MYANMAR FINANCIAL SERVICES REPORT

2018

MYANMAR FINANCIAL SERVICES MONITOR

FMR RESEARCH & ADVISORY

In association with:

British Chamber of Commerce Myanmar

Baker McKenzie.

Introduction and Methodology

This report is based on research carried out in Yangon by FMR in the first quarter of 2018, as well as the longer-term market understanding of our staff.

We conducted a wide range of interviews with executives and officials from a range of market segments, including banking, insurance, microfinance, private equity, capital markets and mobile money.

We would like to take this opportunity to thank all those who generously provided their time and insight.

The report is aimed at a wide range of readers, including professionals directly active in Myanmar's financial services sector, as well as a broader audience interested in the industry.

While we have made every effort to ensure that the information in the report was accurate at the time of research, the financial services market in Myanmar is undergoing rapid change. It is therefore inevitable that some information in this report may become outdated.

FMR accepts no liability for the consequences of any decisions that may be taken on the basis of this report.

Frontier does not provide legal or tax advice for companies intending to operate in Myanmar. Any discussion of regulations or laws in this report should be seen as an overview only. As legislation in Myanmar can be subject to unforeseen change, we recommend that companies seek specialist advice from a qualified local law firm where required.

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About FMR

FMR is a business information and research company based in Yangon and established in 2014. It is part of Frontier MEA, a UK company that covers emerging markets and has worked in south-east Asia, the Middle East and Africa.

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FMR would like to thank Baker McKenzie and the British Chamber of Commerce in Myanmar for their kind support in researching and publishing this report.

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The British Chamber of Commerce Myanmar has a business network of 200+ local and international companies. Our mission is to provide a proactive and professional approach to facilitating access and information. Our vision is to be the leading Chamber in Myanmar, supporting our members with access, advocacy, information and connectivity.

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Baker McKenzie.

Baker McKenzie Yangon is full service, with one of the longest standing offices and largest legal teams of any law firm currently operating in Myanmar. Drawing on Baker McKenzie's emerging markets expertise, they advise on all manner of investment in Myanmar, helping clients navigate and comply with the constantly developing legal framework.

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Spelling

English spellings of place names, surnames and other terms in Myanmar tend to vary. The reason is that these are often phonetic transcriptions of Myanmar characters into the Latin alphabet, and there is no set system for this as there is, for example, in Mandarin Chinese (pinyin).

For consistency's sake, this report will follow the spellings used by Google. Occasionally this will not reflect the most common local way of spelling a word, but it will allow the reader to easily search online for a place and to find it on a map.

Exchange Rates

When converting amounts, we have used an exchange rate of
$1 = Ks1,350, which was the approximate average rate during Q1 2018.

Acronyms

ADB	Asian Development Bank
BOT	Build-Operate-Transfer
CBD	Central Business District
CBM	Central Bank of Myanmar
CHDB	Construction and Housing Development Bank
DICA	Directorate of Investment and Company Administration
DUHD	Department of Urban and Housing Development
F&B	Food and Beverage
FDI	Foreign Direct Investment
FIL	Foreign Investment Law
FX	Foreign Exchange
FY	Fiscal Year (April-March)
GDP	Gross Domestic Product
IBC	International Business Centre
IRD	Internal Revenue Department
IMF	International Monetary Fund
JICA	Japan International Cooperation Agency
MIC	Myanmar Investment Commission
MIL	Myanmar Investment Law
MPF	Ministry of Planning and Finance
MP	Member of Parliament
MPA	Myanma Port Authority
MoC	Ministry of Construction
SEC	Securities and Exchange Commission
SEZ	Special Economic Zone
YCDC	Yangon City Develpment Committee
YHT	Yangon Heritage Trust
YSX	Yangon Stock Exchange

Credits

Structure and Contents

Section A: Banking **Pages 8-51**

Myanmar's banks are busy adapting to the country's economic transformation. Deposits are growing rapidly, but huge potential remains given that around 80% of the population is still unbanked. However, interest rate caps, the lack of a central credit bureau and last year's prudential regulations are creating challenges in the sector, making the need for fresh capital only more urgent.

Q&A: Sean Turnell, economic adviser to the Myanmar government

Section B: Mobile Money **Pages 52-63**

Myanmar's underbanked population and geographical features, coupled with rapid growth in mobile phones and internet penetration, have created a fertile ground for mobile money opportunities. Many existing financial services players are looking to get into the market in the years ahead.

Q&A: Melvyn Pun, CEO of Yoma Strategic

Section C: Microfinance **Pages 64-81**

MFIs are hoping that banking reforms will help solve one of their biggest problems — access to capital. New regulations in 2016 lifted caps on MFIs taking voluntary deposits from customers, but they remained barred from taking deposits from the general public. Yet MFIs continue to expand, with demand for credit still far in excess of what the sector can provide.

Section D: Capital Markets **Pages 82-95**

More than two years after it was established, the Yangon Stock Exchange hosts just five companies and sees minimal trading. The bond market consists solely of government Treasury auctions, which are open only to banks and sold at unappetising rates. But the YSX has renewed efforts to attract public companies to consider at listing and the Securities and Exchange Commission is working on a framework for municipal and corporate bonds.

Section E: Insurance **Pages 96-112**

Local insurers remain trapped in a strict regulatory regime that forces them to all offer the same suite of products at exactly the same rate. But with new rules opening up the market to foreign companies, all insurance firms are hoping for greater freedom.

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A. Banking

Introduction

Myanmar's banking sector is growing quickly, but not quickly enough.

Myanmar's banking sector is growing, and growing quickly. The total assets held by the three largest banks increased by 34% throughout the 2016-17 financial year, combined loan portfolios by more than 30% and deposits by almost 40%.

But the sector is not growing quickly enough. The country's GDP growth has recovered after a recent drop and is expected to remain around 7% in the medium-term, infrastructure funding needs are colossal, small and medium enterprises are desperate for loans and consumer demand for credit is rising.

Meanwhile, the extension of domestic credit to the private sector remains easily the lowest in ASEAN as a percentage of GDP. There has been a clear and sustained surge in credit extension — from a very low base — but not nearly enough to meet the country's vast needs across infrastructure, goods and services.

Myanmar's position at the bottom of the domestic credit rankings is in part a legacy of years of political and economic turmoil, isolation and underinvestment. More than 25 years of socialist military-rule began in 1962, during which all banks were nationalised.

It took almost three decades before a Financial Institutions Law in 1990 marked the first small step on the road to liberalisation. Private banks re-emerged two years later. But after a decade of rapid growth for the nascent industry, a crisis in the informal financial sector spread to the banks. The result was a full blown financial crisis in 2003 that saw three banks closed down, and others have their licenses revoked.

In the wake of the crisis, the Central Bank imposed stringent collateral requirements and prudential regulation that severely limited lenders' ability to extend credit.

Change and reform accelerated under the Thein Sein government that took power in 2011, and has continued under the National League for Democracy (NLD) administration. International banks have re-entered Myanmar under a new licensing regime, forming partnerships with local lenders but also increasingly free to compete for business. The authorities have removed state-owned bank monopolies on certain activities, and tried to level the playing field.

The larger domestic banks have undergone technological transformations, installing and updating core banking systems, digitising operations and expanding mobile services. Credit and debit cards have reappeared, and the bigger banks are beginning to offer sophisticated consumer and SME lending products.

Key growth indicators for top three largest banks, 2016-17

Source: FMR Research. Figures in Ks trillion and refer to aggregates of KBZ, AYA and CB Bank.

But for much of the last five years of transformational change, the banks have remained trapped in a regulatory regime under which loans have a 13% interest rate cap, can be made only for one year and even then, require strict collateral requirements.

For all the banking sector's tumultuous history, the modern regulatory regime is now seen as the main culprit in holding back the extension of credit. There is little disagreement that what the banking industry needs is greater freedom to lend to the private sector, and an international standard regulatory regime.

But there has been division over how these two aims are scheduled. The Central Bank is now in the process of enforcing modern prudential regulations under a timeline that bankers are concerned will result in a severe drop in credit across the economy.

Some of the most disruptive regulations are those designed to deal with problems that are a direct result of the Central Bank's own regulatory regime. Meanwhile, although banks have recently become free to lend up to three years and can theoretically devise their own collateral framework, there are limited incentives to do either given that the 13% cap remains in place.

As the legislative and regulatory framework is in many ways the biggest issue facing the sector, the banking chapter starts there.

Legislative framework

The primary piece of legislation governing the banking sector is the 2016 Financial Institutions Law

In July 2017 — 19 months after the FI Law was passed — the Central Bank finally issued its first set of modern prudential regulations.

A snapshot of the key pieces of legislation currently covering Myanmar's banking sector is below. As with many other sectors of the economy, it comprises a patchwork of newer laws that often replace pieces of legislation dating back several decades or longer.

Foreign Exchange Management Law (August 2012)
The legislation removed all exchange rate restrictions and ended multicurrency practices.

Central Bank of Myanmar Law (revised July 2013)
The revised law made the Central Bank operationally independent, removing it from finance ministry control. Under the revision, the Central Bank was also given sole responsibility for monetary policy and the exchange rate regime. The Central Bank submits bi-annual reports to the government and parliament, and publishes monetary reports each quarter.

Financial Institutions Law (January 2016)

The primary piece of legislation governing the banking sector is the 2016 Financial Institutions Law (FI Law). This replaced the outdated and insubstantial Financial Institutions of Myanmar Law, which was enacted in 1990 under the State Law and Order Restoration Council.

The new FI Law is designed to bring Myanmar's regulation into line with the core principles on banking supervision issued by the international Basel Committee on Banking Supervision (BCBS).

The Central Bank's latest prudential regulations issued under the new law are consistent only with Basel I, the initial set regulations issued by the BCBS in 1988. Banks elsewhere in the world, including many of those in emerging markets, are typically compliant with Basel III, or in the process of adoption. For example, under the Central Bank's new regulations banks are required to hold core capital of 4%, compared with an effective requirement of 7% under Basel III.

The FI Law raised the minimum capital requirement to K20bn for domestic banks, and instructs banks to hold 5% of their deposits at the Central Bank as a cash reserve. When the law was introduced there was concern that the K20bn minimum capital requirement would be an issue for the smaller banks. Data is unavailable, but there are anecdotal reports that some smaller lenders are still struggling to meet the requirement.

Prudential regulations (July 2017)

Myanmar has had prudential regulations prior to those issued under the FI Law, but they were typically inadequate and often not properly enforced. In July 2017 — 19 months after the FI Law was passed — the Central Bank finally issued its first set of modern prudential regulations.

These were drafted with help and guidance from the IMF and in some cases replaced rules made 30 years ago. The following regulations came into effect from July 7:

Capital adequacy: The minimum Tier 1 Capital Adequacy Ratio (CAR) is 4% and the regulatory CAR is 8%. Under the new capital adequacy rules, the capital risk weights on many assets were increased, including a 100% risk weight on fixed assets.

Tier 2: Under the prudential regulations, Tier 2 or supplementary capital "may be included subject to approval from the Central Bank of Myanmar up to a maximum of 100% of Tier 1 or core capital."

Many of the instruments that would typically form part of a bank's Tier 2 capital in a more developed banking sector either do not exist yet in Myanmar and/or will require regulatory clarity. This is unlikely to present a problem in the short-term.

LICENSING REQUIREMENTS

Local banks
K20bn capital

Foreign banks
$75m capital
$75,000 application fee
$125,000 license fee

Banks report that in hierarchy of needs, dealing with the overdraft restructuring [see box], revaluing fixed assets and other issues are more of a priority.

Liquidity ratio: This requires that 20% of a bank's assets must be in cash, or assets easily convertible to cash, which include Treasury bonds less than one year maturity, current accounts held at the Central Bank and loans to other banks.

NPLs: Banks are now required to classify loans as non-performing earlier, and hold more capital against the various classifications. The under-reporting of NPLs has been a perennial problem in the banking sector [see section on overdrafts]

NPL classifications

Classification	Days past due	Provisions on shortfall in security value
Standard	30 days	0%
Watch	31 to 60 days	5%
Substandard	61 to 90 days	25%
Doubtful	91 to 180 days	50%
Loss	Over 180 days	100%

Source: CBM

As of April 2018, the December CBM directive on overdraft facilities had not been superseded.

Overdrafts

One of the more disruptive pieces of prudential regulation was the Central Bank's approach to overdraft lending. The regulator's historic insistence on capping loan maturities at one year, together with strict collateral requirements, prompted banks and borrowers to turn to overdrafts as a means to get around the restrictions.

The majority of Myanmar borrowers take out an overdraft — still using collateral — that is rolled over yearly, rather than a traditional loan. A few banks do distinguish between proper term loans and overdrafts, but many do not. Several banks only lend using overdraft facilities, and some industry estimates put overdraft lending at 75%-80% of the banking sector's total loan portfolio.

The Central Bank became concerned that overdraft facilities were being used to issue loans without any maturity date, and that in many cases the borrower was no longer paying interest on the facility. As part of the July 2017 regulation, the regulator declared that from January 2018 banks would have to clear these overdraft facilities entirely for at least two full weeks of every year. Facilities that could not be cleared would be classed as non-performing loans.

Bankers and analysts warned that many borrowers would be unable to clear their overdrafts, and that imposing such restrictions along with the other capital requirements under that timeframe would seriously curtail new credit extension and pull billions of dollars' worth of existing credit from the real economy.

Following discussions between the Central Bank and financial institutions, the bank issued a follow-up directive in November. This stated that banks would be able to convert their overdraft facilities into three-year term loans, and laid out a phased timeline, outlined below, for banks to reduce overdraft lending as a percentage of their loan portfolio.

Overdraft lending terms

Deadline	Overdrafts as % of loan portfolio
July 6 2018	50
July 6 2019	30
July 6 2020	20

Source: CBM

The November directive gives banks until 31 March 2018 to submit a list of their largest overdraft facilities and their restructuring plan to the Central Bank. A subsequent directive in December clarified that restructured loans can be up to three years, with quarterly interest payments and a one-year grace period until amortization. Some banks are still hopeful that this phased timeline will be softened further. But at the time of writing in early April 2018, the December directive had not been superseded.

By putting an end to the practice of rolling over loans, the new overdraft policy is expected to highlight just how many of the loans in the banking sector are non-performing. Banks have typically reported NPL ratios in the low single digits. Central Bank data showed the NPL ratio across the banking sector doubled in 2016 to 3.6%.

In late 2017, the Central Bank said although most lenders were reporting an NPL ratio in the mid-single digits, it was aware that this was inaccurate . The true extent of NPLs in the banking sector has yet to become clear, but some senior bankers estimate that over a third of all loans across the industry are likely to be classed as non-performing under the new regulations.

Banks made an official request to the Central Bank in early 2018, asking that the implementation period for the new prudential regulations be extended, the definition of NPLs made less strict and asking for clarification on how off-balance sheet items are treated for reporting purposes. As of April 2018, bankers said the regulator had yet to respond.

Financial soundness indicators (local, state-owned and foreign bank branches)

CATEGORY	Q2 2016	Q3 2016	Q4 2016	Q1 2017
Regulatory capital to risk-weighted assets	12.3%	10.8%	15.9%	16.3%
Regulatory tier 1 capital to risk-weighted assets	10.8%	9.2%	13.8%	14.1%
Sectoral distribution of loans	100%	100%	100%	100%
Return on assets	0.7%	0.7%	0.5%	85%
Return on equity	9.5%	10.0%	6.4%	11.1%
Interest margin to gross income	60.0%	55.9%	52.3%	-1.3%
Non-interest expenses to gross income	63.3%	68.5%	64.6%	11.1%
Liquid assets to total assets	46.6%	42.6%	38.9%	35.8%
Liquid assets to short-term liabilities	63.9%	61.1%	55.8%	39.6%
Capital to assets	7.0%	7.0%	6.9%	7.7%

Source: CBM

There is industry speculation that one of the existing deputy governors will be appointed as the new governor in 2018.

The role of the CBM

The Central Bank of Myanmar has a nine-member board of directors made up of a governor, three deputy governors, and five government appointed banking experts.

Governor

Kyaw Kyaw Maung took office in August 2013 for a five-year term that is expected to expire in August 2018. He also served as governor from 1997 until 2007, directing the Central Bank's response to the 2003 banking crisis.

Under his most recent term, the Central Bank has drawn criticism from the banking sector and economic analysts for the slow pace of reform.

Deputy governors

Soe Thein joined as deputy governor for a four-year term in July 2017. He served as deputy director general in the Ministry of Finance budget department for many years, leaving in 2009. He later became an executive director and consultant to the commercial lender Asian Green Development Bank.

Bo Bo Nge joined as deputy governor for a four-year term in July 2017. He was formerly head of research and risk management at KBZ Bank and is a Ph.D candidate in the Department of Financial and Management Studies at the School of Oriental and African Studies, University of London.

Soe Min began a second term as deputy governor in July 2017.

CBM assets, Q2 2016 vs Q2 2017

	Q2 2016	Q2 2017
Cash and cash equivalents	1,418,978	1,392,026
Gold	363,481	395,396
Placement with foreign banks	3,660,821	4,353,062
Foreign securities	426,574	493,506
Deposit with local banks	606,141	699,012
IMF related assets	2,810	2,355
Other assets (foreign)	287	707
Domestic securities	12,835,695	14,096,636
Loans to banks	1,186	12,067
Loans to government	-	-
Property, plants and equipment	14,491	21,144
Other assets (domestic)	113,926	120,914
	19,444,390	**21,586,825**

Source: CBM. Figures in Ks millions

The Central Bank underwent organisational reform in early 2016, which saw the number of departments halved. There are now seven departments:

- Governor's Office
- Monetary Policy Affairs and Bank Regulation
- Currency Management
- Administration and Human Resources Development
- Financial Institutions Supervision
- Foreign Exchange Management
- Accounts

In January that year, the Central Bank also moved to real- time gross settlement system (RTGS), replacing a manual process of clearing and settling payments. The Japan International Cooperation Agency (JICA) built and installed the system, which also forms the platform for interbank trading in currency and securities.

The initial roll-out of the system involved providing private banks with a dedicated computer connected to CBM-NET, into which staff input information. JICA is now working on phase II of installation, which involves connecting the core banking systems of private lenders directly to the CBM-NET and allowing more functions.

Although the Central Bank has drawn criticism from banks, typically for the slow pace of reform but more recently for the proposed speed, senior executives say that one of the more positive changes in the last year or so has been an increase in dialogue between the industry and the regulator.

This appears to be both in terms of frequency and quality, which several executives said was due to the efforts of the two most recently appointed deputy governors. There is industry speculation that one of the existing deputy governors will be appointed as the new governor in 2018.

CBM office in Naypyidaw

Recapitalisation

As part of the July 2017 regulations, banks were asked to prepare plans for increasing capital in order to comply with the new requirements on tier 1 and tier 2 capital. In many cases, banks have watched their assets and liabilities grow over the years without adjusting capital accordingly.

The deadline for lenders to submit their plans to the Central Bank was 31 March 2018.

The size of the recapitalisation plan and the source of capital varies across the banking sector. Some of the larger banks have received approval for the equivalent of $100m or more in additional capital, others require much less.

As many banks are part of a larger corporate group, they can rely on funding from elsewhere in the organisation. In some cases, shareholders are injecting more capital, and at least one of the more advanced lenders has taken long-term foreign loans. The regulatory framework prevents banks from taking foreign equity, although this is likely to change when the new Companies Act comes into force [see Outlook section].

One factor potentially slowing down recapitalisation is the approvals process. One bank reported that it can take around a year for the Ministry of Home Affairs — which houses the Financial Intelligence Unit that combats money laundering — to process a request for additional capital.

Lenders also have to seek Central Bank approval first for the capital increase, and then submit a second separate application to deploy the new funds.

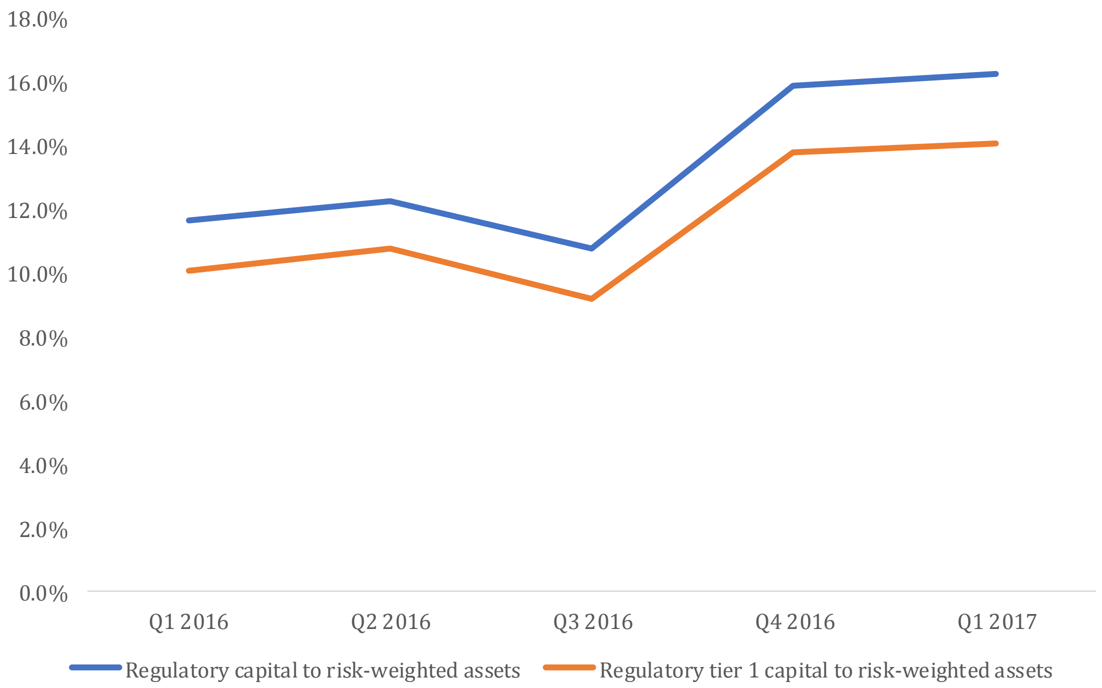
Banks report that the need to recapitalise, and hold more capital against NPLs and risk-weighted assets, has had the knock-on effect of sharply reducing lending following the July 2017 regulations. Data on detailed lending practices throughout 2017-18 was unavailable, but there are anecdotal reports of a widespread drop in credit, with some banks reporting a rise in new customers approaching them having been unable to secure credit from their existing lender.

The extent to which individual banks report reduced lending, however, varies considerably. Some report only a very limited impact on lending, others report having made reductions across the board. Others have stopped lending at the branch level, but continue to make corporate loans or carry out trade finance.

In some cases, lenders report that the Central Bank has issued written instructions curtailing certain activities in the wake of the regulations. But reports are conflicting. One senior banking executive said that all lenders were told to stop opening branches until the regulator has assessed recapitalisation plans.

However, executives at other banks said they had not received any such instruction. Similarly, FMR received conflicting reports from executives within the same firm, one of whom said the bank had received a letter instruction it to stop making new loans. The other said the bank had received no such instruction.

Regulatory capital to risk-weighted assets, Q1 2016-Q1 2017



Source: CBM

Interest rate caps

For years now, banks have been constrained by an interest rate floor of 8% on savings deposits and a ceiling of 13% on loans.

One effect of this is to dent profitability. Although the 5% spread between the deposit floor and loan ceiling is higher than in many countries, banks report that their net interest margin is considerably less than 5%. Firstly, given regulatory requirements and the need to keep a prudent capital buffer, banks say they can only lend around 75% of their liabilities — the majority of the top 10 largest banks appear to have loan to deposit ratios of between 60% and 70%.

Banks claim their average cost of funds is higher than 8% and potentially above 9% because some classes of fixed deposits pay between 8% and 10%. When operational costs, the Central Bank's reserve requirement and other factors are taken into account, banks report an average net interest margin as low as 1%.

Accepting these claims would mean that although Myanmar has one of the highest interest rate spreads in ASEAN, it has one the lowest net interest margins, which has prompted scepticism from observers in other parts of the financial sector.

Another result of the 13% cap has been to restrict lending to a relatively small group of potential borrowers.

Another result of the 13% cap — together with the Central Bank's traditional insistence on collateral requirements — has been to restrict lending to a relatively small group of potential borrowers. Entrepreneurs or SMEs seeking working capital, but lacking sufficient collateral or representing a higher risk, are pushed into the informal market to borrow at far higher rates than the 13% cap.

The World Bank surveyed over 600 private sector firms between October 2016 and April 2017 on the main obstacles they faced — the most common answer was access to finance.

The July 2017 prudential regulations led to more vocal calls from banks for greater freedom to set their own interest rates. Banks argue that if they are to be required to hold far more capital, they should have the means to expand their business and build capital through organic growth.

There has long been talk of allowing banks to lend to certain categories of borrower — for example SMEs — at higher interest rates. This could help increase SME lending by allowing banks to lend at rates that better reflect the higher risk in that segment. SMEs are already able to make use of a small-scale credit guarantee insurance program, which involves 3% for insurance in addition to the 13% interest rate.

