggesting the relatively minor role being played by the MFIs in the financial landscape.

Another major characteristic of the financial landscape is the glaring gender gap in financial inclusion. The national survey data revealed that only 15.4% of adult females have a bank account against 42.1% of the adult males, thus the gender gap is alarmingly high at 26.7%. The gender gap of ownership and usage of financial institution accounts in favor of male adults applies to all other banking products as well. However, in the case of outstanding loans from MFIs the gender gap was minimal: 2.8% of the adult males and 3% of the adult females had outstanding loans from MFIs. This is due to the credit policy of MFIs that emphasizes targeting women.

The absence of service providers that supply mobile banking services based on mobile phones is another major feature of the landscape. The reason behind this is simply the non-existence of any mobile financial services provider in the market. This has been one of the reasons for the low level of financial inclusion in the country.

The absence of a mobile financial service system put tremendous strain on other channels to deliver financial products and services and put in particular women into a disproportionately disadvantaged position in the formal financial market.

Gender disaggregated data on the supply of formal financial products and services are scanty. However, it is widely recognized that supply to females is far behind that to males except in the case of microfinance loans. For example, only 39.1% of the total outstanding loan volume of microfinance institutions (MFIs) were accounted for by females in 2015²². The availability of gender-wise data on lending by these institutions suggests there is a concern about the gender dimensions of finance.

In the non-banking financial sector, the access to insurance products and services remains very low. A total of 10 insurance companies operate with a network of 111 branches and representative offices, 215 agents and insurance producers. The number of branches or offices for insurance products and services for every 100,000 adults was only 4.5. There is a wide gap in density of access points between the West Bank and the Gaza strip as far as insurance services are concerned. In the West Bank the average of branches and offices of insurance companies is 6.6 for every 100,000 adults as compared to 0.8 in the Gaza Strip. In 2015, total insurance premiums amounted to only USD165 million. Car insurance accounted for 57% of this, health insurance accounted for 18%, and workers' compensation insurance for 8%. The data indicates significant room for inclusive insurance.

With regards to the non-banking financial services, the percentage of adults owning an insurance policy is the highest. It was found that around 8.6% of adults have an insurance policy, followed by 2% of adults who have pension service, 1% stock trading services, 0.5% Takaful and bond trading with a percentage of 0.2%. The percentage of adults using mortgage loans, financial leasing, and Ijarah Muntahia Bittamleek did not exceed 0.1%.

The usage of non-banking financial services was higher among males. It was found that 11.6% of males have an insurance policy against only 5.5% of females and 3.5% of males have a pension against only 0.9% of the females. These percentages on pension however reflect the fact that all public sector employees are entitled to a pension. There is a wide gap in the usage of financial products and services between the West Bank and Gaza Strip and between genders. The war in the summer of 2014 in the Gaza Strip widened this gap. The percentage of adults having a bank account in the West Bank is 1.6 times higher than that of adults in the Gaza Strip. However, for bank loans, the percentage of adults with a loan was 1.3% higher in the Gaza Strip than that of the West Bank.

²² Annual report 2015, PMA.

The percentage of having a bank account among adult residents of refugee camps is 3.6% less than adult residents of rural areas and around 4.2% less than the adult residents of urban areas. It is worth highlighting the extremely low usage of insurance services in the Gaza Strip and the refugee camps.

Although the comprehensive study covered financial inclusion issues relating to individuals only, there are many issues of access to and usage of finance for SMEs. According to the PMA, SMEs account for 95 % of the total existing firms and contribute to about 16.4 %²³ of GDP.²⁴ However, a vast majority of SMEs suffer from poor access to formal finance. As of June 2016, the number of outstanding loans from banks and MFIs to SMEs were only 44,000, and these loans accounted for 17% of the total credit portfolio of these institutions. Compared with the high level of contribution of SMEs to GDP, the flow of credit to SMEs is highly inadequate and this is a significant constraint to their growth. Banks serve only a very small proportion of SMEs. A majority of the SMEs with an outstanding loan is served by MFIs. Because MFIs' loans are generally small in size, it may be safely assumed that those SMEs having access to MFI loans are also underserved. This gap is a result of banks' stringent lending conditions. For example, banks' collateral to loan ratio for SME loans are very high and this reduces the effective demand for bank loans from SMEs. PMA has taken measures to address financial infrastructure issues relating to SME lending. The public credit registry in Palestine is considered one of the most effective ones in the region. The authorities have also established an electronic registry of movable assets with a view to facilitating SME lending. The banking sector has responded positively, but a large gap in lending to SMEs remains.