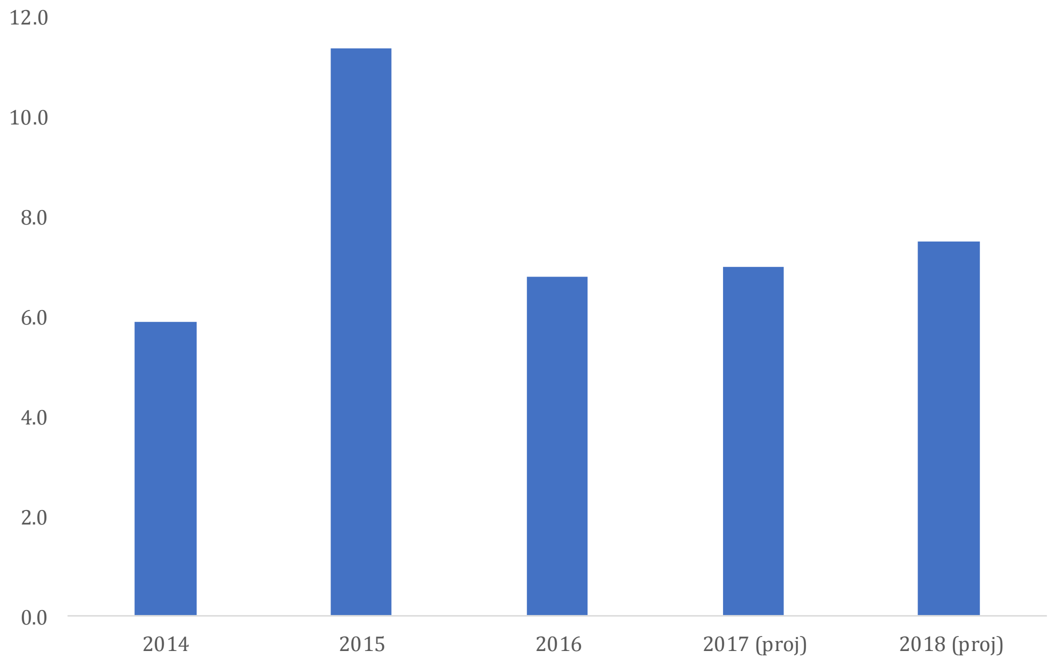
However, some banks argue for interest rates to also be raised on their existing loan portfolios, both in order to reflect actual risk and to help them generate capital organically. As SME lending is a very small chunk of most banks' loan portfolios, the immediate impact of such a move on their net effective interest rate margin would be negligible.

Central Bank deputy governor U Soe Thein in November 2017 was reported has saying that the regulator was preparing to move the 13% interest rate cap on loans up to 16%. But as of April 2018, the 13% cap remained in place.

In concert with the bank calls for higher loan rates, there have been calls from politicians to lower interest rates. Bankers and analysts argue that calling for cheaper loans may be politically expedient, but this neglects the fact that interest rates need to reflect credit risk and inflation.

Inflation has come down significantly in recent years, but remains high and at risk of future rises. The World Bank expects consumer price inflation (CPI) to average 7% over medium-term, but notes there is a risk from higher energy prices and other factors.

Annual inflation (%)



Source: World Bank

Bankers report there was discussion between the MBA and the Central Bank in 2017 about the possibility of moving the entire interest rate band — deposits and lending rates — down by around 3%. This would have made credit cheaper without reducing further bank's net interest margin, although it would have taken loan interest rates further away from accurately reflecting risk.

In January 2018, however, the Central Bank announced that it had no immediate plans to allow any shift in the floor or ceiling for deposits and loans respectively. Some executives interpreted this as taking the debate around moving the interest rate band downward off the table, at least in the short term. The Central Bank said it would continue to review interest rates every 6-8 months.

Loan maturities

The Central Bank's Directive No. (7/2017) on asset classification and overdraft regulation states that banks can issue loans with a maturity of up to three years. The vast majority of loans — as distinct from overdrafts — that have been issued in Myanmar are understood to be for one year.

Some banks were already issuing loans of up to three years before the directive, but these were very rare. Several lenders noted that regulation on loan maturities prior to the 7/2017 directive were unclear, and that although there was no obvious bar on lending beyond one year the Central Bank issued verbal warnings to banks making longer loans.

Although the 2017 directive makes it clear that banks can issue term loans of up to three years, the presence of the 13% interest cap makes this problematic. Banks report the vast majority of loans in Myanmar are issued at the 13% cap, and banks have a very limited incentive to lend for longer periods at the same interest rate.

ASSET LIABILITY MANAGEMENT

In the same directive, the Central Bank also addressed asset liability management and the development of new lending products. Banks are "encouraged to develop new lending products with repayment terms that consider the business cycle and cash flow pattern of the borrower." The directive states that these new lending products "and their corresponding credit risk analysis" shall be submitted to the Central Bank "on a no-objection basis".

Banks immediately pointed out the conflict between the instruction to develop new products with varying repayment terms, and the fact that interest rates remain capped at 13% and acceptable forms collateral are limited [see below].

Similarly, the regulator instructed banks to submit an Asset Liability Management (ALM) risk framework showing how liquidity risk arising from longer-term lending will be managed. Banks point out that there has been limited guidance or instruction on developing ALM practices or systems, and note their very limited ALM experience given the historical restrictions on lending beyond one year. The industry argues that ALM against a backdrop of longer term lending should include tools such as longer-term fixed deposits and corporate bonds.

Collateral requirements

For many years banks were required by regulation to lend only with collateral. In the wake of the 2003 banking crisis, the only acceptable collateral was immovable property, but from 2011 the list of collateral was gradually expanded. Land, buildings, gold and jewellery, bank deposits, shares and in some cases agricultural produce are all permitted forms of collateral. Although land is overwhelmingly the most commonly used form of collateral.

In 2017, the Central Bank began allowing banks to make unsecured loans, provided the lender implements proper risk management systems. As a result, some of the more sophisticated banks now lend on a small-scale based on criteria such as cash flow and receivables.

The issue is that the interest rate cap of 13% means banks have to extend unsecured loans at the same rate as those secured with the legal title to land. Still, the more sophisticated lenders are making clear progress in building up the internal credit and risk assessment architecture for unsecured lending, which will stand them in good stead when the interest cap is finally removed or at least adjusted.

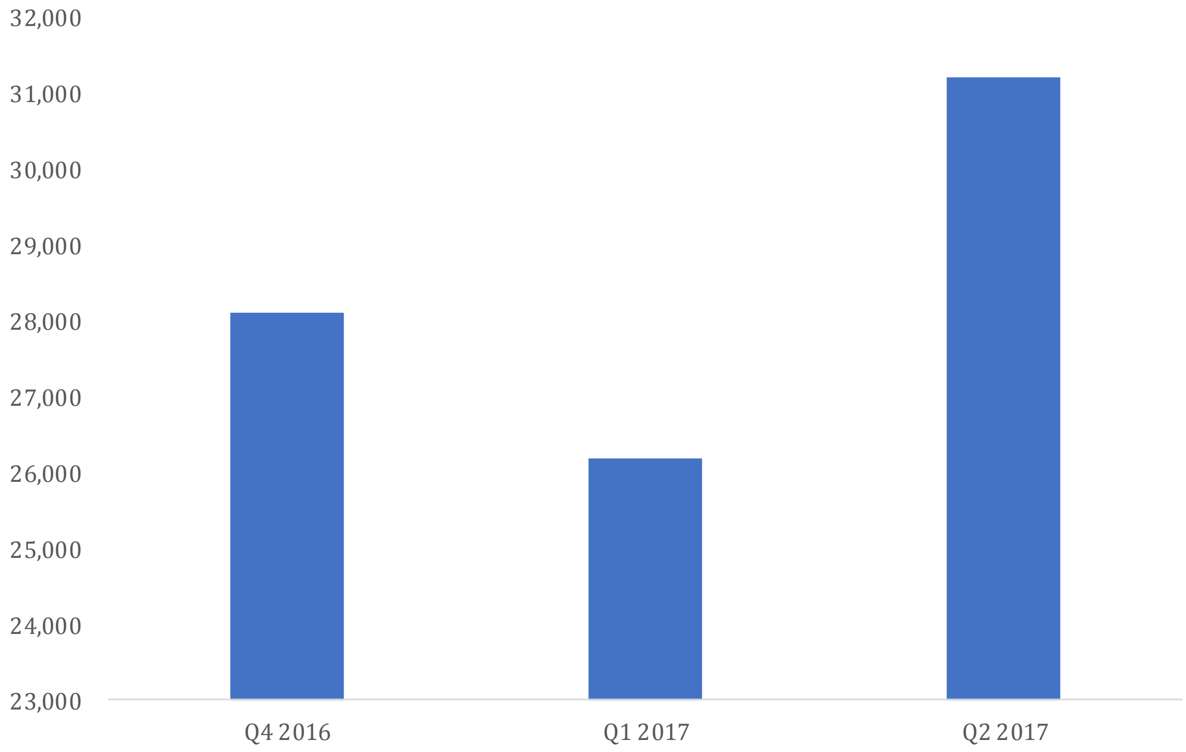
SME lending

SMEs will in theory be the biggest beneficiaries of a growth in unsecured loans. The sector is the backbone of the Myanmar economy — though reliable data is scarce, SMEs likely account for a very high percentage of total companies. But they are largely unable to access credit from the formal banking system. This is due mainly to a lack of collateral, the inability to meet various other loan criteria and administrative issues governing how SMEs operate.

In late 2015 there was only one dedicated SME loan product, a three-year development loan with an 8.5% interest rate provided by the Small and Medium Industrial Development Bank. SMIDB receives credit lines from Myanma Economic Bank (MEB) in order to provide these low-interest SME targeted loans.

In the last two years, however, additional SME loan programmes have sprung up and private banks have stepped up their SME lending. In December 2016, SME loans appeared for the first time on the Central Bank's breakdown of private banks by sector.

Private bank SME lending



Source: CBM. Figures in KS million

JICA has a two-step loan programme to provide funding to SMEs. This involves JICA making a very low interest rate loan to MEB, which in turn lends funds on to selected private sector banks at 4%. These private sector banks then make one-year loans to SMEs at the same 8.5% as SMIDB.

The six banks selected for the 2016 disbursement were SMIDB, MAB, AYA, CB, MCB & KBZ. JICA is planning to carry out another disbursement in 2018 with a fresh group of banks, and is considering altering the interest rates.

Banks are keen to develop a market for SME lending that does not rely on development aid from foreign partners

Meanwhile, German government development bank KfW has committed €15.3m in grant funding to the MoFP for SME promotion. The agency selected CB Bank as the first participant in the programme in 2016. The first phase of the programme involved the MoFP making a €4.45m loan to CB Bank to help SMEs refinance. As part of the programme, KfW has placed two officials inside CB Bank to work with the lender to improve its SME lending division.

However, banks are keen to develop a market for SME lending that does not rely on development aid from foreign partners.

CB Bank offers an SME loan product with credit guarantee insurance (CGI) provided by Myanma Insurance, which allows CB Bank to provide a loan with no collateral. MI is the only entity allowed to provide CGI, which typically covers 60% of the loan value.

As of March 2018, the Financial Regulatory Department (FRD) of the finance ministry said that a drafting committee was in the process of creating a dedicated Credit Guarantee Corporation Law, which would help create a legal framework for providing credit insurance to SMEs.

Several lenders, including CB Bank and KBZ, have opened SME centres dedicated to extending loans to the SME sector, which in the case of the KBZ centre includes explaining the loan requirements and improving financial literacy among potential borrowers.

Yoma Bank has long had a strong focus on lending to SMEs, and has received support from GIZ on a pilot program building a credit-risk appraisal with SME lending in mind. In early 2018, the bank announced new lending programs for SME value chain financing. KBZ has a similar SME pilot program with GIZ.

Expanding SME lending faces several challenges, however. Bankers report that many SMEs have a limited understanding of finance and debt management, and often lack the financial documents necessary to allow a lender to provide a loan based on cash flow. In addition to the issues around collateral, interest rate caps and financial literacy, banks note that SMEs require a letter of permission from the Ministry of Industry before taking a bank loan. The MoI bureaucracy governing SME borrowing is reportedly quite cumbersome.

For many lenders, the incentive to spend time and money putting credit-risk systems and procedures in place for SME and unsecured lending is minimal. Although several of the larger more advanced banks are working on training their staff and building systems in preparation for unsecured lending, they remain constrained in their ability to roll out such services by the interest rate cap.

Some have small-scale pilot projects, which will require Central Bank approval should the bank decide to offer them to customers. Banks note that a key part of the move towards unsecured lending is a change in institutional mind-set.

This involves training staff to consider a borrower's credit worth in much more detail — looking at business models, cash flow, debt management, receivables — even while continuing to require collateral. International agencies and groups are providing support on this front. GIZ is planning to hold workshops on unsecured lending in 2018.

Reporting standards

Since 2010, the Myanmar Financial Reporting Standards (MFRS) to which financial institutions must adhere have reflected the 2009 version of the International Reporting Financial Standards (IFRS). The Myanmar Standards in Auditing likewise reflect the 2009 version if the International Standards on Auditing (ISA).

There is an expectation in the banking sector that the Central Bank and the Myanmar Accountancy Council (MAC) will follow a process of bringing MFRS into line with the latest IFRS standards, but as of April 2018 there had still been no public announcement in this regard.

Some Myanmar banks use the most up-to-date IFRS reporting format, but the disclosure standards across the industry often falls far short of IFRS 2009. Lenders generally lack the necessary treasury software system to produce international-standard IFRS reports. A resulting problem, according to senior bank executives, is that the current reporting regime gives lenders leeway in how they represent certain aspects of their balance sheet for reporting purposes.

There is also reportedly variation in reporting practices across products and branch networks. For example, amortization and accrual accounting are recorded in some products but not in others. Some banks have branches that report monthly and others that report only quarterly.

GIZ is one of the organisations offering support on this front, and has a programme with three participating banks – KBZ, Shwe Bank, Myanmar Oriental Bank — helping the lenders prepare annual financial statements according to IFRS. Some banks are independently moving towards the latest version of IFRS and expect to be fully compliant — though not out of regulatory necessity — within a few years.

Others say they will follow the Central Bank's pace of disclosure requirements. For a majority of banks, however, meeting the reporting and disclosures of even IFRS 2009 is reportedly a challenge.

Lenders report it is unclear whether, on aggregate, the revaluation will see fixed assets rise in value or fall

Fixed asset revaluation

The majority of the banks and certainly the larger and more advanced lenders have recently gone through a process of revaluing their fixed assets. Some lenders began the process well over a year ago, but reported that the Central Bank had delayed signing off on revaluation for reasons unclear. Banks that have more recently submitted their fixed asset revaluation to the Central Bank have also not heard back.

Lenders report it is unclear whether, on aggregate, the revaluation will see assets rise in value or fall. One well-established bankreports beginning its revaluation in advance of the new prudential regulations because it expects the process to help boost its internal capital. The older part of the lender's branch network and many of its physical assets and collateral — mostly land — have not been revalued in some time, and its expectation is that updating the process will show higher values.

Banks' experience with their revaluation will clearly depend on the composition of their assets, when those assets were booked, how conservative the lender has been in the value they assigned and what has happened to the underlying market for that assets in the interim. This raises the issue of having a banking sector that has historically been heavily dependent on land-based collateral to extend loans.

In some segments of the real estate market prices have reportedly dropped by as much as 30%, according to data from FMR's *Myanmar Real Estate and Construction Monitor.*

AML/CFT

The Central Bank issued an AML/CFT Risk Based Management Guidance Note to banks in January 2015, which was then partially replaced by new guidelines issued in October that same year.

These guidelines provided instructions on customer due diligence, risk management requirements and monitoring, and suspicious transaction reporting. Financial institutions report that the Central Bank has made progress in stepping up its AML/CFT operations, though from a relatively low base.

Myanmar's 2014 AML law provides the legal framework for the Central Bank to specify a threshold for reporting different transactions. The threshold for transaction reports on domestic transactions is Ks100m for domestic transactions and $1,000 (or equivalent) for foreign currencies. Suspicious transactions reports, where there are issues around the beneficiary or the issue off funds, have no lower limit. Again, banks report there is a detailed documentation process that is checked quite thoroughly by the Central Bank

International agencies and advisors to the government on AML/CFT say the authorities are working on a more sophisticated system that takes into account a variety of different factors to assess risk. A number of key challenges will remain, however. The country and the banking system relies on a paper-based system of ID certification that can be easily misused by customers eager to hide their real identity.

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The Banking Landscape

Private banks

There are 24 licensed private banks in Myanmar, according to the Central Bank's classification of "private", and another five are expected to begin operating in 2018.

However, three of the 24 existing "private" banks are owned by municipalities, government ministries have a stake in at least another three, and two are controlled by military conglomerates.

The three biggest private banks—KBZ, CB and AYA—dominate the landscape and as of March 2017 accounted for 58% of total private bank assets, 64% of loans and 66% of deposits.

Institution	State/military links
AGD Bank	
Asia Yangon Bank	
AYA Bank	
Ayeyarwaddy Farmers Development Bank	
CB Bank	
Construction & Housing Development Bank	Ministry shareholder
First Private Bank	
Global Treasure Bank	
Innwa Bank	Military-owned
KBZ Bank	
Myanma Apex Bank	
Myanmar Citizen's Bank	Ministry shareholder
Myanmar Microfinance Bank	
Myanmar Oriental Bank	
Myawaddy Bank	Military-owned
Naypyitaw Sibin Bank	Municipality-owned
Rural Development Bank	Ministry shareholder
Shwe Rural and Urban Development Bank	
Small and Medium Industry Development Bank	
Tun Commercial Bank	
United Amara Bank	
Yadanabon Bank	Municipality-owned
Yangon City Bank	Municipality-owned
Yoma Bank	

The five newly approved lenders, which are expected to start operating later this year, are mostly sector-specific:

- Myanmar Tourism Bank
- Mineral Development Bank
- Glory Farmer Development Bank
- Mandalay Farmer Development Bank
- Shwe Nann Saw Bank

Plans for a tourism-focussed lender have been in the works for years, and there was an unsuccessful application under the previous Thein Sein government. The shareholders of the approved Myanmar Tourism Bank are reportedly all existing tourism industry operators, including the head of the Myanmar Tourism Federation U Yan Win. They are hoping that a dedicated financial institution can remedy the difficultly small and medium tourism firms have in accessing credit.

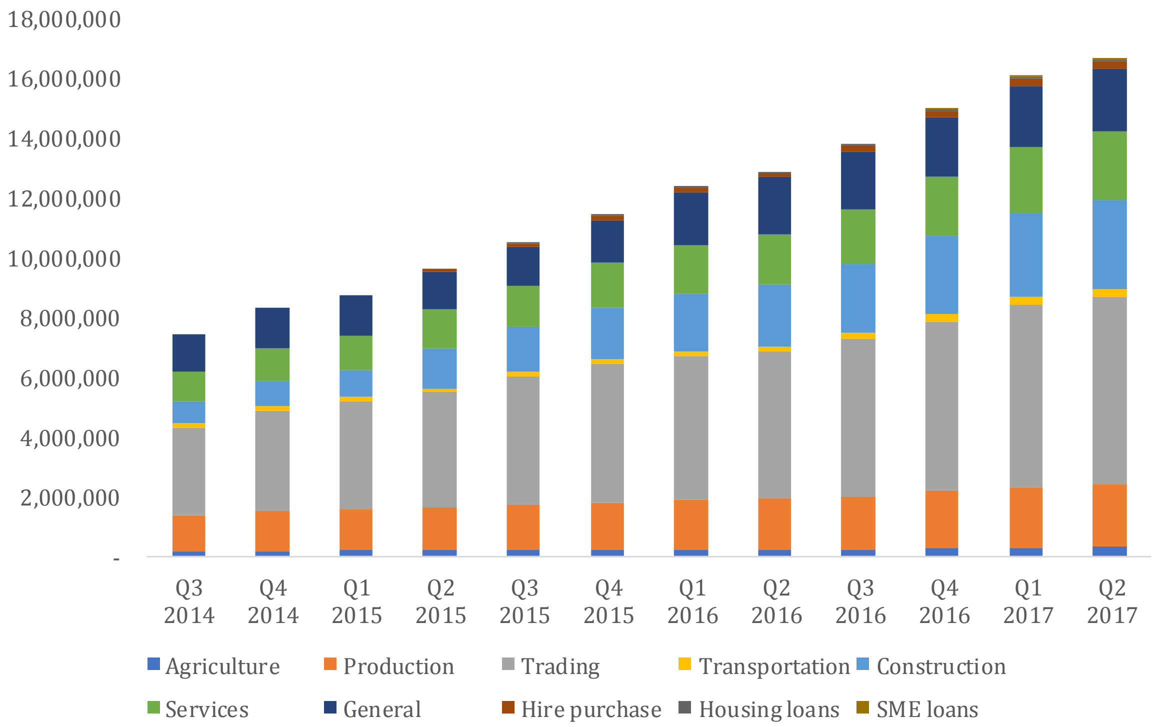
Similarly, there were attempts to set up a Gems and Minerals Development Bank back in 2015 among prominent members of those industries. Mandalay Farmer and Glory Farmer are understood to be regional agriculture-focussed institutions, similar to existing lender Ayeyarwaddy Farmers Development Bank (A Bank).

Private banks have historically struggled, or been reluctant, to extend credit to farmers. Some banks do have dedicated agriculture financing schemes — Yoma Bank and Myanmar Apex Bank for instance — which takes farmland ownership certificates (Form-7) as collateral. A Bank lends to farmers on the same basis. Based on the most recently-available Central Bank data, agriculture continues to represent a relatively small proportion of total lending. As indicated in the graph below, the majority of private bank lending is concentrated in the production, trading and construction sectors.

The breakdown of lending by sector appears to have undergone no fundamental changes in the past few years, though the proportion of lending to agriculture has risen compared to other sectors. SME lending has also increased, though still comprises a negligible proportion of the total.

Private bank lending by sector

Source: CBM

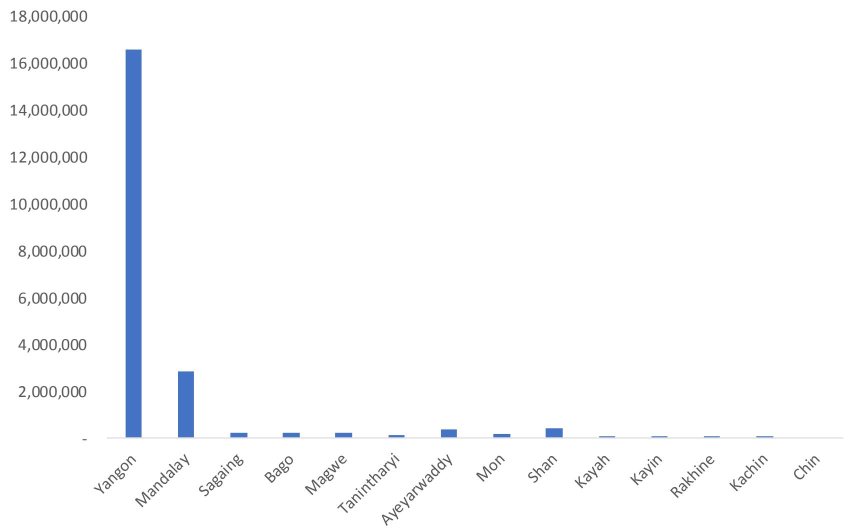


The vast majority of credit from private banks goes to Yangon, and to a much lesser extent Mandalay

Geographically, the vast majority of credit from private banks goes to Yangon, and to a much lesser extent Mandalay. The graph below shows total private bank loans of March 2017 by state and region.

Private bank lending by geographical breakdown

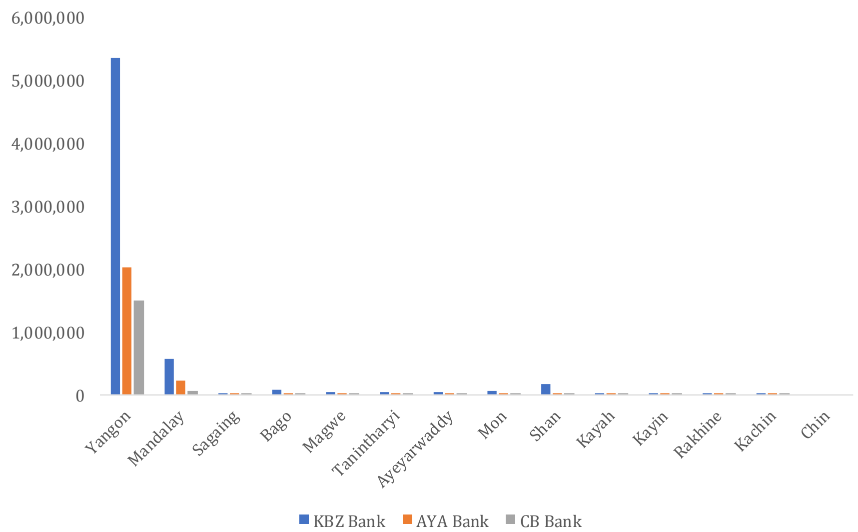
Source: CBM



The graph below shows the same breakdown, but for the three largest private-sector banks

Geographical lending of top three banks

Source: CBM



Foreign banks

In 2015, Myanmar granted licenses to nine foreign banks that had opened representative offices in the country, marking the first time in half a century that foreign lenders had been allowed to operate. A second round of licenses followed in 2016, which was open only to banks from countries without a successful applicant.

Under the terms of the license, foreign banks can lend only to foreign or local-foreign joint venture firms, and local banks. Although they can partner with local lenders to bank local corporations and offer other products, they are barred from conducting their own retail banking operations.

The restrictions have limited foreign banks' participation in the market, although foreign banks have provided financing to the construction, telecoms and microfinance sectors among others.

Bank Name	Nationality	License issued
The Bank of Tokyo-Mitsubishi UFJ	Japan	02/04/2015
Oversea-Chinese Banking Corporation	China	02/04/2015
Sumitomo Mitsui Banking Corporation	Japan	02/04/2015
United Overseas Bank	Singapore	30/04/2015
Bangkok Bank	Thailand	26/05/2015
Industrial and Commercial Bank of China	China	26/05/2015
Malayan Banking Berhad (Maybank)	Malaysia	27/07/2015
Mizuho Bank Limited	Japan	27/07/2015
Australia and New Zealand Banking Group	Australia	29/09/2015
Commercial Bank for Investment and Development of Vietnam (BIDV)	Vietnam	30/06/2016
Shinhan Bank	South Korea	15/09/2016
E.Sun Commercial Bank	Taiwan	27/09/2016
State Bank of India	India	27/09/2016

There are advantages for firms in taking onshore financing from foreign banks, as opposed to looking to lenders in Singapore or Thailand. Onshore loans do not require approval from the Central Bank. Cross-border loans do, and there are various criteria a borrower must meet to receive that approval, including:

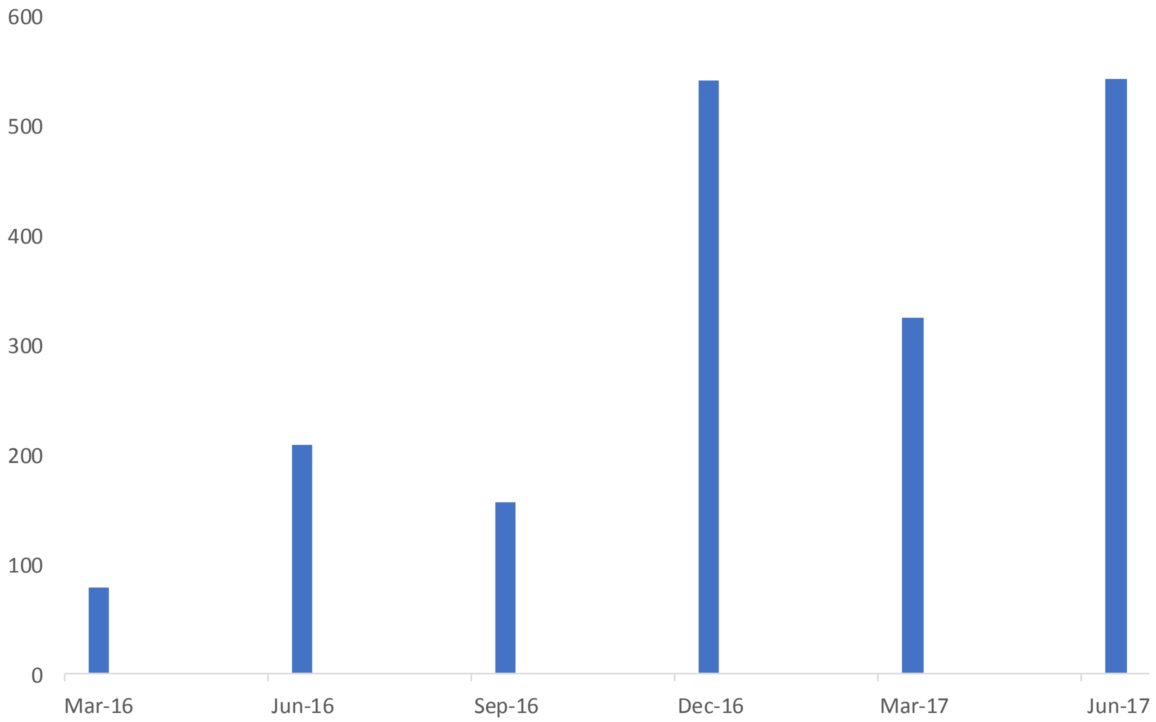
- Paid-up capital in excess of $500,000
- Sufficient profitability to repay the loan
- Access to sufficient foreign-currency income or plans to mitigate the exchange risk
- A debt to equity ratio not higher than 4 : 1

Most loans from foreign banks have been made by individual lenders, rather than by a group or through syndication. One factor limiting foreign banks' lending to eligible joint-ventures is the combination of a limit on lending to a single borrower, and the fact that a relatively small number of local conglomerates dominate much of the economy.

The relatively small limit on lending to a single borrower — 20% of the branch's capital — is applied at the group level, and does not distinguish between separate companies owned by one conglomerate. Some banks have increased their capital from the initial $75m in order to raise their lending, but would like the regulator to apply to lending limit below the group level.

While this remains unchanged, foreign banks expect syndicate lending to continue to increase over the medium term as demand for loans increase along with economic growth. Foreign banks report several syndicated deals under discussion as of early 2018.

Aggregate outstanding loans of foreign banks

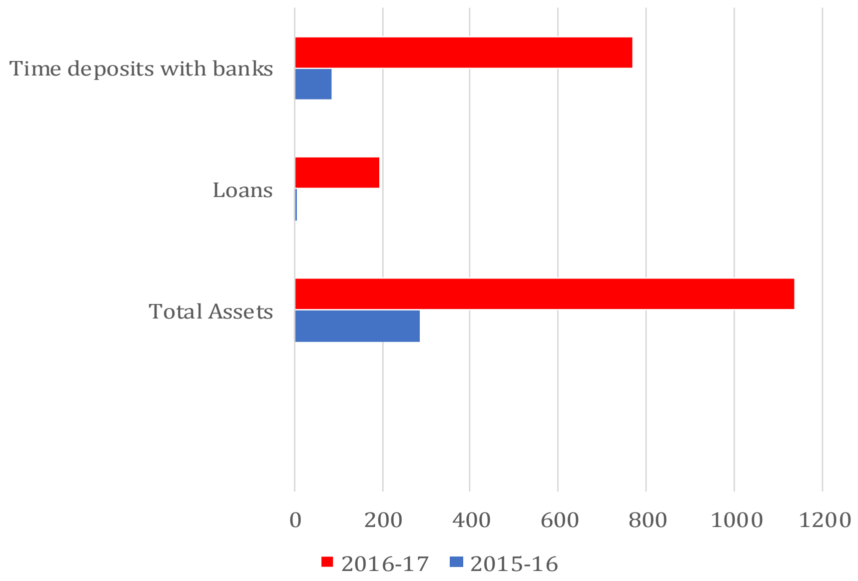


Source: CBM. Figures in Ks millions

Another factor that limits foreign bank lending is that many foreign firms are in the early stages of operation funded largely by initial capital. This is the case, for example, in the Thilawa special economic zone, where firms have yet to reach the stage where they would look to take on debt in the local market. Foreign banks expect more opportunities for lending as firms' operations mature.

Still, Central Bank data and data from individual banks indicates loans from foreign banks are steadily increasing. The graph opposite shows the growth over the 2016-17 financial year in total assets, outstanding loans and time deposits of one of the foreign banks that received licenses in 2015.

Deposits, loans and assets of an unnamed foreign bank in Myanmar



Source: CBM, FMR research. Bank involved wished to remain anonymous.

Foreign banks report little involvement in the interbank currency market, which remains in need of more regulatory support. Although some banks do provide sizeable foreign currency accounts for local lenders. Most of the loans foreign banks make appear to be in dollars, although several have made kyat denominated loans to foreign microfinance operators. These loans involve trading currency with local lenders.

Since foreign banks were allowed back into the market there has been speculation about when the various lending restrictions would be lifted. In May 2017, U Set Aung — then a deputy governor at the Central Bank – told parliament that the bar on retail banking would be lifted "soon" once the regulator was confident the financial sector was "stable".

Almost a year later however, and the bar remains in place, potentially because a few months after Set Aung's statement the new prudential regulations cast the sector into a state of relative instability. As of April 2018, banks were still barred from retail operations, although other areas have been opened, such as trade finance.

The government appears keen to allow foreign banks a wider range of lending options. In February, the government released a draft of its overall scheme for economic and social development — the Myanmar Sustainable Development Plan. The wide-ranging document includes a section on financial and economic management. Recommended measures include allowing "authorized foreign banks to provide both kyat and foreign currency loans to domestic borrowers". The plan also calls for the development of a currency swap auction market to improve currency trading between foreign and local banks.

However, foreign banks report that even if restrictions on lending to local borrowers were lifted, they would face several issues in extending credit. One is a bar on holding the rights to land or other fixed assets that can be used as collateral, which means their lending must be unsecured. Here they run into the same difficulties as their local peers, in that few local corporates have the disclosure and financial reporting standards to allow a bank to be comfortable extending financing based on cash flow or receivables.

This is equally the case when it comes to lending to local banks. Foreign banks also face the same maturity and interest rate limits on kyat-denominated loans as the domestic lenders.

Some foreign banks suggest that the new Companies Act will bring in fresh foreign investment to the local banking sector and elsewhere in the wider economy. This in turn should help raise compliance, reporting and governance standards, creating a new pool of borrowers with whom foreign lenders could do business.

The Central Bank has only allowed foreign banks to provide trade finance to local exporters, not to the much larger market for imports

Other complaints from foreign banks include some local laws and regulations not in line with international practice — the general provisions for loans is set at 2% instead of 1%, for instance. But foreign banks also report regular consultations between the banks and the regulator on changing and improving regulation.

Some foreign lenders have also signed MOUs or agreements with local banks, which typically involve the local banks using their branch networks to help serve the foreign lender's international clients across Myanmar. CB Bank has an agreement with BTMU, KBZ with SMBC, AYA Bank with Mizuho.

Foreign banks and trade finance

In December 2017, the Central Bank did announce that it would allow foreign banks to offer export finance to local companies, and licensed the seven that applied in the first quarter of 2018. The regulator had hinted earlier that it would permit foreign lenders into the trade finance business if local banks were unable to meet demand from importers and exporters.

Chairs of prominent industry organisations had complained that local banks offered trade finance only in small amounts, and that many were unable to offer letters of credit. Even the larger banks that have credit lines with overseas banks are limited by low ratings.

However, the Central Bank has only allowed foreign banks to provide trade finance to local exporters, not to the much larger market for imports. In addition, foreign banks face a variety of challenges illustrative of the Myanmar market. Due diligence is challenging as local firms are often interlinked, often through conglomerate ownership, and understanding the nature of these connections is difficult.

Many firms also lack the documentation and financial records foreign banks are used to. One problem specific to the trade finance sector is that many firms engage in both export and import businesses, and foreign banks can find it hard to be sure the financing they provide is funding exports.

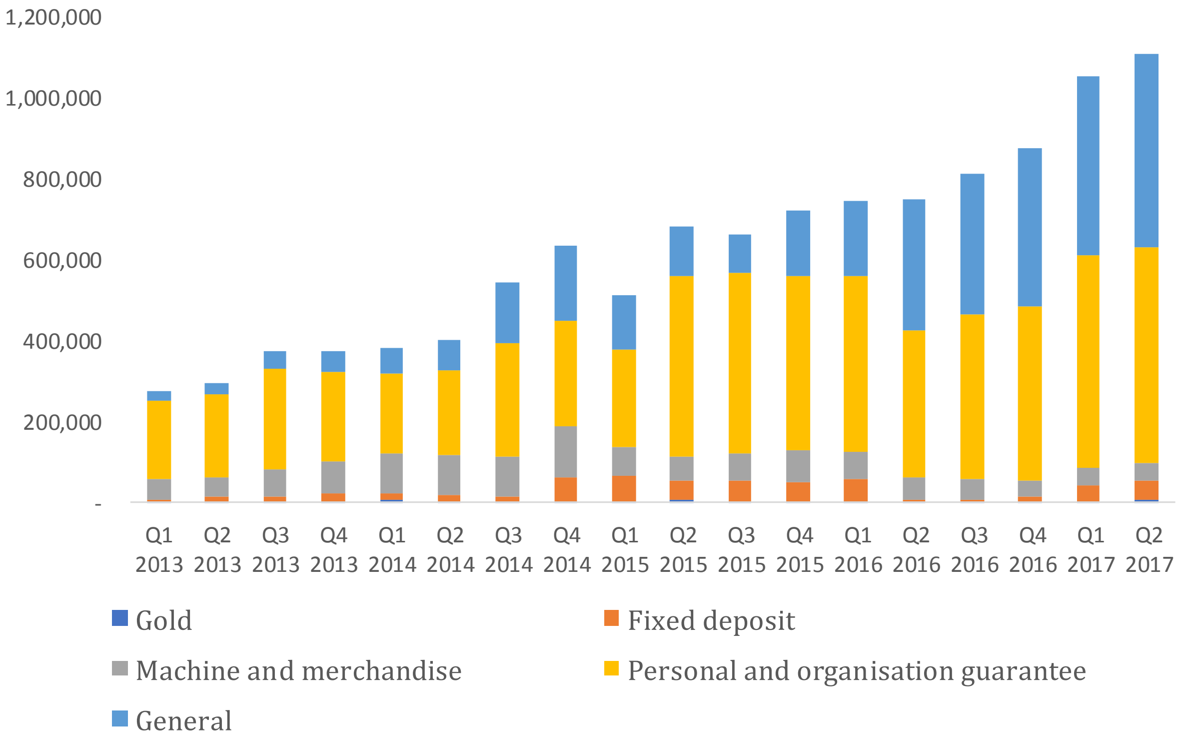
Some local banks complain that they will struggle to compete with foreign lenders, who have far more experience with trade finance. This complaint in turn illustrates a more general issue banks have with how the Central Bank has managed reform over the years.

From the Central Bank's perspective, it has allowed local lenders to conduct trade finance, but they are still unable to provide the service in sufficient volume, prompting complaints from the import/export community.

Banks see things somewhat differently. Private lenders were allowed into trade finance in 2012 breaking a decades-long state-owned bank monopoly. State-owned banks had typically requested 100% cash collateral for trade finance, and so local banks followed this practice as they expended into what was for them a new product. Understandably, requiring 100% cash collateral made trade finance difficult to access for many traders. The Central Bank responded several years ago by making it clear to private banks that they could set their own collateral standards for trade finance.

Over the last few years, many banks significantly lowered their collateral requirements for trade finance — at least for long standing customers. Regular customers of the larger banks are often able to access trade finance without collateral, while new customers are required to post collateral of 30% - 40%, and sometimes higher. The reasons for the enduring collateral requirements include a still-pervasive conservative, relationship-based approach to lending.

Total bank loans by collateral type



Source: CBM

Although the Central Bank freed private banks from trade finance collateral restrictions, banks say there was no guidance about how and when that product or any others would be opened to foreign competition. Bankers say there has been obvious progress in lowering collateral requirements and extending trade finance, but that shifting the cultural mind-set of the industry will take time and far more guidance and instruction than the regulatory has hitherto provided.

Similarly, many banks feel that with the new prudential regulations the Central Bank is forcing them to move towards international standard capital and asset liability management standards, without removing antiquated restrictions on interest rates and collateral requirements.

The ADB began a Trade Finance Programme (TFP) with local banks in 2015. CB Bank was the first to sign on in an agreement that allowed the ADB to provide guarantees of up to $12m per annum for the commercial bank. There are now three local lenders signed onto the programme, which the ADB reports has been used to guarantee transactions in the agriculture and energy sectors.

ADB officials involved in the TFP report that trade finance activity among local banks has grown at its fastest rate ever in recent years, but is still mostly regional and collateralised. Senior bankers at local commercial lenders say Myanmar banks still struggle to accept trade facilities as self-liquidating products that do not require collateral. ADB officials say expertise remains in short supply and implementation will be key if the banks are to manage their trade finance businesses appropriately in the future.

Outlook

On the prudential path

The prudential regulations released in July 2017 were only the first of many — reportedly over 20 are planned — that will be implemented over the next three years or so.

Banks say they should have much greater clarity over the content and timeline for these incoming rules and regulations. This is part of a wider complaint that the regulator has at no point shared with the industry a roadmap for banking sector reform.

Foreign investment and the quest for capital

A Roland Berger report published in September 2016 estimated that between 2015 and 2020, in order to meet the demand for loans given anticipated GDP growth, total banking sector equity would need to increase nine-fold from $2.8bn equivalent to $25.2bn.

Even if this estimate is overambitious, there is clearly a huge need for fresh capital to allow banks to expand their operations. Expanding balance sheets through raising deposits will be difficult given most lender's limited branch networks. Roland Berger noted that retained earnings and shareholder injections would be insufficient to provide the additional capital necessary under their projection.

Some bankers point out that the interest rate caps severely constrain their profitability, and that allowing a higher net interest margin would provide the equivalent of hundreds of millions of dollars' worth of capital each year.

The July 2017 regulations have thrown this need for capital into sharp relief. As usual, the larger and more sophisticated banks are further ahead, and have looked into the possibility of issuing bonds or using other products to increase tier 1 and tier 2 capital. The lack of a functioning domestic capital market or regulatory framework for corporate bonds, however, makes this route difficult [see Capital Markets section of this report].

Several banks are in conversation with potential foreign investors, and suggest that even lenders hitherto opposed to foreign shareholders will now have to at least consider that route. A new Myanmar Companies Act passed and approved in late 2017 allows for foreign investors to hold up to 35% of the shares in a firm, while still allowing the business to be classed as a domestic company.

The new act is expected to come into force in August 2018 at the earliest. For the first time, there will be clear legal basis for allowing foreign equity into the banking system, although the Central Bank will still have the authority to allow or prevent such deals.

Conversations between banks and potential foreign investors were taking place well before the Companies Act was approved. But some senior bankers suggest the tone of these talks has changed in light of the new prudential requirements. Where previously the banking sector offered scarcity value because most banks were unwilling to accept foreign investment, the need for capital has made banks much more open to the idea.

At the same time, the new regulations and the timeline for compliance have also brought to the fore banks' overdraft and NPL problems.

Private equity investors that have previously considered the banking sector cited moribund loans as one of several factors — along with a lack of amortized accounting and proper documentation — behind their decision not to invest. The 35% limit in the new Companies Act means foreign investors will be taking minority stakes, which argues for additional caution in choosing the right firm.

Some bankers suggest that the institutions that are likely to be in a better position to attract foreign equity are those that are relatively young, and have therefore had less time to build up moribund loans or problematic overdrafts, and those that are properly audited and working towards international standards in areas like corporate governance and reporting.

A Myanmar credit bureau has been in the works for years but it still not operational

Other senior executives suggest that many local banks fail to appreciate just how important corporate governance and disclosure will be in attracting foreign investment.

Credit Bureau

A Myanmar credit bureau has been in the works for years but it still not operational, making Myanmar the only southeast Asian country aside from Laos to lack either a public or private sector credit bureau.

The Myanmar Banking Association's Credit Bureau Committee selected Singaporean firm NSP Holdings as a partner for the venture back in 2014. Under the agreement, the MBA will hold 60% of the shares and the Singaporean partner 40%. It took until early 2017 for the Central Bank, with support from the IFC, to published credit reporting regulations necessary to lenders to share credit information through a bureau.

As of April 2018, the Central Bank had yet to issue the license for the Myanmar Credit Bureau. Members of the MBA's Credit Bureau Committee are hopeful that this will happen later in the year, though even then it is likely to take at least a year before the bureau is fully operational. The practice of using multiple NRC numbers to open accounts will continue to create difficulties in investigating credit history.

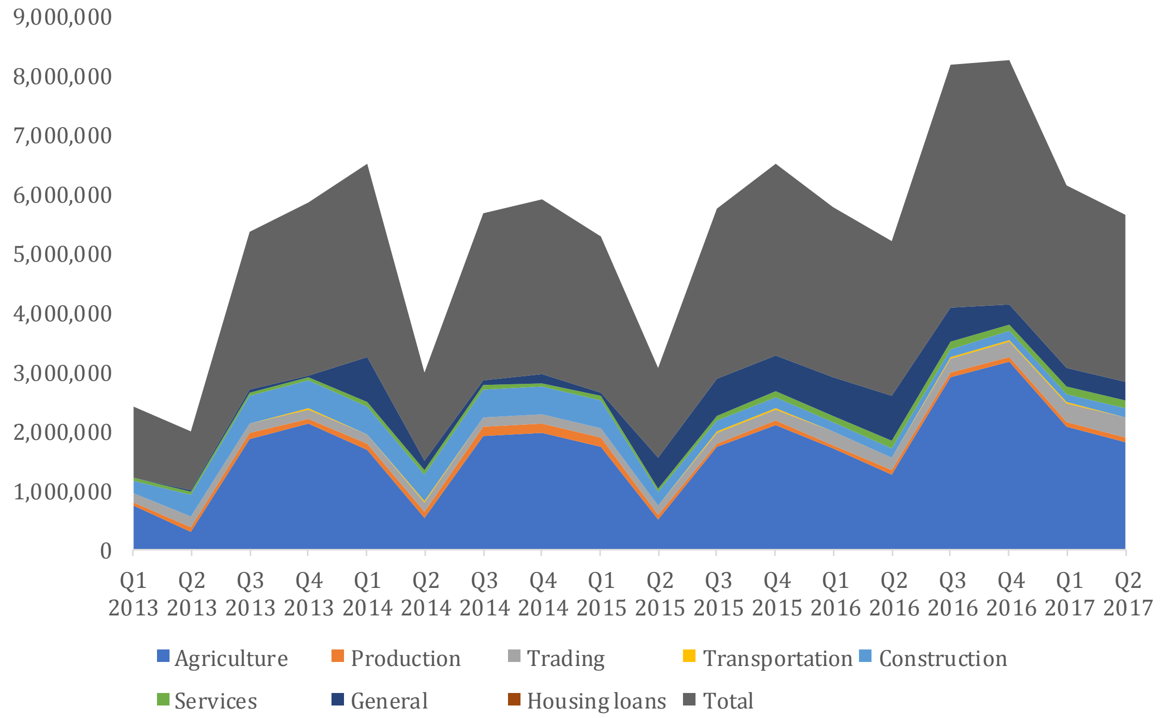
State-owned bank reform

Serious discussions around the need to reform the four main state-owned banks began under the previous government and have continued under the NLD-led administration. The state-owned lenders are not regulated by the Central Bank, but by the MoPF's Financial Regulatory Department.

As yet, the FIL and the new prudential regulations have not been imposed on the state-owned lenders. The government, however, is well aware of the need to introduce strong prudential risk ratios on the state-owned banks as part of the reform process.

In recent years, the state-owned banks' share of total banking sector assets has steadily declined, from 66% in March 2013 to 46% by March 2016, according to Roland Berger. Central Bank data indicates that as of June 2017, private banks had 64% of total assets, state-owned banks 28% and foreign banks 8%.

Sectoral breakdown of lending by state-owned banks



Source: CBM

The decline in the SOB share is due mainly to the growth of the private banking industry and to a lesser extent the entry of the foreign banks. The government and the Central Bank have also remove the state-owned banks' monopoly in areas like trade-finance and foreign currency accounts for state-owned enterprises and joint ventures. In addition to increasingly being placed into direct competition with local and now foreign banks, the state-owned banks report a lack of funding to allow them to appropriately upgrade and adapt to a changing environment.

The World Bank is providing advisory support to a State-owned Bank Reform Committee, comprising representatives from the MoPF, the Central Bank and the banks themselves. As part of an effort to conduct proper audits of the banks and ascertain their fiscal positions, the government hired Deloitte to carry out a special diagnostic assessment of Myanmar Foreign Trade Bank and Myanmar Investment and Commercial Bank, while Rabobank was tasked with conducting a similar investigation of Myanma Economic Bank and Myanmar Agricultural Development Bank.

There is a differentiation to be made between MEB and MADB, which have clearer policy mandates that include providing subsidised loans to key sectors like agriculture, and MICB and MFTB, which fulfil many of the same banking services as their commercial competitors.

Myanma Economic Bank (MEB)

MEB is the largest of the four state-owned banks and was established in 1976 to provide general domestic banking services. As a result, it has a much larger branch network than the other three, with over 330 branches nationwide — many in rural areas. MEB provides a general range of retail and corporate banking services.

MEB sits under the Ministry of Planning and Finance, which appoints the board of directors. The bank also acts on behalf of the MoFP and the Central Bank in managing state funds and currency. It also has a mandate to provided subsidised loans to state-owned enterprises, other state-owned banks — primarily MADB — and to SMEs.

MEB also lends to the Construction and Housing Development Bank (CHDB) at 9% which lends to SMEs in the construction sector at 11%.

JICA has programmes with MEB under which it makes loans to the state-owned bank, which in turn provides funding to MADB and to commercial banks for SMEs lending. Under the two-step SME loan programme, MEB receives the funds from JICA at an ultra-low interest rate, and lends to commercial banks at 4%. The commercial banks use the funds to issue one-year loans to SMEs at 8.5%.

However, the majority of MEB's subsidised policy lending appears to be done at a negative net interest margin, which contributes to the bank running at a significant loss. MADB accounts for a large chunk of MEB's loans, with one MADB official estimating that their bank receives on average around one-third of MEB's yearly loans. MEB relies partly on deposits — on which it typically pays 8% — to fund its loans to MADB, which in the most recent fiscal year came with just a 5% interest rate.

One of the key difficulties in reforming MEB is its very large number of staff — over 8,000 — many of whom would risk redundancy as part of a restructuring or corporatization process, or even streamlining the operations while keeping the bank under government control.

Myanmar Agricultural Development Bank (MADB)

Myanmar has had a state-owned agricultural bank since 1953, when the State Agricultural Bank was created. This was followed by the Myanma Agricultural Bank in 1975, which in turn was replaced by the broader-focused Myanma Agricultural and Rural Development Bank in 1990. In 1997, the 'rural' was dropped from the name to become MADB. Formerly controlled by the Ministry of Agriculture, Livestock and Irrigation, MADB is now under MoFP control.