The main problems in the landscape of financial inclusion include extremely limited access to and use of formal credit by SMEs and the wide gap in access to and use of finance of women. Wide gaps also remain in the access to and usage of financial products and services between the West Bank and the Gaza Strip. As revealed in the study, financial capability is a formidable cross cutting bottleneck that has severely limited financial inclusion. The issue of financial capability will be discussed in detail in Chapter 3.

3. Constraints on financial inclusion

There are internal and external constraints for financial inclusion in Palestine. The internal constraints include supply-side and demand-side constraints that affect both access to and/or usage of financial products and services and the quality of financial products and services in the market.

²³ PCPS, 2016

²⁴ PMA. Annual Report 2013. p.65

The main supply-side constraints include high transaction costs of providing the products and services and inadequate legal framework within which the financial institutions are compelled to operate. The demand-side constraints restrict the capacity of individuals and firms to access available products and services. These include socio-economic and cultural factors and religious beliefs, extremely low levels of financial literacy, and the lack of awareness on financial consumer rights.

The external constraints are those beyond the control of the authorities concerned with financial inclusion in Palestine. The dominant external constraint is the Israeli occupation and the restrictions imposed by the Israeli authorities on the free movement of Palestine people and trade. Rigidly enforced AML-CFT requirements are also part of the external constraints.

1. Demand-side constraints

Demand side constraints are those constraints that prevent people from access to and use of available financial products and services. The comprehensive study of financial inclusion showed that a large proportion of adults are still unable or unwilling to use financial products and services for a variety of reasons. The demand-side constraints are:

1.1 Lack of financial capability²⁵

Lack of financial awareness, knowledge and skills limits the capacity of a vast majority of adults to identify their financial needs and make prudent financial decisions that best fit the circumstances of their life. The survey on financial inclusion shows that 59% of adults have weak or very weak level of financial literacy. The financial literacy level among women is particularly low. According to the survey, 68.8% of adult females have weak or very weak level of financial literacy against 49% of adult males.²⁶ Lack of financial capability is reflected negatively on adults' behavior towards financial products and services in general, which creates a constraint on effective access to and usage of financial products and services.

The survey also showed that 37% of adults have reported that they knew about the financial products and services from friends and relatives; only 16.6% relied on the information available at the branch of the financial institution.

²⁵ Financial capability is the internal capacity to act in one's best financial interest, given socioeconomic and environmental conditions. It encompasses the knowledge (literacy), attitudes, skills, and behavior of consumers with respect to understanding, selecting and using financial services, and the ability to access financial services that fit their needs.

²⁶ Adults' financial literacy was measured on five levels based on a set of questions that reflect their financial knowledge as follows: very good, good, medium, weak, and very weak)

1.2 Religious beliefs

Evidence indicates that religious reasons significantly affect the access to and usage of financial products and services. According to the survey, 31% of adults, a very high percentage, abstain from taking loans for religious reasons, 13.9% of adults do not have a bank account because of their religious beliefs and 11.7% do not have an insurance policy for the same reason. Taken as a whole, these data suggest that lack of suitable products and services is a major reason for the low level of financial inclusion.

1.3 Poverty and unemployment

Both poverty and unemployment are considered among the most important constraints on access to and usage of financial products and services and to participate in the formal financial system. Evidence suggests that both access to and usage levels are lowest among the poorest and unemployed people. Unemployment rate reached 26.9% in 2016 and poverty has reached 25.8% in 2011. In some geographical areas both unemployment and poverty rates are much higher than what is indicated by the above averages. For example, the rate of unemployment in the Gaza Strip is estimated at 41%. Other related constraints are the high cost of products, income inequality, and the cumbersome procedures for accessing the products and services. The affordability is obviously low among the poor and unemployed and this problem is aggravated by the high cost of receiving financial products and services. For example, 37% of adults who do not have a health insurance policy reported that high cost of private insurance is the main reason for not having an insurance policy and 29.8% reported that they do not have an insurance policy because of lack of a regular income. 60% of the adults reported that they do not have a bank account because of their low level of income. The survey data generally indicate a significant mismatch between the supply of products and services and the demand for the low income people.

2. Supply-side constraints

Supply-side constraints also play a major role in limiting financial inclusion. Such constraints include inadequate legal and regulatory framework, high transaction costs of providing services to certain areas and population segments.

2.1 The legal and regulatory environment.

Policymakers have made an effort to improve the legal and regulatory framework for financial inclusion in recent years.