Like MEB, its rural lending mandate means it has a large branch network and staff. As of early 2018, the bank had over 2,400 staff and over 200 branches.

MADB provides subsidised loans to farmers and credit for purchasing agricultural machinery and equipment. As of February 2018, senior staff said MADB had around two million customers and Ks1.9trn in outstanding loans. Like the other state-owned banks, MADB reports funding is a key problem. The bank has around K9.5bn in paid-up capital, a reserve fund of Ks9.4bn and only Ks16.5bn in deposits. This amounts to Ks35.4bn against almost Ks2trn in outstanding loans. As of February 2018, the bank had Ks126bn in NPLs outstanding across all its loan classes.

The bank's three main loan types, which all have a one-year maturity, are:

- Monsoon loans for paddy farmers
- Pre-monsoon loans – mainly for sugar plantation
- Winter loans – mainly for beans and pulses

Interest rates vary year-by-year, but have fall steadily over the last decade or so. MADB reports it lent at 17% in 2000-01, 13% in 2012-13, 8.5% in 2014-15 and 8% in 2017-18. Farmers typically lack collateral and so MADB loans are usually unsecured group loans. The bank has no real credit appraisal or screening system in its lending operations. MADB reports it lacks the funds to install a core banking system, although it is planning to upgrade the software it uses for international operations.

MADB reports a key recommendation from the Rabobank diagnostic was improving capital adequacy. The bank is hoping to increase its deposits, and receive soft loans from international agencies. JICA has already provided a loan equivalent to around Ks180bn, which has a 10-year grace period, 40-year maturity and an interest rate of 0.01%.

Another recommendation is that MADB be governed by the FIL. At present, MADB operations are guided by MADB Law (1990), which has many weaknesses including an absence of provisions for modern risk management. MADB, for instance, has no requirements on capital adequacy or liquidity ratios. Corporate governance is also lacking, and the bank has no board of directors.

MADB borrowed Ks200bn from MEB in the 2017-18 financial year at 5% and lent to farmers at 8%. The bank reports its operations turn of a net profit, but one entirely reliant on concessional funding from MEB. In addition, if the bank was to meet the Central Bank's requirements for loan loss provisions it would become loss making. MADB used to receive funding from the Central Bank as well, but reports this is no longer the case.

From its creation in 1976 until 1990, the bank essentially had a monopoly on providing international banking services and foreign currency accounts

Myanma Foreign Trade Bank (MFTB)

MFTB, as the name suggests, was created to focus on international banking and foreign currency services.

The bank is under MoPF control and has historically provided accounts and support for government-owned enterprises and departments. MFTB also reports it frequently acts as the designated borrower for government-to-government commodity loans.

From its creation in 1976 until 1990, the bank essentially had a monopoly on providing international banking services and foreign currency accounts. This ended in 1990 when Myanma Investment and Commercial Bank (MICB) was created.

However, these two banks remained the only institutions providing foreign currency services until 2012. It took until 2016 before the government allowed private banks to provide foreign currency accounts to state-owned enterprises, and joint-ventures between SOEs and foreign firms.

Despite reports of customers moving their accounts from MFTB to private banks, the state-owned lender reports a steady rise in its customer base. MFTB reports it now has over 150,000 accounts, and relationships with between 250 and 300 correspondent banks across the world. MFTB also recognises the need to reform in order to compete with the private sector, and senior staff welcomed the Deloitte diagnostic and its proposals.

Independently of any outside recommendations, MFTB has begun introducing new products and services for its customers. In August 2017, it introduced kyat denominated accounts for the first time. The bank now offers a full range of local currency accounts, including savings and fixed deposits. The bank does not make kyat-denominated loans, but is considering adding this to its product base in the future.

The bank has signed a MOU with Singaporean bank DBS to facilitate remittances from Myanmar workers in the city state. MFTB is planning on similar agreements with banks in Thailand and Malaysia.

MFTB has expanded its suite of dollar-denominated trade finance services for importer and exporters beyond simply a letter of credit. The bank is also planning to expand its trade finance operations to act as an export-import (EXIM) bank, while continuing to build out its commercial banking operations. Under this tentative plan, the EXIM operations would expand and eventually be carved out to form an independent Myanmar EXIM Bank.

The state-owned lender is also planning to introduce its own mobile banking system, and has now has 50 ATM terminals — 30 of which are inside its single branch in downtown Yangon. The bank is considering building new branches in border trade areas and urban centres like Mandalay, but is limited by its budget.

As MFTB is yet to being making term loans this would simplify any compliance with the new prudential regulations being applied on commercial banks. However, MFTB reports that complying with the capital requirements would still be difficult, and that overall raising capital is its greatest challenge. The bank reports that it operates profitably without a reliance on subsidised loans.

Myanma Investment and Commercial Bank (MICB)

MICB is the youngest of the four state-owned banks, created in 1990 to provide commercial and investment banking services in kyat and dollars to the private sector. These include deposit accounts in local and foreign currencies, issuing term loans in kyat to domestic customers and providing bank guarantees in local and foreign currencies.

Product Development

Deposits

Lenders offer a variety of deposits accounts including call, current, fixed and savings. As with loans, some banks have begun offering deposit products tailored to specific borrowers, for example professional seamen or couples saving for a wedding.

- Current accounts are typically non-interest bearing.
- Fixed deposits typically range from one to 12 months and pay between 8.5% and 10% depending on the fixed period.
- Savings deposits have a regulatory floor of 8%

CALL DEPOSITS

Unlike with savings deposits, Myanmar banks are able to alter the interest rate without Central Bank approval. In late 2017, several Myanmar banks agreed to lower the rate on call deposits from 8% down to 2%, although some still offer 4% or even 6%. The agreement was notable as a coordinated move among banks to significantly alter the rate on a product.

One bank suggested the reason for the move was that borrowers are in the habit of keeping funds in call deposit account for the first few days of the month, before moving them to a savings deposit account. In this way, the borrower can receive a full month's interest on their savings deposit account, and a few days additional interest from the call deposit account.

Another is simply that as banks are unable to lower the interest rate on their savings deposits below 8% and current account rates are already at or near 0%, the only other deposits on which banks can reduce their cost of funds is call deposits. As call deposits account for a small percentage of banks' balance sheet, however, this is unlikely to have much impact. Some banks involved in the initial decision to lower their rates say they plan to push the Central Bank for a reduction in fixed deposits.

Loans

Myanmar banks are able to provide overdrafts for up to one year and term loans of up to three years. Loan products include development loans for specific projects, standard commercial loans and retail products tailored to specific circumstances. For example, some institutions provide "education loans" for students to cover fees at accredited higher learning institutions, or a short-term loan product where a customer offers their deposit account as collateral.

Consumer finance

Demography, economic growth and the fact that retail lending has hitherto been stymied by regulation, creates the conditions for a boom in consumer finance. Over one-third of the population is aged between 10 and 29. GDP growth is expected to stay north of 7% over the medium term. Mobile penetration is now over 75%, and estimates say that 80% of mobile users have smartphones. The government has turned its attention to drafting a dedicated E-commerce law.

Expanding into unsecured consumer finance lending will require much more sophisticated systems than banks currently have in place, however. Once again, the issue is that there is limited incentive to spend time and money putting such architecture in place while the ceiling on interest rates remains in place. However, lenders are starting to seriously investigate how credit analysis and scoring for consumer finance will work.

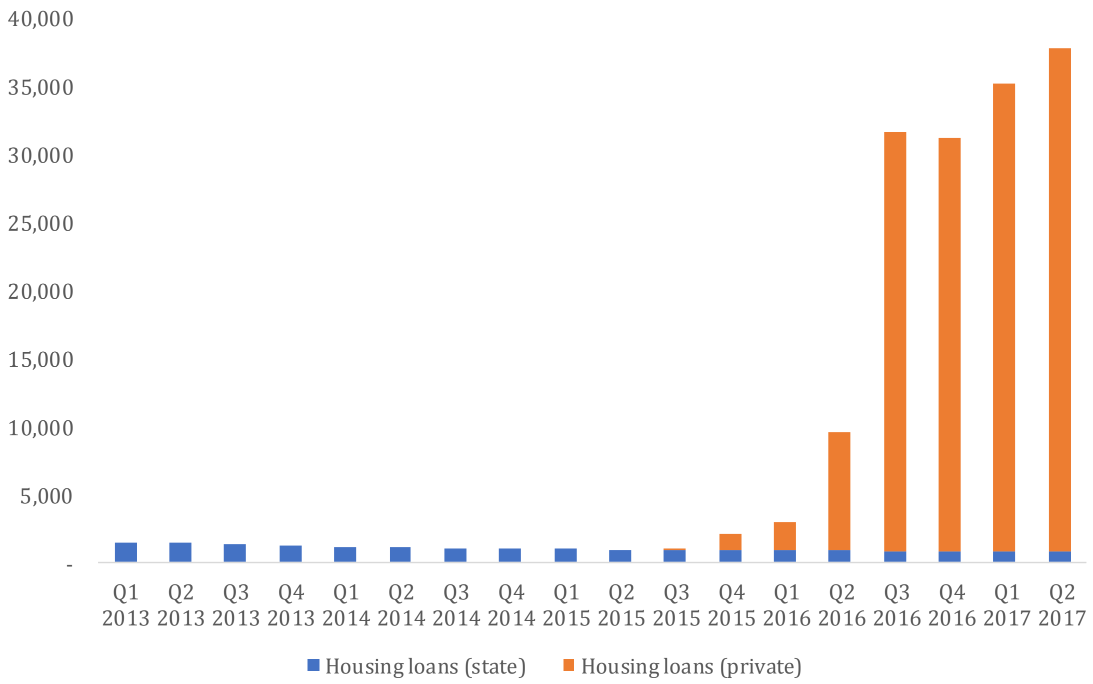
There are clear opportunities for collaboration between data analytics companies and banks to work on the relevant systems, and there are already pilot programmes in operation.

Home loans

The mortgage market is still virtually non-existent, although several banks offer home loans structured as a hire purchase product. Yoma Bank, for instance, has a dedicated home loan product that requires a 30% down payment and has a term of up to 15 years on condos and up to 10 years on apartments. AYA Bank recently launched a home loan product for units and land worth over K20m, with a 30% down payment and a tenor of up to 15 years. Other banks offering home loans require a down payment of 30%-50%.

Central Bank data shows housing loans appearing for the first time in late 2015.

Housing loans by state and private banks



Source: CBM

As ever, the 13% cap presents a serious challenge in structuring a mortgage product. Home loans also require a great deal of credit work, and even then, banks have typically preferred to lend when they are able to acquire legal title to property.

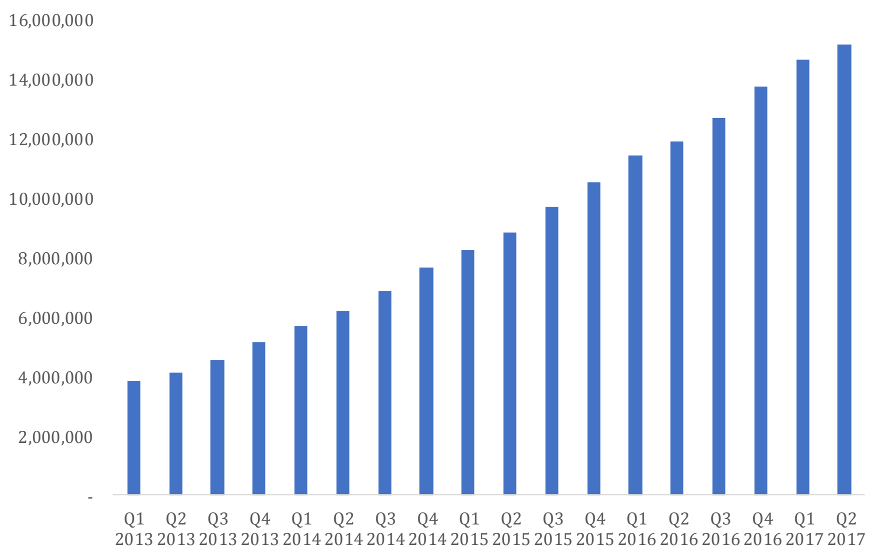
The lack of strata titling in the country makes this another hurdle for lenders. Some banks have declined to offer home loans because of the maturity mismatch involved in structuring a 10-year or 15-year product without any assets of similar maturity. They report being eager to enter the home loan market, but only when the asset-liability mismatch issue is solved.

One option reportedly being discussed is having MEB provide dedicated funds to banks for mortgage lending. MEB would provide funds at a subsidised rate, which would in turn allow banks to issue mortgages with a single digit interest rate.

Construction and Housing Development Bank, which is partly-owned by the Ministry of Construction, has a focus on funding low-cost housing development and mortgage financing. The bank's current mortgage product comes with an interest rate of 8%, a 30% down payment (50% for higher value properties) and a maturity of up to 8 years.

Given Myanmar's young population and growing economy, banks expect rapid growth in mortgage products once the necessary regulatory and legal changes are in place. The biggest recent change in the property market was the release of the rules and regulations for the Condo Law, although many questions remain about how the law will work in practice [see box].

Private bank loans collateralised by land and buildings



Source: CBM. Figures in Ks million.

THE CONDO LAW

The government passed the long-awaited Condominium Law in January 2016 after three years of legislative limbo, and in December 2017 the rules and regulations accompanying the law were finally published. The real estate and construction industries had been calling for this law for years in order to allow foreigners to purchase condo units and improve the legal architecture around property ownership.

The law allows foreigners to own up to 40% of condos in a given development, and transfer, lease and mortgage their ownership rights. The legislation also introduces ownership certificates for condominiums and a form of strata titling. In order for apartments to be registered as condos, the land must be converted into collectively owned land. In turn, there are criteria that must be met in order for the land to be converted.

The main advantage of the Condo Law and rules for banking lending appears to be the introduction of strata titling — though only for condos. The government intends to construct a central registration office for recording ownership. Law firms hope that certificates of ownership with clear strata titling would reduce some of the uncertainty around whether mortgage borrowers really own their property, potentially making banks more comfortable in extending loans.

Law firms report that developers are considering converting their projects. However, not all landowners will be willing to convert the land to collective ownership. Many developments are on government owned land leased to developers. The government department that owns the land is highly unlikely to agree to give up direct ownership of the land. In many cases, developers that are constructing condo projects have not yet paid the owner of the land, and will do so partly with proceeds from sales. In such case the owner is again unlikely to agree to convert the land to collective ownership. Also unclear is when the central registry office will be established.

Another issue is that although the Condo Law allows developers to start pre-sales once 30% of the construction process is finished, ownership certificates for condos can only be issued once the development has a building completion certificate. Potential buyers would be unable to get financing based on the bank taking ownership of the condo.

Although there is likely to be progress in providing general security over ownership, the great majority of properties will continue to suffer from the same old problems.

At least one bank is planning to begin pursuing commercial paper issuance in 2018.

Cards

Credit cards disappeared from Myanmar in the wake of the 2003 banking crisis, but returned in 2015. In the last three years, some of larger lenders have issued hundreds of thousands of credit and debit cards, with varying credit limits and interest rates. As with deposit accounts, some banks have tried to tailor credit and debit cards to certain groups. KBZ, for example, has a "Teens card" — a debit card aimed at customers under 18.

Although the interest rate ceiling of 13% still applies there are fees and other charges that banks can and do add. As many banks are still unable to score borrowers and the credit bureau is still not place, they tend to reserve credit cards for existing customers. But some of the larger banks report a steep rise in new card customers. Pre-paid and debit cards are linked to existing accounts, while credit cards are issued to customers that meet a monthly income requirement. The interest rate on credit cards are subject to the same 13% cap, although banks are able to charge joining fees, annual fees and other charges.

For many years, cards were issued using the Myanmar Payment Union (MPU) system, which had a monopoly on the domestic payment market. Then in January 2017, the regulator removed restrictions on international payment companies, allowing banks to provide co-branded and international credit cards to customers. Visa, MasterCard, JCB and UnionPay International all have co-branded cards.

Visa reports that transactions from Myanmar-issued credit cards grew almost 300% between the restriction being lifted in January 2017 and September of that year. The US firm now has six local banks issuing visa-branded credit cards. However, international payment firms are still barred from processing debit and pre-paid cards, which remain reserved for MPU and still represent the bulk of the card market.

MPU data shows a similarly dramatic rise in the use of bank cards. The number of point of sale card transactions in 2015-16 was less than 40,000. MPU recorded more than 200,000 transactions in 2016-17 for a total of over K20trn — approximately $14.8m using 2016-17 exchange rates.

MPU data for 2016-17 also showed:

- Average monthly ATM transactions: 500,000
- Average monthly ATM transaction volume: K35bn
- Average monthly POS card transactions: 50,000
- Average monthly POS card transaction volume: K1.7bn

Treasury products

Though far from widespread, some of the larger banks have begun rolling out treasury products in the last year or so, including forwards, cross currency swaps and more recently repos. The 2016 FI law paved the way for lenders to begin using derivatives and other modern financial products, but this still required a great deal preparation from banks, including legal consultation and the installation of modern treasury software.

At least one bank has, for its own purposes, designed a simplified version of the International Swaps and Derivatives Association (ISDA) Master Agreement suited to the Myanmar market. Based on this it has created a forward product that is aimed mainly at local importer and exporters, and as of early 2018 was issuing forwards to the notional value of $4m-$5m each month.

Cross currency swaps (CCS) are also being introduced, with MFIs among the expected customer base [see micro-finance section]. The few banks that are providing CCS will structure swaps for a variety of maturities up three years, which is the length of the yield curve provided by Bloomberg based on Treasury bond and bill yields. As T-bond yields are not determined by either primary or secondary market trading [see capital markets section], the Bloomberg curve is only a rough guide for CCS pricing.

Banks began conducting trial repo agreements in 2017, and after some initial hesitation the regulator is now willing to allow such operations to continue. Repos remain small scale however, and at present can only be conducted between banks — local and foreign. Regulation and some recent reports state that lenders are unable to conduct repo agreements with the Central Bank, although banks report that this is simply short-term borrowing using T-bonds as collateral and not a true repo agreement. The CB "repo" is on a fixed rate based on the nominal value of the bond.

Banks are at the stage of developing their own report agreements with support from law firms.

As such, although the repo market is expected to grow it will likely take years to unify and standardize Myanmar repo agreements.

At least one bank is planning to begin pursuing commercial paper issuance in 2018.

Q&A: Sean Turnell

Sean Turnell is a professor of economics at Macquarie University in Australia who has written widely on Myanmar's economy and financial sector. He is also an economic consultant to the Myanmar government and director of research at the Myanmar Development Institute in Naypyitaw. *FMR* spoke to Professor Turnell about the challenges and priorities for banking reform.

What are the main challenges facing the banking sector at present?

In the short term, it is meeting the new prudential regulations issued by the Central Bank of Myanmar (CBM). Various implementation dates come up across the next three years, and the banks have a lot of work to do to meet these new measures.

It is important that they do I hasten to add – these new regulations are best-practice international standards, and they are designed to keep the banks safe, as well as growing.

All of this is especially important in Myanmar of course, given the country's long history of monetary and banking crises, and profound lack of trust in financial institutions broadly.

So, staying safe, behaving prudently, and building confidence and trust amongst the people of Myanmar should be priority #1 for Myanmar's banks. But, of course, they have much to do beyond this.

One of the most important of the prudential measures is designed to shift banks away from their current model of simply granting overdrafts on land and property, and into doing 'real banking' – assessing risk, assessing business plans, and genuinely allocating capital to Myanmar's entrepreneurs.

This will require investment in systems and methods, in technology and, above all, in people.

At the same time, Myanmar's banks will face increasing competition from new more nimble players, but especially mobile financial service providers.

The latter may just revolutionise Myanmar's financial sector, and they combine low costs (no expensive branch networks), well-established brands (the important mobile financial providers are subsidiaries of the big private Telco's), have access to vast amounts of data of the sort useful for the provision of finance (they know, for instance, who pays their phone bills on time!), and outreach on a massive scale (more than half of Myanmar's population have access to a smart-phone, and the telcos have very large agent networks of use in accessing cash).

Of course, such firms threaten critical parts of the business models of banks everywhere, but in Myanmar their threat is likely to be greater for a sector not otherwise known for its outreach, service, or technological savvy.

In short, Myanmar's banks may need to invest much more in technology (a given), but also in people - as the one comparative advantage they might still be able to create and leverage.

How urgent is it that banks are allowed the freedom to set their own interest rates?

In my opinion this is very important. Allowing banks to set their own interest rates is the same thing as allowing them to price for risk. It is right and proper that banks should be allowed to charge higher prices (that is, higher interest rates) on riskier borrowings than they do on less risky ones.

And this makes for a better functioning economy – capital flows to where the returns are highest, and away from those parts of the economy that contribute least to growth. In the case of Myanmar, this should shift the allocation of capital away from entities exploiting merely their 'connections', to those genuinely growing and innovating.

The latter cohort especially includes small to medium enterprises (SMEs), which currently get little in the way of finance from banks in Myanmar (they have little in the way of 'connections', and little political power), yet are over-represented as the sources of new ideas, products, and as the generators of employment.

Some banks would like new prudential regulations to be softened or implemented over a longer timeline, is that reasonable?

It is partly reasonable. Nobody would want to make regulatory demands that the banks honestly cannot meet. This would not only be pointless, but it would undermine the credibility of regulators too, as rules went by without being truly implemented.

But we must be careful not to give too much leeway on this front. Most of Myanmar's private banks have been around for well over twenty years, and if they cannot meet basic regulations now, when will they be able to?

I sometimes make the analogy with the airline industry. If an airline said to safety regulators that they could not do all that was required for them to get an airworthiness certificate, I think there would not be too many people who would then get on their planes. Regardless of the financial health of the airline, its plea for safety regulation forebearance would, I suspect, not be greeted with much sympathy.

Same for the banks surely. As we have all seen in the recent global financial crisis, banks can be very dangerous entities that can do great harm to an economy, and all the people in it.

What is being asked of Myanmar's banks is not much more than the minimum required everywhere. In an increasingly interconnected world, not least in finance, we cannot have a situation where Myanmar's banks are under-regulated laggards.

Are local banks right to be worried about foreign banks being allowed into new areas of the sector?

No. Foreign bank activities are overwhelmingly complementary to those of the domestic banks, not in competition with them.

Foreign banks in Myanmar mostly just serve, more or less as they do in just about all the countries in which they operate, foreign enterprises, and a limited number of other entities concerned with trade. Servicing the foreign and trade sectors is pretty much their comparative advantage, and they usually don't have enough local knowledge to be major domestic lenders.

In an increasingly interconnected world, not least in finance, we cannot have a situation where Myanmar's banks are under-regulated laggards

There are some counter examples to this, but not many. Foreign banks can, however, supply the capital, expertise, trade and network connections that will be vital to Myanmar's economic future.

How likely or necessary is consolidation in the near term?

I would not at all be surprised to see some consolidation in Myanmar's banking sector soon, and personally I think this would be a good thing. Myanmar has quite a number of banks now, and some of these are rather small.

Banking is becoming even more a business of economies of scale, so one might expect at some point a round of mergers to create a smaller number of larger entities able to support the technology and other platforms that are increasingly necessary.

What can the government do to help ensure a stable, steadily expanding banking sector?

The major thing it can do (though, of course, by 'government' here we mainly mean the Central Bank, since it has such broad powers over the banks) is to push on with its current trajectory, but especially in terms of the twin track it is engaged in: liberalisation, in parallel with the implementation of appropriate prudential rules.

My own feeling is that the government should also expand the freedoms allowed to mobile financial services firms such as Wave Money. As I have already noted, the promise of these firms, especially in dramatically expanding financial inclusion, but also in initiating an entire ecosystem of other products and services, is very great indeed.

The NLD Government has done much to support these new players, but some unnecessary restrictions (including, for instance, not allowing them to full service overseas remittances) remain. Time to give the mobile financial services sector an expanded mandate, all the while making sure they act in prudent ways too.

What is the priority when it comes to state-owned bank reform?

As probably most people are aware, right now the Government is involved in a major restructure of Myanmar's four largest state-owned banks. To assist in this it has enlisted the World Bank, from whom in turn it has taken out a $100m loan in order to re-capitalise the newly-reconfigured and rehabilitated state banks.

The World Bank meanwhile has been working with some excellent partners in this task, including Rabobank (the world's most highly-rated bank, and one of the largest agricultural lenders on the planet) and the big-4 accounting firm, Deloitte.

These private-sector counterparties have been undertaking a deep diagnosis of Myanmar's big state-owned banks (Myanmar Economic Bank, Myanmar Agricultural Development Bank, Myanmar Foreign Trade Bank, Myanmar Investment and Commercial Bank) to ensure that, whatever action the government takes with respect to the reconstruction of the banks, it will be based on the best information and evidence available.

B. Mobile money

Introduction

The boom that followed took even the telcos by surprise

Discussions about the huge potential for mobile money in Myanmar started back in 2012. Over 80% of the country was — and likely remains — unbanked, and commercial lenders' branch networks were modest in size and confined mainly to key urban centres. Internal migration for work and remittance flows, meanwhile, were already significant and increasing steadily. Mobile banking and payments presented a huge opportunity.

However, the cost of SIM cards remained high, dropping from K500,000 to between K200,000 and K250,000 following a Ministry of Communications, Posts and Telegraphs notification in March 2012. Mobile penetration as a percentage of the population was still in the single digits.

But the cost of SIM cards continued to fall, and in late 2013 the Central Bank published a directive on mobile banking that opted to start with a bank-led model for Myanmar. The first licenses were issued to commercial lenders in 2014 — often in partnership with a mobile money business — who built robust IT systems for their service.