Measures to improve deposit insurance, issuing the financial leasing law, movable assets law and the Presidential Decree on licensing and supervision of specialized credit institutions are some examples.²⁷ Despite these efforts, inadequacies remain in the legal and regulatory environment. These include the following:

- Lengthy, inefficient and costly judicial procedures and the lack of technical understanding of financial sector issues within the judicial system.
- The absence of a functioning Palestinian Legislative Council.

2.2 Informal financial sector

The survey showed that 20.8% of adults have obtained loans and 57.2% of those with outstanding loans have obtained them from the informal sector,²⁸ whereas only 42.8% of those with loans used banks or MFIs for their loans. According to some analysts, the greater preference for informal sources reflect the convenience with which those sources can be accessed and the relatively low prices prevailing in some segments of the informal markets. This suggests the relative attractiveness of informal markets could be a constraint to financial inclusion.

2.3 Non-financial technological infrastructure

Lack of technological infrastructure limits the use of technology in access to and usage of and provision of financial products and services. The technological constraints include:

- The non-existence of retail payment methods, which are low-cost E-payment tools that enables users to conveniently access financial products and services.²⁹
- The non-existence of E-government and access to data (open data) causes delays in accessing financial services.
- Limited availability of landlines and internet services in rural areas.
- The lack of a conducive environment for engagement of telecommunication and mobile companies in providing micro payment services.

²⁷ Palestine Deposit Insurance Corporation (PDIC) issued in accordance with a Presidential Decree Law issued in May 2013. The PDIC protects bank deposits at licensed institutions subject to a ceiling of USD10,000.

²⁸ Through family, friends and other informal sources and channels

²⁹ Such methods allow the users to execute payments from different places, and it includes (Point of Sale, E-Payment, Mobile Banking, Mobile Payments). PMA has launched an Electronic National Switch in 2015 this system enable payments/withdrawals via such devises as ATMs and POSs. Through the Switch all ATMs and POSs will be linked to a unified data base. The operation of the Switch is expected to expand the distribution of POSs, boost the use of prepaid cards and provide needed liquidity. The Electronic Switch will promote financial inclusion by giving all social segments access to banking services in particular in outlying and remote regions where bank branch presence is minimal.

2.4 Products and services provided by the financial sector

Another significant constraint on financial inclusion is the mismatch between the supply of and demand for financial products and services. As referred to in an earlier section, the survey data revealed clearly that a large proportion of adults including women do not use financial products and services for religious reasons. According to this reasoning, the real constraint is the lack of suitable products and services.

Another related factor is the shortage of financial products targeting specific groups such as low income less educated women, small farmers and entrepreneurs (micro enterprise).

2.5 Financial infrastructure

A number of measures have been taken to improve financial infrastructure in recent years. However, the agenda is unfinished and the gaps that remain constraint financial inclusion. These include:

- Insufficient legal framework that limits foreclosures and debt recovery; and
- Insufficiency of credit guarantee schemes to expand the supply of credit to SMEs.

3. External constraints

The main external constraint is the Israeli occupation of the West Bank and siege on the Gaza Strip. As a result of the occupation:

- The risk of providing financial services has substantially increased in certain geographic areas such as Gaza Strip and Area C. The Area C which makes up about 60% of the West Bank remains under Israeli military control.
- Limitations exist on movement of cash. In particular, Gaza Strip suffers from the non-availability of a smooth cash flow necessary for managing its banking operations.
- Financial services providers find it difficult to reach certain segments of the population and geographical areas.

- Lack of Palestine National Authority (PNA) control over the clearance revenues ³⁰, which eventually lead to financial instability and restrictions on supply of certain products and services.
- Volatility of external financial aid.

4. Overarching Goal and Strategic Objectives and Measures

The overarching goal and strategic objectives of the national strategy were determined based on a thorough analysis of the landscape of financial inclusion and an exercise to identify binding constraints on accelerating the level of financial inclusion in quantitative and qualitative terms. The constraints identified through the diagnostic study that was underpinned by the comprehensive demand and supply-side surveys were further analyzed through a series of brainstorming sessions by the technical group and working group members. The strategic measures were formulated through a consultative and collaborative process to address the identified key constraints in a systematic and effective manner.

Overarching Goal

The overarching goal of the National Financial Inclusion Strategy (NFIS) is to increase financial inclusion from the current level of 36.4% of adults to at least 50 % of adults by the end of 2025.

The purpose of formulating a NFIS is to harmonize and lead the numerous currently uncoordinated or inadequately coordinated efforts to improve financial inclusion in a more systematic manner and to focus on addressing most binding constraints on advancing financial inclusion. This makes it essential to carefully select areas of focus based on a high quality diagnostic and in close consultation with the relevant key stakeholders. Recognizing the vital role that women's financial inclusion could play to ensure the achievement of this overarching goal, increasing the level of financial inclusion among adult women is a main area of focus in this strategy.