The main bank-led mobile money operators in Myanmar are:

Operator	Partner bank
Myanmar Mobile Money	Innwa Bank
myKyat	FPB
663 Mobile Money	MCB
TrueMoney	AGD

Also in 2013, the telecoms sector was opened to foreign competition, with Norway's Telenor and Qatari firm Ooredoo winning the right to compete alongside MPT, which was already expanding rapidly.

The boom that followed took even the telcos by surprise. Mobile penetration has risen from around 10% to perhaps 80%, tens of thousands of kilometres of fibre cable have been connected, and tens of thousands of mobile towers constructed.

The country now has one of the highest smartphone penetration rates in the world and competition over price prompted the regulator to set a floor of 1.25 kyat per megabyte.

Non-banks enter the market

In 2015, the Central Bank began drafting regulations on mobile financial services to open up the market to non-bank financial institutions. Wave Money, a partnership between Telenor and Yoma Bank, began commercial testing with approval from the Central Bank later that year.

The regulations were approved in early 2016, and in October that year Wave Money became the first recipient under the non-bank financial institution licensing regime.

It was 2017 that saw the beginnings of real growth in Myanmar's mobile money sector. Wave Money expanded its agent network from 5000 at the start of 2017 to 16,000 by January 2018 to cover 85% of the townships in the country.

After Wave Money received its license, the market had to wait almost a year to see a second issued. OK Dollar, operated by Internet Wallet Limited, received its license in August 2017 although it launched the service in June 2016.

The firm operated for more than a year without a license, prompting concern across the industry that any potential problems with an unlicensed operator could damage the sector's reputation. OK Dollar also received media attention for its initial terms and conditions that were in direct opposition to many of the requirements laid out in the mobile money regulations. These were later changed.

Ooredoo, meanwhile, launched its own mobile money service — M-Pitesan — in September 2017 after a six-month pilot. M-Pitesan is also seeing rapid growth, with 7000 agents and 300,000 registered customers as of March 2018.

The market is now waiting for MPT, which still claims the largest number of mobile subscribers and the greatest geographic coverage. The expectation is that MPT will launch its service in mid-2018. Although the presence of the state-owned telco will represent competition, raising awareness and understanding of mobile money across the population appears to be a far bigger priority for market participants. Having the three largest telcos operating in the market is generally seen as crucial for the sector's growth.

Mobile money executives with experience in other markets report that the regulatory framework is robust and supportive of expansion.

Legislation

The key pieces of legislation in the mobile money segment comprise:

Directive on Mobile Banking (No. 4/2013)

The Central Bank's directive was the first piece of regulation governing mobile banking and stated that "mobile banking services shall be run using a bank-led model". The directive included a list of mobile banking services that commercial lenders could provide with permission from the Central Bank.

The directive states a K500,000 transaction limit, K1m daily limit and a limit of three transactions in a given day.

Financial Institutions Law (January 2016)

The law gives the Central Bank responsibility for establishing the "systems and practices" for e-banking services and laying out the regulations.

Regulation on Mobile Financial Services (FIL/R/01/03-2016)

These regulations laid out the application and licensing requirements for non-bank Mobile Finance Services (MFS) providers. Mobile money executives with experience in other markets report that the regulatory framework is robust and supportive of expansion.

Application requirements

- K3bn minimum capital
- K3m application fee
- Minimum three-year business plan, including the nature of the services to be offered
- In the case of mobile network operators, a letter of no objection from the Ministry of Communication and Information Technology

The regulations include:

- Every MFSP shall keep 100% of the float in a trust account at the bank consisting of liquid assets and it shall remain unencumbered and not be commingled at any time with any others funds of the MFSP.

- Every MFSP shall on an ongoing basis, but by no later than 4.00 pm each day, reconcile the balance in the trust account against the float.

- A MFSP shall transact MFS accounts and transactions in Myanmar Kyat only

- MFSPs shall, upon request by a MFS account holder, redeem, at any time and at par value, the money held in the MFS account.

- MFSP is allowed to offer the following services:

(1) Opening and maintaining MFS accounts;
(2) Cash-in/cash-out transactions to/from MFS accounts
(3) Money transfer between MFS Accounts
(4) Domestic payments between individuals
(5) Domestic payments between government and individuals
(6) Domestic payments between business and individuals
(7) Domestic payments between businesses;

Transaction limits

The limits on daily and monthly transactions for the non-bank mobile money providers were initially set as follows:

Customer Tier	Requirements	Cumulative transactions per day	Cumulative transactions per month	Maximum balance limit
Level 1	ID (national, driving license, passport) if necessary	K50,000	K1m	K200,000
Level 2	SIM registration or ID required	K200,000	K5m	K1m
Level 3	Business registration certificate, ID requirements for opening bank accounts	K1m	K50m	K10m

In December 2017, the Central Bank raised its limit on the size of a single transaction for level 2 customers to K500,000 and the volume of transactions a mobile money customer can carry out in a single month from K5m to K12.5m.

Wave Money reported that from January 2018 it saw revenue growth significantly higher than growth in the number of transactions, due to a 30% increase in transaction size. The rise in transaction limits is likely to be particularly useful for business customers that send a high volume of transactions. The average Wave Money transaction was K70,000 in late February 2018.

Outlook

Coverage

Wave Money had 21,000 agents as of March 2018, M-Pitesa 9,000 and both are growing rapidly. Myanmar has one the lowest bank branch penetration rates in the region — 3.3 commercial bank branches per 100,000 people. Wave Money alone has more agents that can process a transaction that the combined branch networks of top 10 largest local banks and the four state-owned lenders.

Wave Money had 21,000 agents as of March 2018, M-Pitesa 9,000 and both are growing rapidly

A key pillar of a successful mobile money service with wide-scale coverage is a liquid and expansive agent network. The initial bank-led mobile money operators have found it hard to expand coverage, with limited branch and agent networks.

Some have still built sizable agent networks — CB Bank has well over 1,000 mobile banking agents and is launching an updated version of its banking app later this year. AYA Bank announced in August 2017 it had signed on fintech firm mFino to further develop its digital wallet services.

The potential for banks and non-bank financial institutions to use the mobile money platforms to offer financial services to the currently unbanked is considerable [see Q&A with Melvyn Pun].

Some lenders reportedly view non-bank mobile money providers as competitors, particularly in the remittance business. But the industry expectation is that the regulator will in the future allow mobile money operators to partner with banks to become a channel for savings and loan products. In the near future, non-bank operators hope to establish real time connections with commercial lenders.

Although the non-bank mobile money operators are prohibited from international or dollar denominated transactions, industry executives expect these regulations to be rolled back over time.

Like the telcos, however, the mobile money providers will face challenges rolling out their networks to the more remote and harder to reach areas of Myanmar.

Disbursements

Bulk disbursements for private firms, NGOs and humanitarian agencies is a large area of opportunity for mobile money providers. Mobile money offers NGOs and INGOs a much cheaper way to make loans and receive interest payments, and the operators are building agent networks many times larger and more expansive than the MFI’s.

Wave Money has partnered with the World Food Programme (WFP) to distribute monthly stipends to refugee families from the Kachin State border. Wave Money also works with Save the Children in Yangon and Ayeyarwady region.

Salary payments are another option. M-Pitesan already pays its own staff using its mobile service. Wave Money disburses salaries of some KFC employees and has partnered with ride-hailing app Grab to provide a payment solution for its drivers. Grab provides a list of drivers to whom it needs to pay commissions and Wave Money carries out a bulk payment of electronic credit that the drivers can exchange into cash at Wave Money outlets.

Digital literacy

The great majority of mobile money customers still rely on the over-the-counter service. This is partly because Myanmar's economy remains very much cash driven, and a related point is a distrust or lack of familiarity with keeping funds in digital format.

OTC dominance is likely to remain in place for short to medium term. Industry operators suggest that some form of non-brand specific national education campaign would help raise the awareness and understanding of mobile money in general. MPTs entry into the mobile money market will also help in this regard. Industry executives are eager for there to be interoperability between all market players.

While the majority of the market will continue to be OTC transactions, there is a core group of young, digitally literate urban professionals and students that will increasingly have a preference for digital wallets. Getting more of the population to move from cash to digital currency will help enable to a range of additional mobile money services, and digital wallets could become a source of credit data for unsecured consumer lending.

E-commerce

The ubiquity of Facebook and smartphones has created a group of entrepreneurs using the social network to advertise and sell products. Credit and debit cards have reappeared but remain relatively rare. Mobile money now presents an online payment solution that many vendors are making use of.

As the use of mobile money becomes more widespread, the greater the argument will be for online sellers to engage and allow transactions through the service. Mobile money providers could opt to create an escrow account option for customers purchasing goods online order to help prevent fraud issues and create greater security for people purchase items in advance.

Payment solutions

Falling internet prices and faster connection speeds is opening up a new market for streaming and other online content services across music, film and gaming. Firms are buying up the rights to film and music content, but there is lack of existing payment solutions. Mobile money providers offer a potential payment platform, and as online services there are likely to be partnerships.

There is also considerable scope for providing online payments for public services, including tax, and utilities. One issue is that Myanmar's state-owned utility firms do not have suitable IT systems. This creates the need for third-party aggregators. Wave Money began a pilot project in January providing pension payments on behalf of MEB to retired civil servants and military personnel.

The government is willing and even eager to solve more of the logistical problems around collection and disbursement through digital providers. The MoFP is reportedly planning to enable mobile payments for other pensioners, the World Bank is supporting the government on an electronic tax system and mobile money providers have discussed the digitisation of payments with the Ministry of Social Welfare.

Q&A: Melvyn Pun

We look very closely at the whole financial sector, and it's clear to us that there are two big bottlenecks across the country

In early March, the Singapore-listed Yoma Strategic Holdings announced that financial services would become a "fourth pillar" of its business operations, joining real estate, automotive and heavy equipment, and the consumer market.

As part of the move, Yoma Strategic is taking a 34% stake in Wave Money, and planning to use the mobile money provider's huge network to reach consumers with new lending and payment services. *FMR Research* spoke to Yoma Strategic's CEO Melvyn Pun about the firm's strategy and the opportunities and challenges ahead.

What prompted the move into financial services, the evolution of Yoma Strategic's business operations or a change in the financial services sector?

We look very closely at the whole financial sector, and it's clear to us that there are two big bottlenecks across the country. The first is the inability to access credit, aside from the people at the very top. This inability applies from SMEs all the way down to individuals at the village level. There is very little official credit, and the informal lending market charges extremely high rates.

The second is a payments issue. It has gotten better, but many companies still conduct payroll and internal transactions in cash because most people do not have a bank account and there is a general inability for companies to reconcile payments automatically and electronically. This is extremely inefficient. We felt that if the country is to develop quickly, we need to unlock these two areas.

What are the immediate opportunities for expanding financial services?

Wave Money has grown very fast and we expect that to continue with sizeable business expansion. Currently, we have 20,000 agents, and by the middle this year we expect a network of 30,000 agents throughout the country.

We want to cover all townships and it's an excellent way to move money. The next thing is the digital wallet – in China everyone pays for coffee, taxis with their digital wallet on their phones. We don't have that here, but we also don't really have the option for credit or debit cards either. So, there is scope for us to develop the wallet that allows electronic payments instead of cash.

We would expect different financing or lending companies to be on the Wave platform, which would have different functions for microloans, hospital payments, electricity bills etc.

Yoma Group already includes a bank —Yoma Bank — and Yoma Strategic will now have a stake in a mobile money provider. What else will the push into financial services involve?

There's now an impetus to grow the non-bank financial sector, which is driven by what we see as likely market developments over the next two years. Yoma Bank is well capitalised and will continue to focus more on SME lending.

But the banking sector in general is undercapitalised for the years ahead. Looking at how fast the country is growing and how large the banks are at the moment, it's very hard for me to believe that there will enough capital coming into the banking system to meet the need for credit. Either the economy has to slow down, banks have to add capital substantially, or other providers of credit must emerge.

If you look at other countries like Cambodia and Vietnam, the non-bank market provides alternative forms of lending which has grown very fast. Non-bank institutions have a major role to play and is regulated differently from banks, perhaps better leveraging technology and focussing on smaller loans.

Our non-bank finance business will focus on consumer lending and auto lending. Wave Money will help provide more efficient payment and distribution. If you think about how to build strong non-bank financial companies, the first critical factor between being very good and just being good is the use of technology – the use data analytics to provide smart underwriting decisions.

The second factor is distribution – how to get the money to and from the borrower as quickly and efficiently as possible. Both of these things are going to be served by Wave Money— although it won't be lending directly, it's a catalyst for a lot of the non-bank activity.

How far advanced is the plan for establishing a non-bank financial services business?

We've been thinking about this for a long time and talking to different partners. We're already active in vehicle leasing, and we have a new partnership with Grab. The intention there, which is still being worked out, is to own a portfolio of new taxis and lease them to drivers. But these are the steps that require a bit more work.

The other area is small-scale consumer loans. There will be a base platform, which we'd expect to grow quite fast, that relies on leveraging technology and the spread of mobile. That is all under discussion, and we don't have a fixed roll-out plan.

I think tech is going to play a huge role. The problem is that everyone says the same thing, which is that through the use of mobile phones and smart data analytics you can collect a lot of information relevant for credit assessment. That's often right, and at Yoma Bank we're looking at those tools to build our credit scoring system.

But the reality is that in Myanmar there is limited data and often no consistent way of collecting it. Even looking at names, identity numbers and registration cards isn't that easy.

So how are we going to solve that. Mobile phone data may play a role, but many people are scared of using their balance and so they turn data on and off, and you don't get the full spectrum of information.

This is one of those areas where it's important to sort out the nitty gritty as well as having a big picture in place. So, we have Wave and Yoma Bank working on projects in this area along with data analytics companies.

How long will it take to build the kind of database you need for consumer lending?

Yoma Bank is working with technology partners on how to collect data and Wave is working with an international agency, which is providing tech support. In three months or so we'll better know where we stand and what the data analytics can tell us.

I hope the regulator is focussing on this, because it's going to be as important as the banking system.

There're a few steps, you need to figure out what you can collect that is verifiable and correct, and then what that translates into.

You can look at many parameters, some of which are used in other markets. But for example, in Thailand a certain parameter might give you a credit score, but that doesn't apply to Myanmar. So, there's an iterative process where you can see what works and what your effective default rates are, and then you keep fine tuning. It takes time to get right.

What does the regulatory framework look like for non-bank financial services?

Non-bank financial services are governed and licensed differently from banks. The key issue is the lending cap and how consistently it's applied, and the other issues are around taking funding. If you are a foreign-owned non-bank financial institution you may borrow overseas but not locally, so there is a currency risk. If you are local, you can borrow locally but only with a track record, which limits how fast you can grow.

We should be able to agree on one thing, that a there is lack of official lending and an abuse of lending in the informal sector where rates are very high.

Now, when you put too much restrictions how licensed firms can lend to consumers, that constrains credit extension from the formal sector and inadvertently protects the informal system. Of course, you need to protect consumers. But the more you regulate the more the informal system thrives. These are the dilemmas.

If you look at many other countries, it's rare that regulation leads technology. In Myanmar, there is a tendency to want regulation to take the front seat, but I think regulation is an area where the whole country have capacity constraints. By definition, technological innovation goes very fast, so what you want is a sandbox — a regulatory regime where you can experiment with what works from the mind-set of a developing country.

I hope the regulator is focussing on this, because it's going to be as important as the banking system.

C. Microfinance

Introduction

The origins of Myanmar's microfinance sector are typically traced back to the mid-1990s, when the government allowed large international NGOs to start providing microfinance services.

As of March 2018, the FRD listed 176 licensed MFIs under its supervision, which does not include cooperatives.

In 1997, the United Nations Development Programme (UNDP) began its "Sustainable Microfinance to Improve the Livelihoods of the Poor" project. The implementing partners were the INGOs Grameen, Gret, EDA, Save the Children and Pact. From 2006, Pact was the sole implementing partner. In 2009, Lift, USAID, the UK's Department for International Development and the Danish International Development Agency became donors for the project, which would eventually evolve into the largest single microfinance operation in the country.

The Thein Sein government gave microfinance its first legal framework in the form of the 2011 Microfinance Business Law (MBL), which was followed in subsequent months and years by a series rules and regulations. The MBL allowed local and foreign companies to establish private MFIs, and provided a licensing regime for entities that were already providing informal microfinance services.

Between November 2011, when the law was passed, and November 2012, almost 120 MFIs received licenses. This rush was due partly to low capital requirements, which lowered the barrier for entry, although the regulatory environment remained in many ways quite restrictive.

Among the existing entities to be licensed as MFIs were some 77 financial cooperatives, which until 2016 were under joint regulatory supervision from the MoPF and the Ministry of Cooperatives. In February of that year, the FRD placed the cooperative MFIs under the sole supervision of the Ministry of Cooperatives.

A crowded marketplace

As of March 2018, the FRD listed 176 licensed MFIs under its supervision, which does not include cooperatives.

Total MFIs	176
Local	107
Foreign	39
Joint-venture	3
INGOs	5
NGOs	22

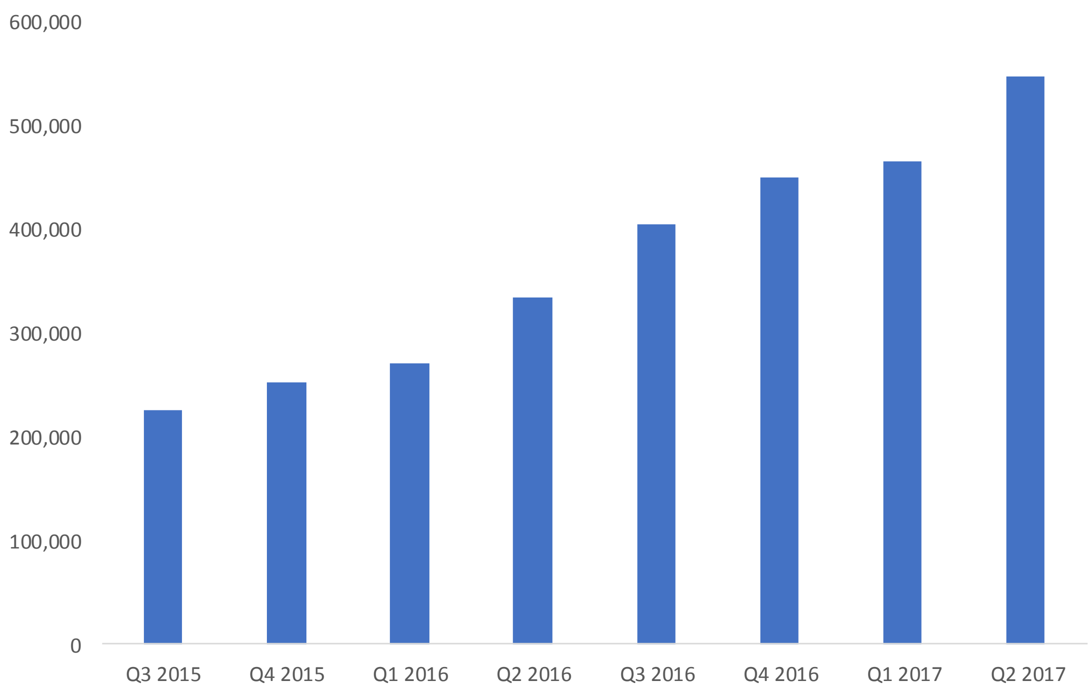
However there are frequently conflicting reports on the total number of MFIs, which the Myanmar Microfinance Association (MMFA) suggests may be due to the fact that cooperative lenders were once included.

In February 2018, the media reported that the Yangon Regional Ministry for Planning and Finance had announced it granted licenses to another 86 operators, of which 84 were already engaged in some kind of lending activity. A figure of over 200 MFIs has also appeared separately in the press. It seems likely that this estimate includes cooperative lenders as well.

Despite the growth in licensed MFIs after the 2011 MBL, the UNDP-Pact operation remained by far the largest microfinance operation. By 2013, it had 630,000 clients in over 6000 villages with a $150m loan portfolio. In June 2014, the UNDP ended the campaign and transferred its microfinance assets and fund to the Pact Global Microfinance Fund (PGMF), which today accounts for around one-third of the country's total microfinance loan portfolio.

The largest MFIs operating in Myanmar are all INGOs —or originate from one — or foreign lenders. A group of between 15 and 20 of the larger MFIs collaborate to share data on their operations. The MMFA reports that FRD data as of March 2018 showed total outstanding MFI loans of over Ks700bn across just over three million borrowers.

Total outstanding MFI loans



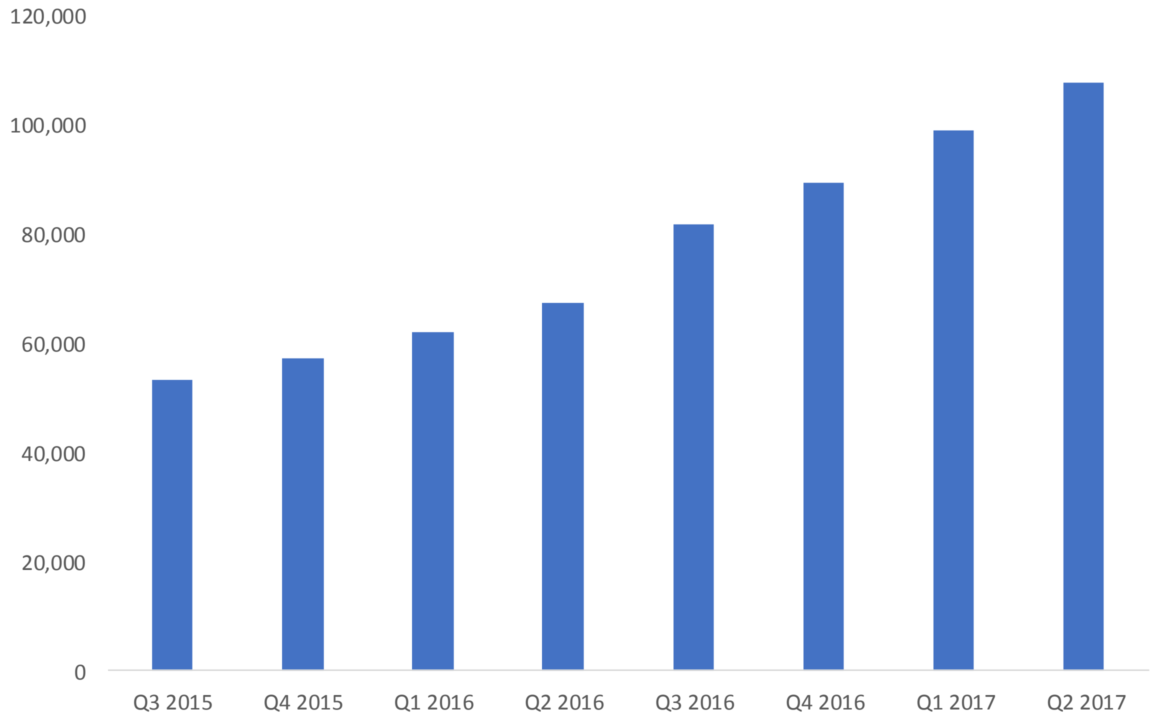
Source: CBM

The association also reports that the 18 largest MFIs have 80% of the market. The MMFA has 85 MFI members of which more than half are foreign entities, although the association is actively working to include smaller local lenders.

As the larger MFIs continue to expand consolidation seems likely. MFIs note that some of the smaller lenders may struggle to meet the capital requirements imposed in August 2016 [see regulation section], and that the regulator is in a position to both enable and potentially enforce consolidation.

Some of the larger MFIs report being approached by small local lenders looking to hand their operations over or be absorbed into a bigger institution. A 2014 regulation laying out the criteria for deposit taking MFIs, gave lenders that were accepting deposits — but unable to meet the new rules — the option of merging with an existing MFI that did. Similarly, MFIs unable to meet the August 2016 capital requirements within two years also have the option of merging.

Total MFI deposits



Source: CBM: Figures in Ks million

Foreign entities — whether NGOs or not — dominate the sector for historic reasons in the case of INGOs and access to capital and expertise in the case of foreign MFIs. Local MFIs have been poorly served by the banking sector, which has until recently lacked familiarity with how the microfinance sector operates and demands collateral that few MFIs have access to [see banking chapter].

A 2014 notification stated that domestic MFIs could only borrow from state-owned MEB, and must have a maximum debt-to-equity ratio of 5:1 to do so. Myanmar Microfinance Bank (MMB), which was established in 2013 specifically to lend to local MFIs, reported that it was later given permission to lend to domestic microfinance lenders.

New regulations in 2016 gave local MFIs the ability to borrow from any local or international bank, but a variety of other barriers continue to make accessing capital difficult.

International MFIs typically have an easier time accessing capital, through donors, grants, a parent entity or international bank borrowing. However, INGOs report a global trend of donors increasingly eager to see microfinance operations become profitable and sustainable. Parent entities can provide paid-up capital, but similarly want to see profitability within a few years at most. International loans come with a problematic currency risk, and so foreign MFIs are also eager to see local banks extend loans.

The regulatory shift in 2016 gave international MFIs freedom to take local or international loans. But they have found domestic banks reluctant to extend credit, again due partly to a lack of familiarity with microfinance. Another issue is that foreign entities are prevented from owning land and buildings that could be used as collateral.

Foreign MFIs do report that local banks are becoming more comfortable with the idea of lending to the sector, but access to capital features high on their list of challenges. A key issue is that even MFIs that qualify to take deposits can only accept them from customers, and not the general public.