The NFIS is in harmony with and complementary to the existing national strategies developed for achieving socio-economic development and poverty reduction.³¹

³⁰ Clearance revenues are those collected by Israel on behalf of the Palestine Authority. The main components of clearance revenue are customs duties, VAT and petroleum excise.

³¹ This strategy is in line with major country strategies mainly Palestinian Public Finance Management Strategy and the Strategy of Sectorial Economic Development.

Strategic Objectives and Measures

The NFIS aims to achieve multiple objectives.

1. Increase the level of financial capability in targeted segments of the population.

The sub-objectives related to this are:

- 1.1 Improve financial capability among students in schools, universities and community colleges.
- 1.2 Promote financial capability among women, youth and unemployed people.
- 1.3 Increase financial capability among MSMEs with special emphasis on women operated MSMEs.
- 1.4 Improve people's trust in the financial service providers and in formal financial services in both banking and non-banking sectors.
- 1.5 Build the financial capability among the economic media.

2. Increase access to and usage of formal financial products and services by targeted segments that acutely suffer from a low level of financial inclusion.

The sub-objectives related to this include the following:

- 2.1 Make demand-driven financial products and services available in the unserved rural areas of north and south of West Bank and of the Gaza Strip
- 2.2 Increase access to and usage of financial services by targeted segments of the society.
- 2.3 Promote usage of services provided by the formal financial sector
- 2.4 Increase access to and usage of formal financial services by MSMEs including those operated by women
- 2.5 Improve legal infrastructure for financial inclusion
- 2.6 Improve the supply and quality of Sharia-compliant financial products and services in the market

3. Strengthen and protect the right of consumers of financial products and services

The sub-objectives related to this are:

- 3.1 Promote a more conducive legal and judicial environment for financial consumer protection
- 3.2 Improvement of the capabilities of financial consumer protection associations
- 3.3 Promote transparency and disclosure of financial consumers' rights and obligations
- 3.4 Strengthen complaint management systems for financial consumers and increase awareness about these systems among people
- 3.5 Promote the knowledge about rights and obligations associated with use of financial services among the unserved and underserved people

4. Strengthen the role of information and communication technology to expand the access to and usage of formal financial services

This objective has two sub-objectives.

- 4.1 Enhance the technical and legal infrastructure for digital financial services
- 4.2 Build a comprehensive database to promote financial inclusion

5. Monitoring and Evaluation Framework

The Technical Committee will be responsible for monitoring and evaluation (M&E) of implementation of the NFIS. The National Committee will provide needed directions and guidance to the Technical Committee for this task. The monitoring will focus on whether implementation is on track while evaluation will focus on the extent to which the actions have generated the expected impact on the relevant variables.

The task of monitoring will be decentralized to manage it effectively and efficiently. Accordingly, each principal agency responsible for carrying out key actions spelled out in the Action Plan will establish its own monitoring system and allocate necessary resources for the task. These institutions will be required to submit quarterly reports to the Technical Committee and bring to its attention major issues faced in the implementation.

The monitoring systems of each agency will be framed in line with the Action Plan in the strategy. Accordingly, the highest priority in monitoring will be given to the high priority actions identified in the Action Plan to ensure that they are carried out effectively and a timely manner. However, this does not mean that other activities will not be monitored.

In addition to monitoring by each implementing agency, the Technical Committee will field an annual monitoring mission consisting of members of key implementing agencies. Based on the findings of these missions and the monitoring reports submitted by the implementing agencies, the Technical Committee will prepare and submit an annual monitoring report to the National Committee for its information and guidance.

This annual report will be structured according to the main objectives of the NFIS. Financial inclusion indicators endorsed by AFI and G20 that cover access, usage and quality dimensions will be used for the monitoring and evaluation purposes. When necessary, the technical committee can report or refer to the national committee with any urgent matter on a shorter frequency. A specific chapter in the annual monitoring report will be prepared on women's financial inclusion and how strategic measures related to increasing their level of financial inclusion and reducing the gender gap in formal finance are being implemented.

For the purpose of evaluation, the Technical Committee will rely on a comprehensive mid-term survey on financial inclusion that would focus on access, usage and quality dimensions of financial inclusion. Based on this survey, financial inclusion indicators will be prepared to assess the extent to which the NFIS has had an impact. The results of the mid-term evaluation report will be submitted to the National Committee for guidance and will be used to determine whether major changes are needed in any component of the NFIS. Another aspect of the M&E framework is the community-based monitoring. Selected communities will be encouraged through a carefully designed communication policy to engage in monitoring of specific and relevant components of the strategy. Such communities will include economic media, women's organizations, university students and youth organizations and association of banks and MFIS. Selected champions of women's financial inclusion will be invited to submit written comments on the gender issues of implementation and suggest constructive measures to address those issues. These comments will be posted on the websites of both PMA and PCMA for reference by the public. To facilitate the community-based monitoring, the communication policy will use simplicity, clarity and transparency as its fundamental pillars.