Still, there appears to be a clear trend towards profitability among the larger MFIs despite the restrictions. Several of the larger MFIs report they became profitable in 2017 or expect to be so in 2018. Individual enterprise loans for small-business ventures are becoming more popular, partly due to high demand from borrowers and because these loans are more profitable for MFIs.

Even those MFIs that have focussed entirely on group-loans are planning to increase the share of enterprise loans in their portfolios. For similar reasons, hire-purchase is attracting more MFIs, who no longer face restrictions on offering hire purchase for “luxury goods” or on farm equipment.

The growth of MFI loan books, to a point where they are self-funding and profitable, creates the potential for mobile systems to help new entrants reach a similar stage in a short period of time. The opportunities for consumer finance are attracting foreign investors. Some MFIs are highly active in providing financing for consumer good purchases, a market the commercial banks struggle to enter given their regulatory regime.

In other more developed markets, MFIs expand into lending to small and medium businesses, which in Myanmar are largely starved of credit. This would likely require letting MFIs take collateral, and lend in larger amounts — two issues that are now under discussion.

Legislation and regulation

Regulatory bodies

Financial Regulatory Department

The finance ministry's FRD is in charge of supervising and regulating MFIs. The 2011 MBL created a body called the Myanma Microfinance Supervisory Enterprise (MMSE).

This had responsibilities that included reviewing license applications, setting accounting and reporting standards, supervising MFI operations and carrying out field inspections. The MMSE and its responsibilities were subsumed into the FRD in 2014.

Microfinance Business Supervisory Committee (MBSC)

Under the MBL, the supervisory committee is in charge of providing and implementing policy and directives. The committee also sets minimum capital requirements, license fees and — in accordance with Central Bank procedures — sets interest rates on microfinance deposits, loans and the associated charges.

The MBSC is charged with imposing punishments on MFIs for non-compliance with licensing terms and conditions. The MMFA reports it is very rare for a license to be revoked, with just a single case of a suspension in recent years.

Ministry of Home Affairs

INGOs and NGOs have to register at the Ministry of Home Affairs.

Ministry of Cooperatives

Cooperatives have to register at the Ministry of Cooperatives

Key pieces of legislation

Microfinance Business Law (No.13/2011)

The law's stated objectives are to reduce poverty and improve social, health and economic conditions for low-income people.

The law defines microfinance as issuing micro-credit, taking deposits, remittances, insurance and carrying out "other financial services". Microfinance institutions can be local, foreign, partnerships, companies, co-operatives, banks and non-bank financial institutions.

According to a UN Capital Development Fund (UNCDF) report, MFIs were in reality only allowed to carry out remittances services from August 2016 [see box on regulatory revision].

Rules and requirements

MFIs receive a one-year temporary license, which is converted into a full license after a regulatory review.

Capital

- Deposit taking MFIs: Ks300m
- Non-deposit taking: Ks100m

Interest rates

- Loans: maximum of 30% per annum, 2.5% per month
- Voluntary deposits: minimum of 10% per annum
- Compulsory deposits: minimum of 15% per annum

Loan sizes

- Maximum loan size: K10m
- Collateral requirements: MFIs cannot accept collateral for any types of loan products

Prudential requirements

- Solvency ratio: 12%
- Liquidity ratio: 25%

Deposit taking

MFIs are only allowed to accept deposits from customers. As of August 2016, in order to qualify as a deposit taking institution a lender must meet the following criteria:

a) A minimum of K300m in paid-up capital

b) A minimum of 3 years' experience in carrying out microfinance activities in Myanmar

c) Profits made for a minimum of 2 consecutive years

d) A properly operating management information system (MIS)

e) Strong internal controls

f) Abidance by the prescribed rules

These requirements were published in a 2014 notification that stipulated that any MFIs that were "already taking deposits" but were unable to meet these requirements had two-years to do so, and may "merge with, form a partnership with other organizations, become deposit taking microfinance institutions or return their license."

The percentage of MFIs that take deposits is unclear. MFIs report that many of the smaller microfinance lenders have skirted deposit taking regulation in the past, and regulatory capacity is insufficient to police all the lenders — many of which are very small.

The MBSC delivers directives providing new regulations, and updating or replacing existing rules

Large MFIs like PGMF have taken deposits since becoming licensed. Foreign MFIs including ACLEDA and LOLC either qualified through the criteria listed above or were given permission to take deposits from the start.

In March 2018, the MMFA reported that there were only six MFIs that were permitted to take voluntary deposits. The FRD can and does revoke a deposit taking license, for example if it has concerns about changes in an MFIs growth plan or business operations.

Regulatory revision

The MBSC delivers directives providing new rules and regulations, and updating or replacing existing ones. In 2014, the MBSC published three directives, which included stipulations that:

- The 2.5% month and 30% yearly interest rates be strictly applied as effective rates
- At least 50% of total loans and 50% of customers must be from rural areas
- The maximum loan size be K5m
- MFIs may not provide loans for luxury goods
- MFIs may provide goods and equipment under hire-purchase, except for farm machinery and "small production equipment"
- MFIs may provide one loan per household
- MFIs should only offer loans after assessing ability to repay and making sure the customer does not have existing loans from other MFs
- Local MFIs can only borrow from MEB, and to do so must have a maximum debt-to-equity ratio of 5:1
- International MFIs may not borrow from local banks, and may only borrow up to $3m through an international loan

A 2014 regulation also allowed MFIs to “utilize mobile payment systems when performing microfinance activities”, although the UNCDF notes that remittances were excluded.

The conditions included:

- Applying to the Central Bank and Ministry of Communications and Information Technology
- Following Central Bank directives on mobile banking
- Providing a plan to deal with clients’ limited knowledge of mobile payment systems

The bulk of these regulations stood for the next two years until the MBSC issued Notification No. (1/2016) in August that year. The changes were significant, not only because of their impact on the sector and how MFIs operate, but because it represents the outcome of debate and discussion between MFIs — through their Myanmar Microfinance Association (MMFA) — and the regulator.

Just as commercial banks report a marked improvement in dialogue with the Central Bank, MFIs say the FRD approach to regulating microfinance has become more inclusive.

Although the FRD rejected some of the MMFAs requests in the August 2016 notification, MFIs report the regulator made a point of publically accepting the MMFA position paper. In October 2017, MFIs report the regulator held a sector-wide forum during which it took questions from lenders. MFIs are universally positive on this increasing openness to discussion.

<u>Notification No. (1/2016)</u> (MBSC)

The notifications aimed at addressing consumer protection, over indebtedness and easing some of the restrictions on how MFIs operate.

This relaxation of restrictions included:

- Removing the instruction that “50% of portfolio outstanding and outreach should be in rural areas”. However, the regulation states that operating in rural areas is “encouraged” and that MFIs operating in urban areas will not enjoy the same “advantages”

- A cap of 5% of the total loan amount on compulsory deposits was kept in place, but the limit on voluntary deposits was removed. The only limiting factor on how many voluntary deposits an MFI can accept from customers is the 12% solvency ratio

- MFIs are allowed to provide hire-purchase “if it meets clients’ needs”, but will provide data on this lending when the regulator requests it. This can be read as replacing earlier rules against providing loans for luxury goods and hire-purchase for farm equipment

- All MFIs are able to borrow locally and from abroad, providing they meet a list of criteria [see annex 1]

- MFIs wanting to provide other services included in the MBL — for example remittances — should apply to the regulator. The UNCDF reports this was the first time MFIs were given option to provide remittances

The MBSC is in charge of setting limits on the fees and charges MFIs can levy other than the interest rate

- The solvency and liquidity ratios were set at 12% and 25% respectively

- A detailed list of criteria to qualify as a deposit taking institution were introduced, which some MFIs said helped close loopholes around deposit taking.

The MBSC's notification on consumer protection and over indebtedness laid out principles with which MFIs must comply, which included responsible pricing, preventing over indebtedness, and protecting client data. However, there is no definition of what constitutes over indebtedness or any detailed guidelines on how MFIs should collect and protect customer data.

Similarly, the stipulation requiring "fair and respectable" treatment of clients does not define either term in the context of microfinance.

The notifications do require MFIs to check what the loan is used for and prevent customers from becoming over indebted by credit analysis and assessing a borrower's ability to repay. But the absence of a credit bureau, microfinance database and a restriction on sharing customer data between MFIs can make it very difficult for MFIs to properly assess a borrower's situation.

With regard to responsible pricing, the MBSC is in charge of setting limits on the fees and charges MFIs can levy other than the interest rate. Some MFI's report that the MBSC recently set fees at 4% of the loan amount for urban areas and 8% for rural areas, in an effort to help incentivise lenders to expand into rural areas. Other MFIs were aware this fee structure was being considered, but not that it had been approved.

<u>Notification 2017</u>

In 2017, the regulator issued a notification raising the loan limit from K5m to K10m.

DRAFT MFI LEGISLATION

MFIs report that authorities have prepared a revised draft of the MBL, which was submitted to the MMFA for comment in 2017. As of early 2018, the MMFA was in the process of preparing a position paper in response to the draft. The key change introduced in the revised draft is that MFIs would be allowed to take collateral for loans larger than Ks3m.

The August 2016 stipulated that microfinance lenders could not take collateral for any type of loan product. Allowing collateral would be a key step in allowing MFIs to lend more to small businesses and potentially SMEs. Although the limit for loans was raised from Ks5m to Ks10m, MFIs report that most lenders are reluctant to make loans that size without collateral.

A second step would be in increasing the enterprise loan limit from K10m, which would be below the needs of most SMEs. Some MFIs would like to see the loan limit increased to Ks20m. But as the regulator only raised the ceiling to Ks10m relatively recently, lenders think another move to Ks20m is unlikely at this stage. Another issue is the lack of a moveable asset finance and secured transactions framework, though the IFC is working on legislation.

MFIs report some uncertainty about whether the draft would make collateral for loans over K3m compulsory or optional. The introduction of collateral has also reportedly been met with mixed reactions from MFIs, some of whom lack the skills and resources to evaluate collateral requirements and some who believe the use of collateral is in opposition to the spirit of microfinance as a tool to combat poverty. The larger more sophisticated MFIs appear to have no issue with the introduction of collateral, provided there is a clear and well-constructed framework around its use.

The MMFA is expected to make additional requests to the regulator as part of its response to the draft. MFIs report that the most significant of these is that lenders be allowed to take deposits from the general public. The position paper is also likely to include a request for clarity around MFIs use of mobile systems, including making it clear that the existing legal framework for digital financial services will not restrict MFIs.

The UNCDF has noted that following the August 2016 notifications, MFIs can now apply to offer remittances and under the earlier 2014 regulations can apply to offer mobile finance services. MFIs expanding the use of mobile finance services will require greater regulatory clarity from the FRD and the Central Bank.

Products

Group loans: Maximum loan size of K10m.

Agricultural loans: These loans are bullet repayment with monthly interest payments, allowing farmers to repay their loan after selling harvests.

Enterprise loans: Maximum loan size of Ks10m. Larger international MFIs report they plan to increase their enterprise loan activity, and begin to or expand lending to small and medium businesses. These are often distributed through a lender's existing bank account, which lowers the cost of funds. The lending cap and access to funds are the two main issues to expanding small business lending.

Hire-purchase: Many MFIs carry out micro-leasing through hire purchase products, as Myanmar still lacks a regulatory and licensing framework for leasing. The majority of hire purchase in rural areas is for agricultural equipment. Several MFIs report interest in applying to offer hire-purchase services.

Disabilities: BRAC has a pilot programme focused on issuing micro-loans to people with disabilities that may otherwise struggle to access credit from other MFIs

Migration loans: At least one MFI has issued migration loans, designed to help people relocating within Myanmar.

Garment worker loans: VisionFund Myanmar announced a new loan product for garment factory workers in February 2018, funded by the Livelihoods and Food Security Trust Fund (LIFT).

Insurance: The MBL includes insurance within the scope of MFI activity and lenders report that their microfinance license explicitly includes insurance. But many MFIs say they are prohibited from offering insurance products. Some lenders that are part of a business group with a licensed insurer can refer customers to the insurance arm.

Some of the larger MFIs provide a basic insurance package — either voluntary or built into the loan — to cover borrowers in the event of their death. For example, MFIs can charge a fee as a percentage of the loan or a flat fee, which is paid into a pool of funds used to clear loans and cover funeral expenses for customers that die.

However, this is not framed as insurance and not reportedly not offered as such. There is uncertainty over whether MFIs are allowed to provide more sophisticated micro insurance products, even if their license explicitly provides for this.

The 30% interest rate cap would also seem to apply to any potential micro insurance product, which together with the cost of product development and distribution could make offering such services challenging. Of the MFIs that do provide a basic insurance package, some report that it is loss making and others say it is profitable. The potential for micro insurance is significant, especially given the nascent state of the private insurance market [see insurance chapter]. Myanma Insurance estimated in 2017 that there were around 500,000 life insurance policy holders. The number of microfinance customers with an MFI that offers a basic insurance package is over 1 million.

Outlook

Access to capital

MFIs report that their greatest issue is access to capital. This affects local institutions more than international MFIs, who are more likely to have support from a foreign parent or international shareholders. This imbalance has in turn contributed to the majority of the largest and most prominent MFIs being foreign owned. Foreign MFIs, however, are still uniform in citing capital as their primary problem.

One of the few local banks that reports lending to domestic MFIs is MMB. As of March 2018, MMB said it had an outstanding loan portfolio of between Ks9bn and Ks10bn, split evenly between MFIs and corporate borrowers. MMB reports it has to ask for collateral on its loans to local MFIs, which is typically land and buildings, and that this still restricts the number of MFIs it can lend to.

Domestic banks have also been highly reluctant to lend to international MFIs, again due to a lack of familiarity with how to assess an MFI borrower, and the fact that most bank lending still requires physical collateral that foreign MFIs cannot own. Several MFIs report that Myanmar banks are becoming more open to lending to the microfinance sector, and expect more loans to be issued in the near term.

Yoma Bank, for example, signed a Ks2bn funding agreement with BRAC Myanmar in March. MFIs expressed relief that the 13% interest cap on loans remains in place, although a senior executive at a foreign MFI said his institution would happily pay at 16% or 17% for kyat denominated financing.

Foreign banks operating in Myanmar have been more willing to lend, and lenders including Maybank and Mizuho have made kyat loans to MFIs. Other MFIs have borrowed in dollars, or made use of bank-to-bank loans involving one foreign and one local bank. These facilities come with a currency risk, and in the case of bank-to-bank loans two sets of interest payments.

MFIs have options when it comes to currency risk. LIFT has an agreement with international currency hedging fund TCX, which involves TCX providing hedging facilities for foreign investors lending in kyat, and LIFT subsidising the loans to lower the interest rate to the 13% ceiling. Under the terms of the facility, the hedge must have an average maturity of two years.

TCX reports that a $10m subsidy was used to catalyse $80m of funds lent in local currency from 12 international lenders to 11 MFIs.

	Requested allocation	Loans hedged
Volume ($m)	201	80
No. of lenders	20	12
No. of loans	92	40
MFIs	17	11

FOREIGN INVESTMENT

Interest among foreign investors in the microfinance sector appears to be rising. Delta Capital Myanmar in March announced a $7m investment in Easy Microfinance, which has a loan book of around $10m and some 55,000 customers.

Private equity funds and other investors cite several attractive features of the sector in Myanmar, including very low NPLs, huge unmet demand and the increasing availability of digital finance services that lower the cost of funds and help accelerate expansion. They also note the trend towards a removal of regulatory restrictions — this includes higher loan amounts, hire purchase and now potentially collateralised loans to businesses

Regulatory capacity

MFIs face serious bureaucratic hurdles when receiving approval for business plans, operational expansion and new products. Approval for starting operations in a new area, for instances, can take in excess of three months. Part of this may be bureaucratic inefficiency on the part of the regulator.

However, MFIs also report the FRD also has trouble assessing applications for advances such as issuing loans and taking repayments through digital channels, with which it has limited experience. MFIs also report that a significant focus on rural areas generally results in applications and other bureaucratic matters being processed faster.

Clarity is still lacking across key sections of the existing regulations. There is no definition of over indebtedness, for instance. Some MFIs report that they would not lend to customers with existing loans from another MFI, while others say it is possible to identify borrowers that can sustainably take out loans from multiple different lenders.

Support for the regulator in order to help it properly supervise the industry and identify and tackle issues is crucial, and several foreign MFIs are active in this regard.

Saturation / over-indebtedness

Some MFIs report that over-indebtedness in certain urban areas has either become a problem or could become an issue. The August 2016 notifications suggest the regulator is also concerned. MFIs point to a rise in new lenders who focus on the same urban centres in Yangon, Mandalay, Bago and Ayarwaddy.

There are anecdotal reports of new and inexperienced lenders pursuing aggressive loans targets with limited credit assessment, which includes simply poaching existing customers from other MFIs that have more sophisticated credit screening systems.

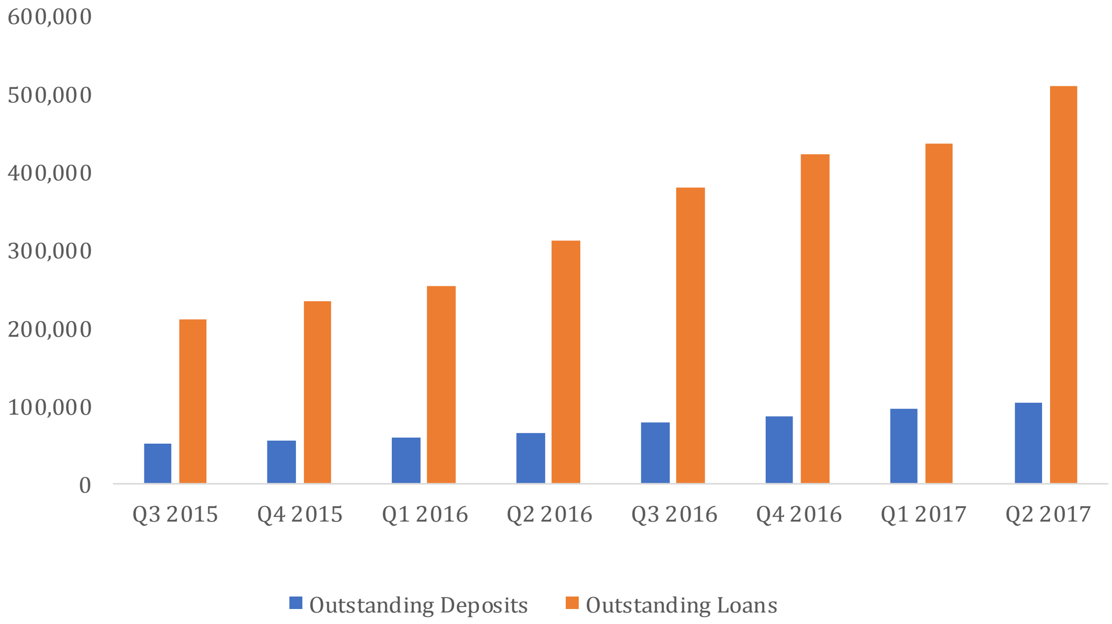
Although demand for microfinance still outstrips supply, MFIs report that there is increasing competition among lenders in areas around Mandalay and the delta.

MFIs report that at a meeting in December 2017 the regulator said that no more MFIs would be allowed to start operating in key urban centres including Yangon, Mandalay and Bago. Several MFIs reported that this verbal directive was also related to the MoPF's concern that there is too little MFI penetration into rural areas. MFIs said that at the December meeting, the regulator encouraged them to push more into rural areas.

One MFI active in Bago Region reports that the local government now provides village level-data on which MFIs are working in which area and that this is proving helpful. The region government also reportedly provides a freephone number for people reporting illegal moneylending.

Despite concerns about over indebtedness, the non-performing loan ratios in the MFI sector remain exceptionally low. The largest MFIs report repayment rates of over 99%.

Deposit-taking MFIs: total outstanding loans and deposits



Source: CBM

Credit analysis

MFIs have no access to a credit bureau or database that would help them identify customers that have already taken out loans from other MFIs. Although lenders work hard to ascertain whether a potential customer has existing loans, borrowers are still able to take out multiple loans from different MFIs. The real extent of the issue remains unclear due to a lack of data.

MFIs report that credit data suppliers from regional countries have visited Myanmar to investigate the market opportunities, but that their prices are typically too high for MFIs to afford. Lenders are also prohibited by privacy regulation from sharing customer level data between themselves.

Some report collaborating to share data on which townships or wards they are active in, and in areas of Yangon, Mandalay and Bago MFI's report sharing customers' National ID numbers. It remains unclear from a regulatory perspective whether this is allowed, although the regulator has yet to object.

Anecdotal reports from sharing exercises suggest there is sometimes significant overlap between MFI customer bases in some areas. Several MFIs said they would be keen participate in data sharing, but would need regulatory clarity first.

The larger MFIs have their own credit rating and screening systems. BRAC is starting a project with the World Bank on a digital credit rating system for borrowers. This would mean customers would not have to visit the BRAC office and vice versa in order to receive approval. The project is expected to help provide more insight into the challenges of digital credit assessment.

The MMFA reports that it is working on potential solutions to the lack of credit information, and a separate initiative to improve data collection and sharing between its members. The FRD is reportedly working on its own project collecting and analysing data from MFIs and is receiving support from a variety of international agencies.

Cost of operations

Some MFIs report that the cap on interest rates of 30% per annum is an issue when expanding into rural areas. They say that the further into rural or remote areas an MFI moves the higher the cost of operations, due to transport, security and administrative costs along with a lack of credit data.

This view is not uniform, however. One large MFI reports that a recent study revealed their cost of operations was in fact slightly higher in urban areas, potentially due to traffic congestion and higher prices in urban centres. The 8% fee MFIs can charge for rural loans was reportedly instituted to address this issue.

Operational experience

Outside of the larger MFIs, many institutions reportedly lack the appropriate expertise, experience and systems to properly conduct sound lending and deposit taking. MFIs report that a large number of lenders, although accounting for a small share of the sector's total loans, suffer from a serious lack of knowledge and resources.

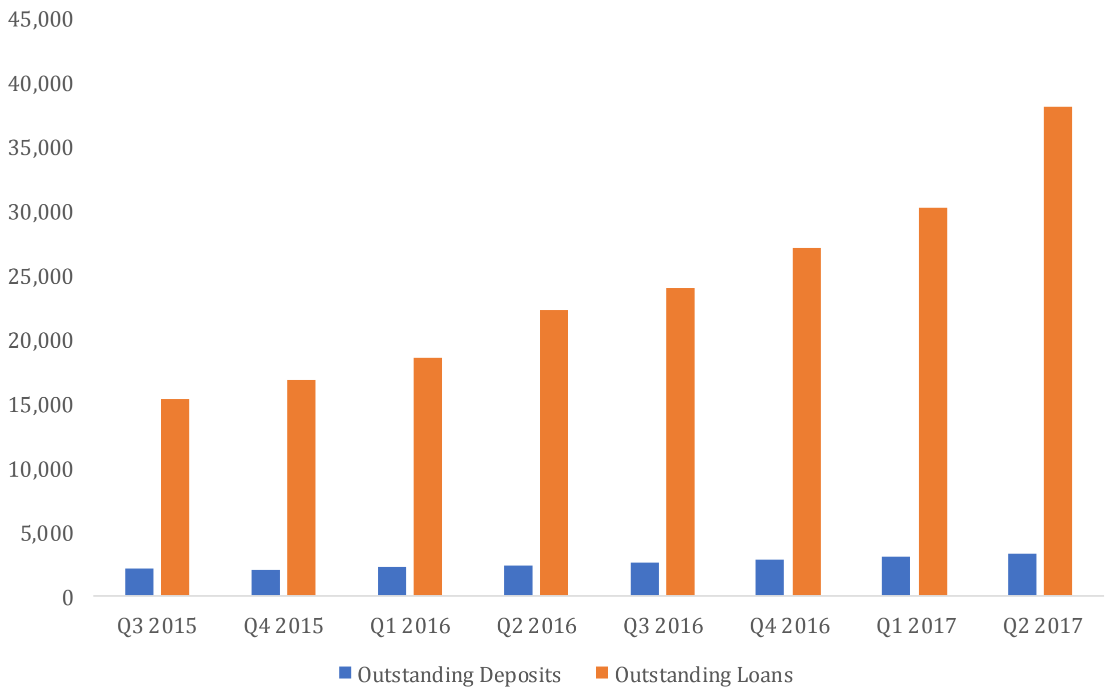
Mobile systems

The World Food Programme already has a small-sale project with WaveMoney in Kachin State disbursing funds electronically. Several MFIs are also keen to make use of mobile money providers to disburse loans and receive interest payments electronically, which they say would significantly reduce their cost of funds. MFIs are already in conversation with mobile money operators, and some of the larger ones have started using the mobile money network in urban areas.

There are likely to be huge client benefits, as many customers have limited free time during long working days to travel to take out or repay loans. For the larger and more established MFIs, the move towards mobile services will be part of larger tech strategy involving making more of their operations digital.

Rural-focussed MFIs typically have even higher costs of operation due to the distances involved in credit analysis and loan disbursement. However, rural-focussed MFIs report that the mobile money networks remain very urban-focussed, and that it will take time before the network is dense enough to allow them to take advantage of digital payment. User adoption is also likely to be a big challenge for MFIs planning to shift into mobile services.

Non-deposit taking MFIs: outstanding loans and deposits



Source: CBM

Some foreign MFIs operate their own mobile system in other countries, and have asked for permission from the regulator to set up similar operations in Myanmar. One MFI reported it was told that this would only be possible if it set up a separate company that then applied for a mobile money license. It appears at present that mobile money licenses are not available to MFIs in the same way they are to banks.

The UNCDF has an Expanding Financial Access country programme for Myanmar, which involves a focus on digital financial services that includes microfinance. The MMFA reports that the FRD, Central Bank and microfinance providers are involved in dialogue over how to help expand digital finance services in the industry.

Annex 1

Rules on MFIs borrowing:

a. Whether from inside or outside the country, all loans for funds shall be taken with the approval of Microfinance Supervisory Committee.

b. Whether borrowing in foreign currency or Kyat backed by foreign currency, prior approval shall be obtained from the Central Bank of Myanmar under section 48 of Foreign Exchange Management Regulation to regulate the inflow and outflow of foreign currency.

c. Approval from Microfinance Supervisory Committee to borrow shall be requested by submitting complete information regarding the following:

i. Loan Contract
ii. The latest profit-loss account and balance sheet checked by the auditor
iii. Non-performing loans
iv. Portfolio at Risk (PAR)
v. Business performance including currently operating areas, number of clients, portfolio, paid-up capital
vi. Business development plans using the funds borrowed (e.g. expansion, bigger loan sizes for clients, upgrading service with IT)
vii. Statement of commitment to utilize the funds in microfinance services
viii. Trustworthiness of the lending organization
ix. Statement that MFI's loan will not exceed the prescribed solvency ratio

Annex 2

Loan Categories and Loan Loss Provision: Loan Categories and Loan Loss Provision for all loans, regardless of the term, lent to the clients shall be as follows:

	Days past due	Provision as % of Loan Outstanding
a)	Current Performing Loans	1%
b)	Sub-standard Loans 30 days past due	10%
c)	Watch Loans 31 – 60 days past due	50%
d)	Doubtful Loans 61 - 90 days past due	75%
e)	Loan Loss Over 91 days past due	100%
f)	Rescheduled one time	50%
g)	Rescheduled two times	100%

D. Capital markets

The Central Bank itself has also historically been a large buyer of bonds, helping finance the government's budget deficit and fuelling inflation

Introduction

The lack of functioning debt and equity capital markets in Myanmar has serious implications for banks, insurers and other financial institutions. In many countries banks and insurers rely on bond issuance to meet regulatory capital requirements and raise cash to grow their business. Corporations turn to bond markets to fund expansion, and municipalities to finance capital expenditure.

At the same time bonds offer investment products — both for ordinary retail investors and financial institutions. Insurers are typically large buyers of longer dated government and corporate bonds, and banks of medium term debt. Similarly, a robust equity market provides both a source of capital and investment. At present, however, Myanmar's equity market is far from robust, and its bond market is non-existent.

Treasury bonds

The Myanmar government began issuing three and five-year Treasury bonds in 1993. Initially the bonds were sold by the Central Bank directly to public and private investors at interest rates set by the Ministry of Finance. The Central Bank itself has also historically been a large buyer of bonds, helping finance the government's budget deficit and contributing to inflation.

In 1996, under direction from the government, MEB and the Daiwa Institute of Research formed the Myanmar Securities Exchange Center (MSEC), which was tasked with helping build a functioning capital market and creating a modern stock exchange. In 2010, the government introduced two-year Treasury bonds, and appointed MEB and the MSEC as underwriters for bond sales.

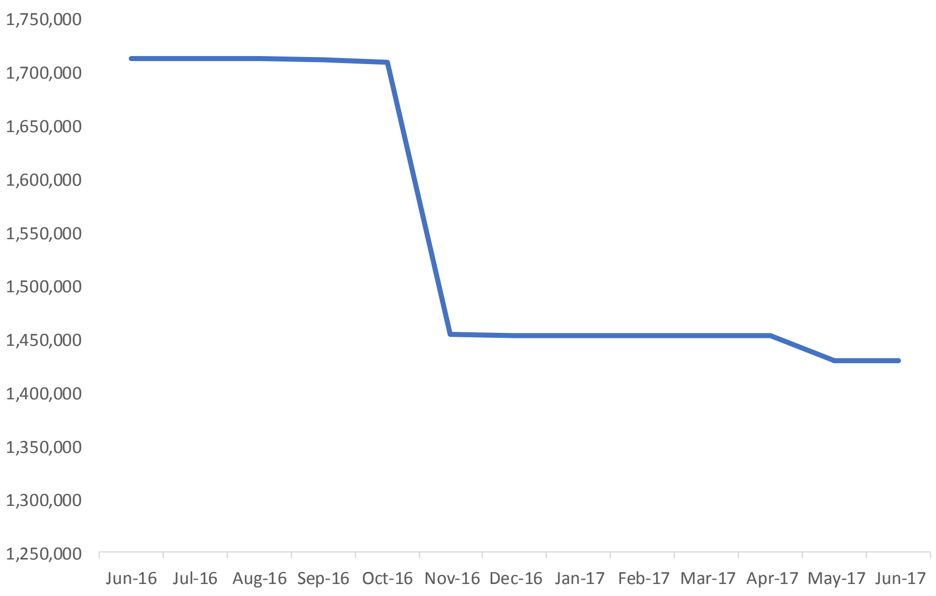
The Central Bank also continued to sell Treasury bonds to banks until 2016. Having already introduced an auction system for Treasury bill sales, the government began issuing Treasury bonds through electronic auction in September of that year. Physical debt certificates were replaced with electronic scrip in 2015 prior to the auction system. Under the auction system, local banks are the only permitted direct buyers of Treasury bonds, which are still sold with an interest rate set by the government rather than market demand. As a result, banks have typically purchased Treasury bonds more out of necessity than real appetite.

Five-year Treasury bonds are sold with an interest rate of 9.5%, three-year bonds at 9% and two-year bonds at 8.75%. Term deposits at commercial banks pay between 8% and 10% for periods of up to one year.

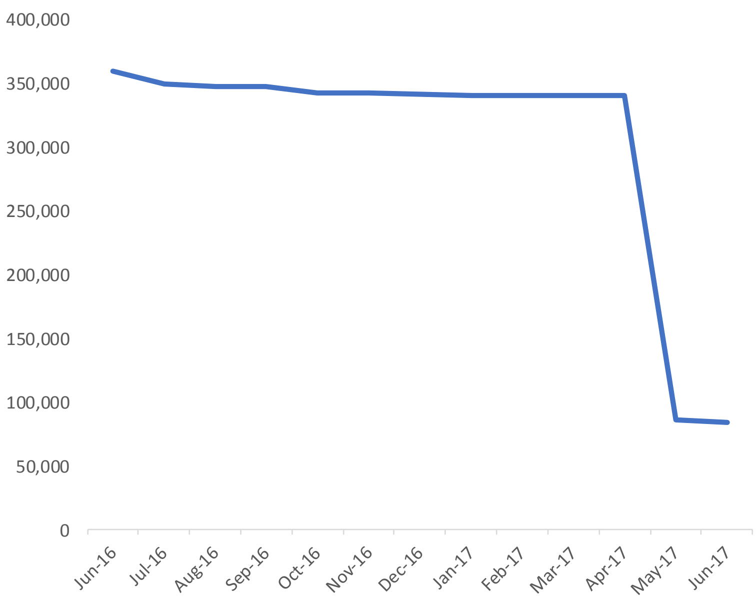
Despite the unattractive interest rates on Treasury bonds, there are few other investment options for banks and government bonds are a key source of liquid assets for regulatory compliance. Insurers also have no choice but to hold a chunk of their capital in government bonds.

Government data up until July 2017 shows the outstanding volume of two, three and five-year bonds declining.

Outstanding five-year bonds



Outstanding two-year bonds



Source: CBM. Figures in Ks millions

There is industry speculation that one of the existing deputy governors will be appointed as the new governor in 2018.

The government's adoption of an auction system came with a stated intention of allowing interest rates to better reflect market demand. This is key to placing more government bonds with the private sector and further reducing Central Bank participation. But there has been limited progress on this front — recent auctions have been undersubscribed.

The government attempted to sell Ks150bn of bonds in its February 2018 auction but only managed Ks87bn. Some observers report that banks have less demand for government bonds for regulatory purposes due to the new prudential framework now being enforced.

The administration has made some progress, however, on reducing the Central Bank's purchasing of government debt, although this remains high.

Despite several decades of government bond sales, there is as yet no framework for corporate or municipal bond issuance. Public companies could in theory issue bonds through private placements, but this has not been tested. Immediate priorities in the debt space are allowing market prices for government bond and bill sales, creating a liquid second market for those securities and building a framework for corporate and municipal bond issuance.

Capital market experts note that a mechanism for issuing municipal bonds already exists, although it appears likely the regulator will look to issue additional regulations.

Equity markets

Myanmar's equity market has seen more recent progress, building on a long history of public companies selling shares over-the-counter (OTC) to private investors.

The MSEC operated an official OTC exchange with two listed firms — Forest Products Joint Venture and Myanmar Citizens Bank — until the creation of the Yangon Stock Exchange (YSX). The MSEC then became one of the licensed securities firms, and stopped operating the OTC market.

Efforts to create a modern exchange began in 2012, when the Central Bank, Ministry of Finance, DIR and Japan Exchange Group signed an MOU on providing human resources and technical assistance for the development of Myanmar's capital markets. Two years later the Yangon Stock Exchange joint venture company was incorporated, with MEB holding 51% of the shares, DIR 30.25% and the Japan Exchange Group the other 18.75%.

In December 2015, the previous Thein Sein government — just four months before the end of its term — announced the names of six firms selected to list on the exchange and 10 firms provisionally chosen to act as underwriters.

Firms originally selected to list	Listing date
First Myanmar Investments	25/02/2016
Myanmar Thilawa SEZ Holdings	20/05/2016
Myanmar Citizens Bank	26/08/2016
First Private Bank	20/01/2017
Great Horkam	yet to list
Myanmar Agribusiness Public Corporation	yet to list

The YSX formally opened that same month without a single company or licensed underwriter, and there is a general belief that the previous administration rushed the creation of the bourse in order to have it opened before leaving office.

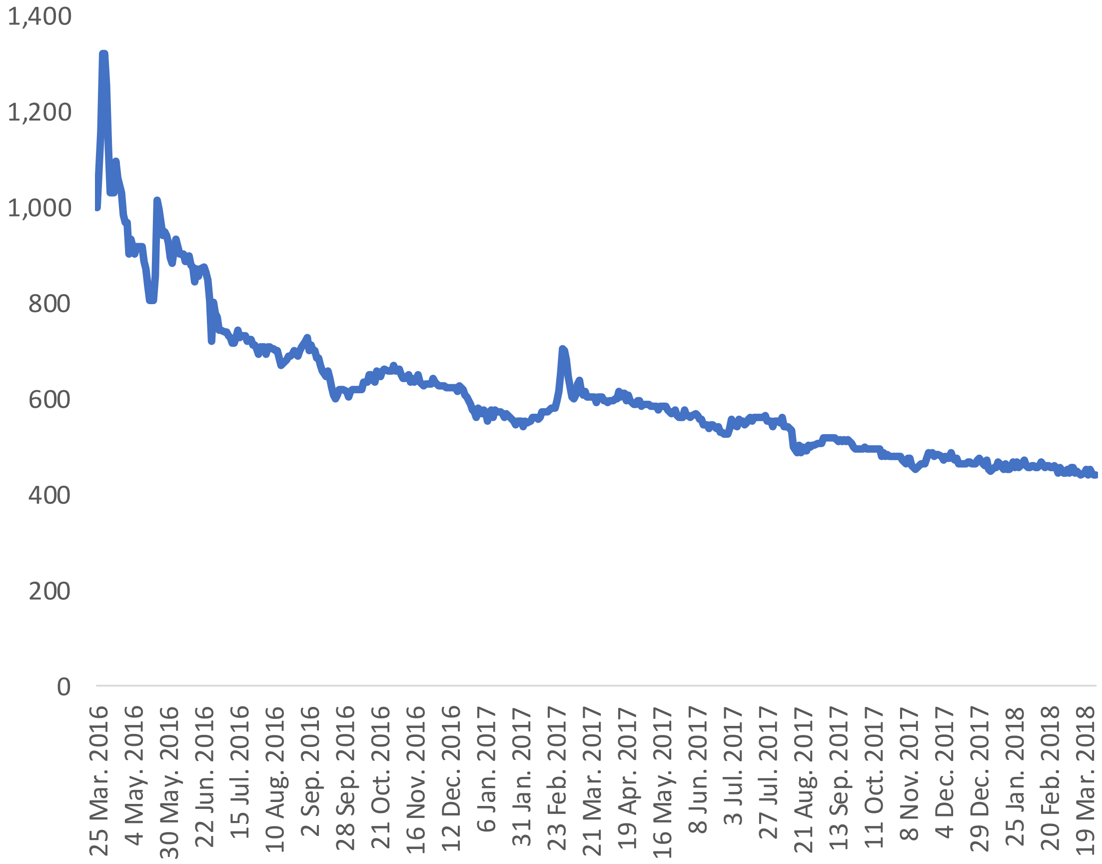
The new exchange had to wait until March 2016 for its first listing — local conglomerate First Myanmar Investments (FMI). FMI, however, simply moved its existing OTC-issued shares onto the exchange, as did the three firms that listed subsequently — Myanmar Thilawa SEZ Holdings (MTSH), Myanmar Citizens Bank and First Private Bank.

The first proper IPO only arrived in January 2018, in the form of TMH Telecom.

As of March 31 2018, there were six licensed securities firms acting as underwriters, all of which received their licenses in 2016.

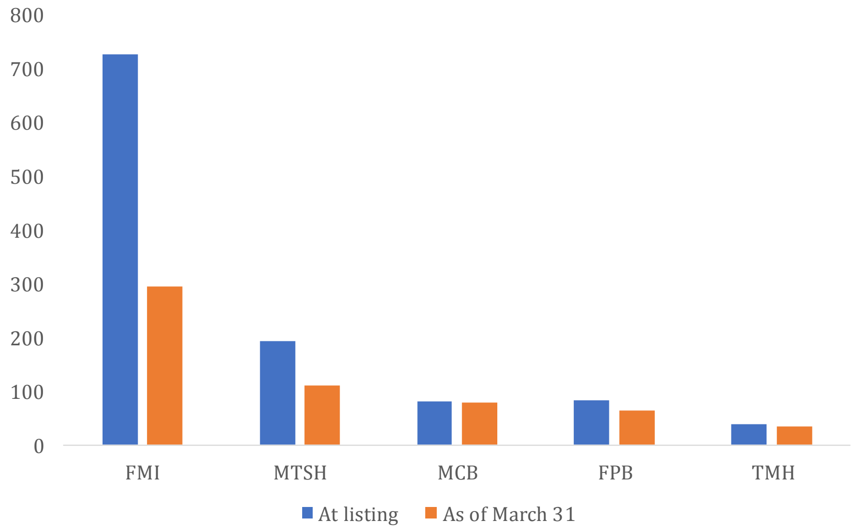
Licensed Securities Firms
KBZ Stirling Coleman Securities
Myanmar Securities Exchange Centre
AYA Trust Securities
CB Securities
KTZ Ruby Hill Securities
Amara Investment Securities

Trading on the YSX has fallen steadily. The MYANPIX index hit a high of over 1300 in the first week after FMI listed. Other than brief jumps when new firms appeared it has fallen predictably and has not been north of 500 since September 2017.



The market capitalisation of the listed firms has without exception dropped too, although the fall has been much worse for the earliest entrants FMI and MTSH.

Valuation of listed firms (Ksbn)



The priorities for the YSX include expanding the family of listed companies, improving liquidity and bringing institutional investors into the market.

Legislation and regulation

Securities and Exchange Law (2013) – Ministry of Finance

The law created the legal foundation for the securities market, created the Securities and Exchange Commission of Myanmar (SECM) and the Yangon Stock Exchange (YSX).

Securities and Exchange Rules (2015) – Ministry of Finance
No English translation available

Additional notifications - SECM

SECM notifications	Date issued
Notification No. 1 / 2015 – Dematerialization of shares	07/08/2015
Notification No. 2 / 2015 – Public offering	14/09/2015
Notification No. 3 / 2015 – Business time and brokerage fees	10/10/2015
Notification No. 1 / 2016 – Continuous disclosure	19/02/2016
Notification No. 2 / 2016 – Securities companies Regulations	11/03/2016

Companies Act (2017)

The law is expected to allow foreign investors to own up to 35% of a local company, and as such potentially pave the way for foreign investors on the YSX. However, there are numerous administrative and regulatory hurdles across the industry that need to be dealt with first [see Outlook section]

THE SECM

The Ministry of Finance formed the Securities and Exchange Commission of Myanmar (SECM) in 2014 and the commission became operational in early 2015. The SECM is the regulator for the YSX and the securities firms, and was responsible for drawing up the rules to accompany the Securities and Exchange Law.

A deputy minister of finance sits as its chair. The commission's stated aim is to provide a safe, liquid securities market and protect investors and the wider economy.

Listing criteria for the YSX

The full listing criteria is provided in Annex 1. Securities firms note that there is a relatively lower bar for listing onto the exchange, with low listing fees and no minimum float, which should help encourage firms to IPO.

Challenges

Equity

Many of the challenges for the YSX stem from the nature of its creation.

Many of the challenges for the YSX stem from the nature of its creation. Rather than license qualified underwriters to go out and build a client base of potential companies to bring to market, the previous government instead selected the first six firms that would list and then set about licensing underwriters.

It took months for the first few securities firms to get their licenses and help FMI become the first firm listed on the YSX. Over two years later and only four other companies have joined it.

The first four firms to list all shifted existing shares onto the exchange, rather than engaging in true IPOs. In most cases there was an initial surge in value from the listing price, followed by a more or less steady decline over time. This is reflected in the MYANPIX index, which has regularly touched new lows over the last year or so.

Trading volumes have dropped steadily over time. The MSEC reports there are around 34,000 registered accounts at the YSX, but only two hundred or so are estimated to be regular traders.

The experience of the initial four companies to list has provided a warning for other firms considering the same route. Several companies, including banks and insurers, report they initially planned on pursuing a listing but have shelved such plans because of the YSX's poor performance.

Analysts and market participants have suggested several reasons for the decline. On the one hand the general public has very limited familiarity with equity markets and how to approach trading. Securities firms report that retail investors typically take no account of a firm's underlying financial performance or fundamentals when making a trade.

KBZ SC research in early 2016 suggested fair value for FMI was Ks20,750 — based on the value of the firm's core businesses. KTZRH research in June 2016 had a target price of K22,300 for FMI.

The conglomerate has reported consistent profits in the two years since, but as of 31 March 2018 its shares were trading at K12,000.

For the first two years of the exchange there was no online trading, and placing an order required either a phone call or a visit to one of the securities houses. There were also only two daily match sessions when shares could be traded, until 30 March 2018 when the number of match sessions was increased to four.

In addition to a cumbersome and time-consuming trading process, it was not immediately obvious to many investors what the benefits were to holding shares. The exchange opened in a backdrop of double-digit inflation, and the dividend yields on many shares were little higher than the 8% deposit rate at commercial banks.

Other than TMH, the other firms listed existing OTC shares bought in many cases years earlier at much lower prices by retail investors. Many of these retail investors appear to have opted to sell at a large profit on the YSX when it opened, after which trading slowed without any institutional investors taking part. Insurance companies are prevented from investing, and Myanmar has no pension funds or asset managers that could provide liquidity.

There is a deeper problem with liquidity, which is that in many cases the floating stock — the total number of shares minus those held by major shareholders, employees and company insiders — is relatively small. FMI's floating stock at listing was at most 25%.

When MTSH listed, its directors and executive officers alone held 46% of all shares. This makes for a limited number of shares available from a small number of listed firms. This situation could limit the benefit of allowing foreign investors or local institutional players onto the exchange. Such investors are likely to want large block trades, which will be hard to facilitate if there are limited number of shares being offered

Securities firms say this also contributed to the limited interest among retail investors, who withdrew money after finding it hard to purchase shares.

The government and the regulator have so far been slow taking steps to improve how the market functions. Securities firms had hoped to be given permission for online trading in 2016, but had to wait until December 2017 for regulatory approval. MSEC, KBZ SC, CB SC and AYA Trust were all granted permission.

Although take up has been fast — some firms report 40% of customers switching to online in the first few months alone — interest in the exchange among retail investors has already declined. Similarly, tax incentives for listed firms were introduced in July 2017, but securities firms report a lack of clarity over how listed companies can take advantage of these benefits and under what circumstances they apply.

Bonds

The main problem in Myanmar's Treasury bond market is that there are not enough bonds being issued at attractive enough interest rates. This leaves the government short of funds and local banks short of liquid assets. There is also as yet no functioning secondary market for government bonds or bills. This will require regulations for secondary market trading from the SECM and electronic trading infrastructure. Even so, there is a concern that there may be too few bonds available to create a proper secondary market, which in turn could help create a repo market [see Outlook section].

The SECM has yet to create the regulatory architecture for private or public companies or other entities such as municipalities to issue bonds, which could provide a new source of funding and fresh investment opportunity for institutional and retail investors.

A new YSX task force was set up in January 2018

Outlook

Equity

Recent efforts have begun to rejuvenate the flagging YSX. In January 2018, Japan's Financial Services Agency, Japan Exchange Group and Daiwa Securities Group presented the MoPF with a support plan for capital markets. The LIST plan — which stands for Listing, Investment Strategy, Timeline is designed to highlight the current issues and challenges, and suggest solutions.

Among the suggestions was the creation of a dedicated team for helping improve the number of listed companies. A new YSX task force was set up in January following an agreement with the MoPF, led by the Deputy Finance Minister and the YSX. The five-person task force will focus on raising the profile of the exchange, educating firms on the benefits of listing and helping securities firms build a proper pipeline of IPOs. The team also hopes to create a list of preferred suppliers for legal, auditing, accounting and other services.

This could create a system where the task force helps explain to companies the advantages of listing and what internal reforms they need to undertake, helps them choose preferred suppliers for listing preparations and then hands the company off to a securities firm for the IPO. The nature of the listing process, however, means that it will take time before this translates into a more regular stream of listings.

Estimates are that it would take the average mid-sized Myanmar firm 18 months to two years to prepare for and conduct an IPO.

The pool of potential firms that could list on the YSX is also very small, although the number of public companies has risen sharply in recent years. The SECM reports that pre-2012 there were only 20 or so public companies in Myanmar. The government later began encouraging more firms to become public and the SECM reports there are now over 300, although it believes that only 30 to 40 would be eligible to list on the exchange. The regulator also notes that many firms are family owned, and may be reluctant to dilute their stake in the firm or take the firm public in the first place.

The SECM reports it plans to work with the task force to help public companies improve their corporate governance standards to help them reach a stage where they could consider listing. Market participants are eager for much more government support, including clearer tax incentives for listing firms and the encouragement of state-owned enterprises to list on the exchange.

Foreign investors

The Companies Act is expected to come into force in August 2018, and would potentially allow foreign investors to buy shares on the YSX. However, the SECM notes that there is a significant amount of regulation, instruction and discussion required before foreign investors are allowed onto the exchange.

The SECM would have to issue instructions and notifications to the YSX and the securities companies on allowing foreign accounts. This would involve deciding what information would be required from foreign account holders and potentially distinguishing between accounts opened by foreigners based in Myanmar and overseas investors.

The commission reports it will also have to discuss with the listed firms whether they are willing to allow foreign shareholders.

The SECM is still in the process of discussing with the YSX how the exchange's systems will have to adapt to allow foreign investors. As foreign investors would only be allowed to hold 35% of a Myanmar firm, this may involve distinguishing between foreign-held and locally-held shares in order to prevent the 35% limit being breached. Theoretically, this could lead to two separate groups of shares trading at different prices.

The commission is unsure of how much demand there would be from foreign investors, although securities firms believe the exchange is too small to draw much foreign interest, and the low floats mean there are limited shares available anyway.

OTC market

Some securities firms are helping firms raise money in the OTC market, sometimes as a precursor to a YSX listing further down the road. Securities firms report there has been discussion around establishing an OTC exchange in Mandalay. However, the SECM reports that it intends to concentrate on strengthening the YSX and has no immediate plans to establish a new official OTC exchange in any city.

The SECM believes that creating an official OTC — that would have inherently lower standards and fees for listing — would divert public companies away from pursuing a listing on the YSX.

There is industry speculation that one of the existing deputy governors will be appointed as the new governor in 2018.

Bonds

Also within the task force's remit is a functioning debt market, although this is at a very early stage. The SECM reports it is starting to look at an issuance framework for corporate and municipal bonds, and a secondary market for the securities. Such securities could be traded on the YSX, and several market participants believe the exchange should have started as a debt rather than equity market.

The SECM, however, has no experience with building or regulating a debt market and creating a framework for issuance will require collaboration between the Central Bank, SECM and the finance ministry.

The government approached Standard Chartered and Citi back in 2015 to help Myanmar acquire a sovereign rating, but the country remains unrated. Traditionally, countries build a functioning rated sovereign bond market to create a yield curve off which corporate issuers can price. But market participants believe there is no reason for corporate issuance in Myanmar to wait for a sovereign rating.

The SECM reports it is focussing on improving the secondary market for Treasury bond trading, and that after this market improves it will turn its attention to municipal bond issuance. The commission envisions initial municipal bond issuance coming with some form of government guarantee.

The commission reports great interest in corporate bond issuance, and is now examining what a regulatory framework for corporate bond issuance could look like. The SECM is eager to ensure that only corporates that can demonstrate an ability to repay investors be allowed to issue bonds. The commission is now in the process of determining which criteria are the most suitable for assessing whether a firm should be permitted to issue bonds, and what a bond prospectus would contain.