At the end of the implementation period of the NFIS, an evaluation will be carried out to assess the overall impact of the NFIS and to determine the extent to which it had achieved the overarching goal and key objectives specified in the strategy.

In line with the communication policy, simplicity, clarity and transparency will also be major features of the M&E framework. After annual monitoring report is approved by the National Committee a summary of the annual report prepared by the Technical Committee will be released for the media and included in the websites of both PMA and PCMA. The annual reports will also be submitted to the Boards of Directors of both PMA and PCMA for review and discussions. Each annual report will be presented and opened for media attention at an annual media event that would be jointly organized by the PMA and PCMA.

At the end of the implementation period of the NFIS, an evaluation will be carried out to assess the overall impact of the NFIS and to determine the extent to which it had achieved the overarching goal and key objectives specified in the strategy.

6. Implementing mechanism for the national strategy

Building a national strategy for financial inclusion has been a joint process. The governmental, non-governmental and civil society stakeholders participated in this process.

The formulation of the strategy took into account implementation issues. It is recognized that two elements are critical to ensure the desired outcomes of the strategy: the coordination structure, meaning the administrative structure which will carry out the action plan of the strategy; and the mechanism of supervision and monitoring of implementation of the Action Plan. At the heart of the implementation structure is the explicit recognition that ensuring the role of financial inclusion in alleviating poverty, economic growth, and promoting financial stability requires a clear leadership from the top-level decision makers.

The implementing mechanism proposed in the strategy has been designed based on lessons and insights drawn from global experience. However, a concerted effort has also been made to ensure the implementation mechanism best fits with the local conditions.

In order to ensure smooth implementation of the strategy the policymakers will establish:

1- **A National Committee**, which will be jointly chaired by PCMA and PMA, the main related parties will participate in the membership of this committee. The committee shall be formed by a Council of Ministers resolution; the resolution will also set the terms of reference of this committee.

2- **A Technical Committee** to support the national committee and to provide operational guidance for the implementation will be established. The terms of reference and the governance structure of the technical committee will be determined by the national committee.

3- Need based **Thematic Working Groups or Taskforces** will be established to support the technical committee. The decision on, and the scope of the working groups will be determined by the technical committee. If the existing working groups are deemed adequate to carry out this task they can be incorporated into this structure.

4- **A Financial Inclusion Secretariat** will be set up. Its location will be decided by the National Committee. The Secretariat will support all the structures referred to above to carry out their tasks efficiently and effectively. The proposed Secretariat will also provide logistical support for the other structures mentioned above.

The Action Plan attached to this strategy is the outcome of institutionalizing and framing all the efforts that need to be taken by the different parties, and the result of putting these efforts into a clear comprehensive national plan according to the main principles of financial inclusion adopted by G20,

the World Bank, and the Alliance for Financial Inclusion (AFI). In addition, the main principles of creating a national strategy on financial education adopted by the Organization for Economic Cooperation and Development (OECD) were taken into account in drawing the Action Plan.

This Action Plan spells out the activities, the parties responsible for and participating in its implementation, the timeframe allocated for each activity in addition to the Key Performance Indicators (KPIs) that would be used to monitor its implementation. Each activity is linked to a strategic goal and its sub-goals based on the nature of the activities. There are two levels for implementing the activities: the level of direct responsibility for implementation and the level of participating in the implementation.

The creation of a tiered structure consisting of a National Committee, a Technical Committee and a Financial Inclusion Secretariat simultaneously is the most effective option for implementing the Action Plan. The National Committee will monitor and follow up the implementation of the plan's activities through the technical committee. The Financial Inclusion Secretariat will also work on monitoring, measuring performance and accomplishment of the process of implementing the strategy using a set of performance indicators identified in the plan.

As for the legal form of the strategy's coordination structure, after the strategy obtained the blessings and endorsement of the government, the proper instructions (regulations) will be issued to create the coordination structure and technical committees as well as the financial inclusion secretariat.

7. Both the National Financial Inclusion Strategy and the Action Plan are available on:

Financial Inclusion website
www.financialinclusion.ps
(Under construction)

PMA website
www.pma.ps

PCMA website
www.pcma.ps