Government auctions

The MSDP has an action plan calling for treasury auctions to be "strengthened" in order to reduce the Central Bank's financing of the deficit and, as corollary, inflation. Another action plan specifically calls for the Central Bank's deficit financing to be reduced to zero, again in order to combat inflation.

Yet a third action plan calls for the government to "acquire more budget to pay higher interest at the auctions" to make them more attractive. This suggests that although the government recognises the need to pay higher interest rates in order to raise demand, such a move may be reliant on raising the budget.

Repos

KBZ and Yoma Bank conducted Myanmar's first repo agreement in 2017 [see banking chapter] an overnight K1bn repo and a one week K500m repo. The repo market remains at a very early stage. The larger domestic banks and foreign bank reportedly conduct the occasional overnight repo.

A recent ADB report states that "repo transactions are carried out by CBM as part of its open market operation. Counterparties are the commercial banks, which participate in the interbank market, comprising the constituent participants of the CBM clearing system, CBM-NET." However, some bankers report that these Central Bank transactions are not true repos, but simply short term collateralised borrowing.

In in other areas of the financial services sector, this is a shortage of expertise and knowledge across the nascent capital market.

Annex 1: YSX Listing Criteria

Announcement of YSX's Listing Criteria Yangon Stock Exchange (YSX) hereby issues the following Criteria for a Public Company to list on YSX in accordance with the Article 41- (b) of Myanmar Securities and Exchange Law

1. It shall be a registered company limited by shares in accord with the Myanmar Companies Act, conducting the business in line with the public company's features and procedures.

2. It shall have at least 100 shareholders and above.

3. Paid-up capital shall be the minimum of K500m on the date of application.

4. It shall have the profit at least 2 years during the period of before the date of application.

5. The business shall have the stable basic income and conduct in accordance with the existing laws.

6. The Board of Directors and the heads of the company shall be in good character and have had not been having any punishment by a court, in addition, have not been facing any lawsuits. They shall perform their duties and responsibilities with well-prepared, in good-faith and fairly in line with the laws.

7. The Board of Directors and the heads of the company shall not act any deceptive manners by the public for the interest of the company and self -interest.

8. Each Director of the public company shall not do any business which has the same interest carrying out by the public company, except with the approval of Shareholder meeting.

9. The company, the Board of Directors and the heads of such company shall not be included in the black list of any public and government organizations.

10. Book-keeping of accounts and auditing of the company shall be undertaken in accordance with the Myanmar Accounting Standards and Myanmar Standards on Auditing.

11. The company shall fulfil tax duties in accordance with existing tax laws of Myanmar.

12. The disclosure of relevant corporate information and the facts that the public should be known, shall be disclosed and submitted to the Securities Exchange Commission of Myanmar and Yangon Stock Exchange, besides it shall be disclosed and announced to the public by means of easy understandable and best suitable ways in timely manner.

For disclosure of corporate information, it shall prescribe especially and precisely on the matters which have a considerable impact on investment decisions of the investors, such as the risk factors for the potential loss and the basic potential business activities

13. It shall set up an effective system to comply with laws, rules and regulations by appointing the compliance officer.

14. It shall have business plan containing business design, business process environment and the risk factors.

15. It shall set up a system to prevent the insider trading.
16. It shall continuously operate and manage stably without any influence by keeping soundness of good corporate governance, internal management and internal control system.

17. It shall have rational expectation to get a profit base upon stable revenue.

The criteria above are minimum standards to be referred as a general guideline for public companies. YSX will grant listing permission only after YSX receives listing application submitted by a public company and YSX confirms the company's eligibility of listing in term of protecting interests of general public through conducting examination.

E. Insurance

It was only in 2012 that the board formally opened the application process, which resulted in 12 private insurers being granted licenses

Introduction

Much like the banking sector, Myanmar's insurance industry thrived in the years before socialism. But by 1964, all private insurance had been nationalised and it took almost half-a-century for them to reappear.

From 1993, the state-owned Myanma Insurance had its own legal framework under which it offered a variety of life and general insurance products. In 1996, a new Insurance Business Law was enacted that created a supervisory board to review applications for an insurance business license.

But it was only in 2012 that the board formally opened the application process, which resulted in 12 private insurers being granted licenses. Three received life-insurance licenses, and the other nine composite licenses for both general and life.

Company name	Insurance license type
First National Insurance	General and Life
I.K.B.Z Insurance	General and Life
Young Insurance Global	General and Life
Grand Guardian Insurance	General and Life
Global World Insurance	General and Life
Excellent Fortune Insurance	General and Life
Aung Thitsar Oo Insurance	General and Life
Pillar of Truth Insurance	General and Life
Ayeyar Myanmar Insurance	General and Life
Capital Life Insurance	Life
Citizen Business Insurance	Life
Aung Myint Moh Min Insurance	Life

Most of these private firms are owned by large conglomerates or groups that also have a bank. A close relationship with a commercial bank presents insurers with an important distribution channel — especially given the recent expansion of bank branch networks and the shortage of trained insurance agents.

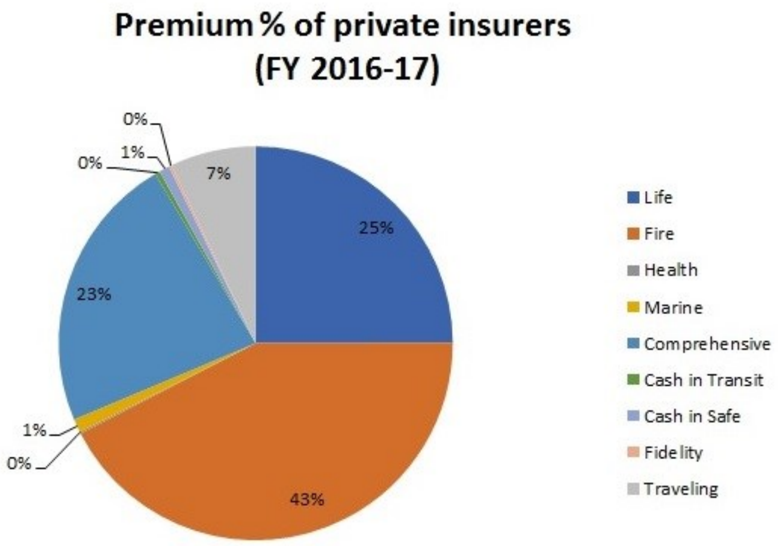
Another advantage is that banks require borrowers to take out fire insurance on developments or property used as collateral. Fire insurance is a huge part of the market, and insurers benefit from business referred through their sister bank. Even conglomerates and groups without a commercial bank can offer an insurer a platform for products like group life, fire and motor insurance.

Insurer	Related Bank
First National Insurance	AGD Bank
I.K.B.Z Insurance	KBZ Bank
Aung Thitsar Oo Insurance	Myawaddy Bank
Ayeyar Myanmar Insurance	AYA Bank
Citizen Business Insurance	CB Bank

The first products general insurers were allowed to offer in 2012 were motor, fire, cash-in-safe, cash-in-transit and fidelity. This list has been slowly — too slowly, say insurers — expanded and some existing products adapted. There has been similarly modest progress in the life insurance sphere [see Products section].

Policy wording and pricing is dictated by the regulator and is identical across all private firms, who can only compete on customer service and branch coverage. In the case of health insurance products, the pricing is not only identical across insurers but also outdated.

Premiums of private insurers by %

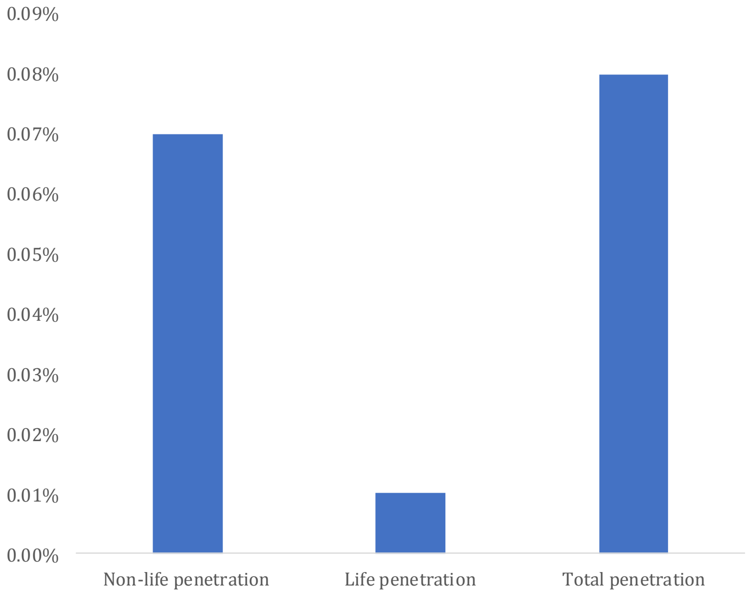


Source: CBM

However the limited product range and rigid pricing framework has not stopped insurers reporting steadily rising premium incomes and net profits — at least in the general insurance market. GGI, one the most successful insurers, reported post-tax profits of Ks3.6bn ($2.7m) for 2015-16 and 2016-17.

But product restrictions coupled with the lack of public awareness and distribution channels have made for minimal penetration. In 2016, it was estimated that the country's largest microfinance operator — Pact Global Microfinance Fund (PGMF) — provided risk-pooling services through its Beneficiary Welfare Program to more people than the entire formal insurance sector. Myanma Insurance estimated in August 2017 that there were around 500,000 life insurance customers in a country of over 50 million.

Insurance penetration as % of GDP (2015)



Source: Swiss Re

Given the nascent state of the market, the potential for growth is enormous. The *Asian Insurance Review* back in 2014 took McKinsey's forecast that Myanmar GDP could hit $200bn in 2030, and assumed that the insurance penetration rate would follow the same trajectory as Vietnam and the Philippines. The result was an estimate of $2.8bn in total annual insurance premiums by 2030.

But to even meet a much less ambitious target, the industry needs serious regulatory and legislative reforms and a coordinated effort to overcome a host of problems including a lack of IT systems, skilled personnel and limited public awareness of insurance.

The potential benefits to the country of a functioning insurance industry are considerable – businesses could protect themselves against bankruptcy, export insurance could boost trade, credit guarantee insurance could support the SME sector and health insurance could provide new savings products. In addition, insurers could play a vital role in helping impose uniform international standards as part of providing products like motor, fire and accident insurance.

After years of much talk but little action on the liberalisation front, the government and the regulator seem at least to be now on the cusp of launching the reform process in earnest. But much of the industry's future health will depend on starting from a set of strong foundations that have yet to be put in place.

Legislation

Key pieces of legislation

Myanmar Insurance Law (1993)

The law created the current legal framework for the state-owned Myanma Insurance (MI) and repealed the Insurance Business Law (1975). The MI Law makes it compulsory for certain groups to take out insurance with MI. Government employees must have life insurance with the state-owned entity, for example, and motor vehicle owners must take out third party liability insurance. The legislation also specifies that foreign investors are only allowed to use MI.

Insurance Business Law (1996)

The law created the Insurance Business Supervisory Board (IBSB), and gives it the power to issue licences for insurers, underwriting agents and brokers. Although only insurance licenses have been issued thus far. The IBSB is also tasked with setting capital requirements, fees and regulatory standards.

A 2015 amendment to the IBL transferred the powers and functions of the IBSB to the FRD [see box], although the IBSB continues to be involved in policy and regulatory decisions.

According to a 2013 notification, the IBSB is chaired by a deputy minister of finance, and its members include the directors general of the Central Bank, DICA, Internal Revenue Department, and the offices of the Auditor-General and Attorney-General.

THE FRD

The government transformed the Myanma Microfinance Supervisory Enterprise, which was originally responsible for supervising microfinance institutions, into the Financial Regulatory Department (FRD) in September 2014. The department was created with over 600 staff to oversee not just MFIs, but also the state-owned banks, private insurance companies and regulate the state lottery enterprises.

Insurance Business Rules (1997)

The rules lay out the paid-up capital requirements for life insurance and general insurance.

THE NEW INSURANCE LAW

Insurers have long argued for a new or revised law, and one that provides framework that can adapt over time to the changing market. A parliamentary drafting committee began working on a revised law and accompanying rules and regulations around 2013, according to senior insurance executives involved in that process.

USAID, the World Bank and JICA are understood to be providing support to the government in drafting an entirely new insurance law. This law is likely to be finished after the sector is liberalised to allow foreign insurers, but will be a priority thereafter. The FRD reports that as this is a new law and not simply an amendment, the timeframe is necessarily longer. Local insurance executives report that despite support from international organisations, the lack of insurance expertise and experience in Myanmar generally makes creating legislation difficult and drawn-out.

Key pieces of regulation

License requirements

Local firms

- Annual business license fee: Ks3m
- Annual fee: Ks1m
- Life-insurance paid up capital: Ks6bn
- General insurance paid up capital: Ks40bn
- Composite paid-up capital: Ks46bn

Insurance firms must place 10% of their paid-up capital on deposit with a state-owned bank and 30% must be invested in government bonds. Insurers report that they do not receive interest on the 10% of their capital that sits on deposit.

Companies have the option to sell products in US dollars, which requires an additional $500,000 in dollar denominated capital. Some insurers have taken this option, reporting that some clients prefer policies denominated in dollars.

Reporting standards

Current reporting requirements lack clarity and depth. Insurers report that the IBSB instructs them to report basic financial data and calculate capital adequacy and solvency ratios, but that there is no detailed instruction on how these calculations should be made. This gives latitude to insurers to choose their own method of calculation — for example, with regard to expected claim ratios.

The regulator, with support from the World Bank, is in the process of moving from capital requirements based on a solvency margin towards a risk-based capital framework.

The new framework is likely to take time to develop, however, and senior executives expect the two systems to run in parallel while insurers adapt. The FRD reported in March that the risk-based capital system will be "introduced to the market" in the next budget year, which for the government will start from 1 October 2018.

Private insurers say that one challenge in improving reporting standards is that many firms — in addition to MI and the FRD — still rely on manual or partly manual systems and operate on a non-accrual basis. AMI installed a digital platform in 2017 and was testing this in Q1 2018, but it appears to be the only insurer with a system capable of automated accrual-based accounting.

FMR understands that at least one other firm is in the process of installing a new digital system. The World Bank, meanwhile, is providing support and capacity building to the FRD on supervision across insurance and microfinance.

The lack of accrual-based accounting poses a clear problem for the sector. There is no differentiation between reserve funds for different products.

The regulator reportedly requires insurers to transfer 30% of their premium income across general insurance to a general insurance fund, and all surplus income for life insurance to a life insurance fund. Insurers believe that the risk-based capital framework will involve solvency and capital ratios and differentiate between the risk involved in different products.

Reinsurance or co-insurance, is mandatory above Ks500m for fire insurance and Ks300m for motor insurance

Reinsurance

Myanma Insurance is the only option for local insurers looking for reinsurance. Under this arrangement, MI acts a reinsurance broker and charges a 15% fee. Many insurers are reluctant to take this route, both because of the costs and the fact that they have no choice in who their reinsurer is.

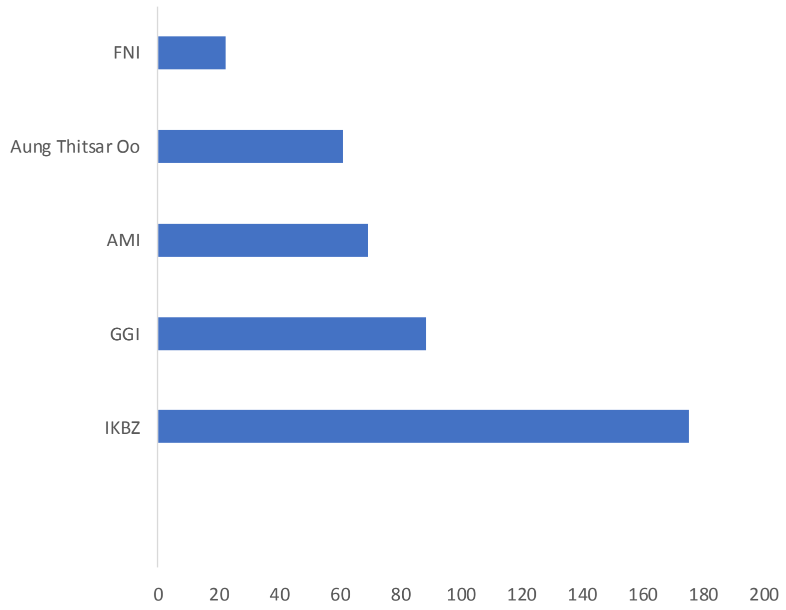
Reinsurance or co-insurance, is mandatory above a certain amount, beyond Ks500m for fire insurance and Ks300m for motor insurance. Above these limits 50% of the additional risk must be reinsured through MI and the other 50% co-insured among the other private providers. There have been reports that underwriting from co-insurance can be unprofitable.

What limited data there is available, however, suggests it can be an important source of income for private insurers. Several firms report it is the third largest source of premium income after fire and motor insurance.

But the co-insurance system also concentrates risk heavily in the local private insurance market. Private insurers are highly concerned that in the event of a large-scale fire in one of Yangon's industrial zones, for example, co-insurance would mean that the all private insurers would be exposed.

Global World is one of the few insurers that provides data on its co-insurance income broken down by insurer, which also offers some insight into which firms are most active in the market.

Global World co-insurance income, 2016-17



Source: Global World. Figures in Ks millions

Private insurers have been trying to convince the regulator to liberalise reinsurance, but to no avail. Their perception is that this is to protect another of Myanma Insurance's monopolies, but are hoping that if and when brokers are allowed to operate they will be able to help establish a more competitive market for treaty or facultative reinsurance. Myanma Insurance, however, reports that private firms will be allowed to conduct their own re-insurance operations in the near-future.

Product development and growth

Although private insurers are still forced to provide the same policies at the same prices, there has been progress in convincing the regulator to allow them to offer some of the products that MI enjoys a monopoly on.

Highway travel insurance was introduced in 2014, and marine cargo insurance and health insurance products in 2015. Health insurance was revised in 2016 to provide more expansive coverage — for instance critical illness coverage — and higher benefits. This was the result of dialogue between the insurers and regulator, but represents a rare case of policy amendment and one that did little to make the product more successful.

Private insurers were allowed to offer two new additional products in 2017 —Farmer Life Insurance and Personal Accident Insurance (CB) — but report that neither is particularly attractive to the public. The FRD reports that there are no restrictions on introducing new products, and that the IBL allows firms to submit new products to the IBSB at any time. Private firms, however, report that most efforts to convince the regulator to introduce new products or amend existing ones have come to nothing.

Life insurance

Life insurers report comparatively stagnant growth in the segment since its creation. Challenges include a lack of distribution channels and the fact that the life insurance product, remains unattractive to the majority of the population. Life-insurance represents a long-term liability, but the longest dated asset in which banks can invest is five-year treasury bonds.

These pay less than 10%, compared with commercial bank term deposits that can pay up to 9.5%. Banks are simply unable to offer a life insurance product that pays an attractive return upon maturity.

- Public life: Maximum insurance Ks30m
- Group life: Maximum insurance Ks5m per individual

One key group of buyers for group life is construction companies who purchase the policies for their workers. This is by no means widespread across the construction industry, but nonetheless represents a large chunk of the small customer base. However, a construction-industry slowdown that began in 2016 has sapped demand, according to one private insurer.

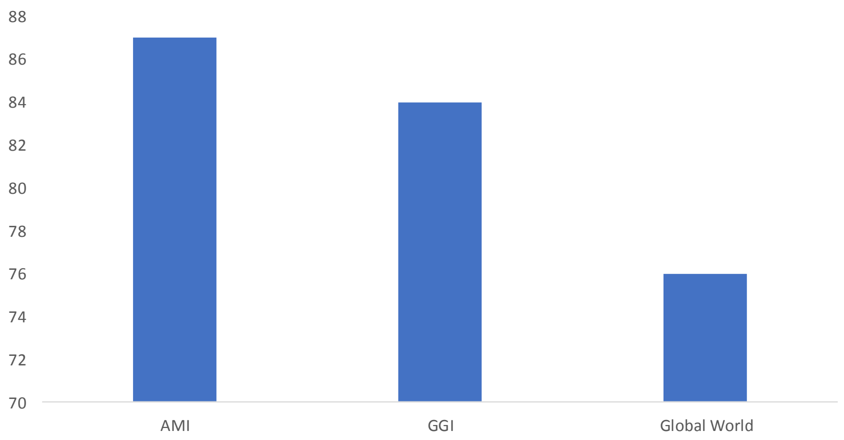
Sales of individual health insurance product remains very limited. This is due in part to the fact that the policy is expensive for the lower and middle-income population, while the upper income segment tends to travel abroad for medical care. This lack of faith in the local health system extends across all income groups, and contributes to an unwillingness to pay for health insurance, according to senior industry executives. Insurers report that the life insurance segment in general is not particularly profitable.

For firms that offer both life and general insurance, life typically only accounts for a very small percentage of their premium income. GGI reports that life insurance accounted for 14% of all policies written in 2016-17 and 5% of premium income. AMI reported 6% of premium income came from health insurance that year, and Global World received just 4% of its premium income from that market.

General

Private insurers have had much more success penetrating the general insurance market, although firms typically report that the only popular products are fire, motor and to a lesser extent travel insurance. For both AMI and Global World, the third biggest contributor to premium income after fire and motor insurance was reinsurance for other private firms.

Motor and fire premium income (as % of total), 2016-17



Source: Company reports, FMR

Insurers report that the popularity of fire insurance stems mainly from businesses and developers being required by banks to take out fire insurance in order to qualify for a loan. Firms that are part of a group that owns a bank are at an advantage here, as their sister bank can refer borrowers to the insurer.

Similarly, the popularity of special travel insurance stems mainly from highway bus companies purchasing individual travel insurance policies for customers. It is unclear whether this is mandatory or simply heavily encouraged by the government, but the upshot is a steady growth in premiums. However the product is far less important to firms than fire or motor, accounting for between 3% and 7% of premium income for the insurers in the graph above.

Motor insurance is the third product showing growth, and appears to be popular on its own merits. However, firms point to a weak regulatory framework for customer reporting, under which policy holders involved in accident can delay notifying an insurance firm for several days.

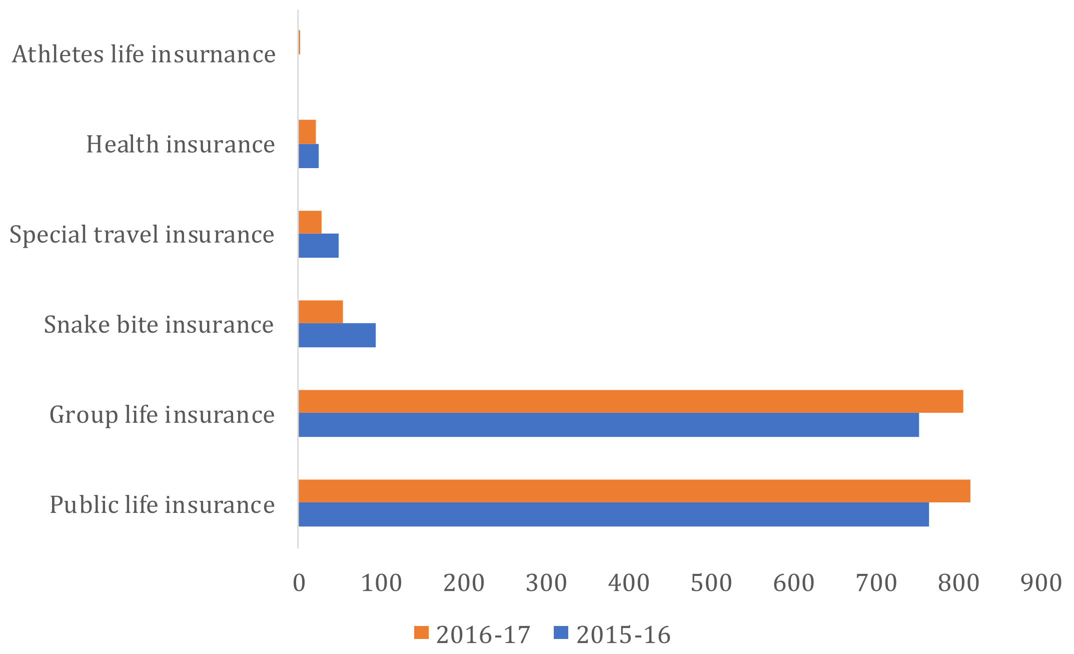
There are also issues around assessing fault and damages that involve multiple vehicles or uninsured drivers. In the early years after private insurers were allowed to begin operating, some executives report being unconcerned over such issues and were happy to pay out in order to demonstrate to the public that purchasing insurance was worthwhile.

However, several insurers report that claim ratios on motor insurance have risen sharply in recent years, and some now reach above 60%. This is reportedly due to customers becoming more familiar with the benefits of insurance, an increased willingness to make claims and the high rate of traffic accidents in Myanmar. Fire insurance claim ratios on the other hand, are typically in the low single digits.

The rise in motor claims highlights a key problem, which is that insurers are unable to raise their premiums in response. This makes motor insurance one of the most popular, but also least profitable products, and one which is loss-making for some insurers.

The claim ratios for travel insurance has shown no significant increase, and many highway bus travellers are unaware they have taken out insurance when buying a ticket. Insurers that have actively pursued paying out to injured customers — in order to highlight the benefits of insurance to the public — report some customers are initially suspicious and reluctant to take payment.

CB Insurance premiums by type



Source: CB Insurance

Outlook

Liberalisation

The previous Thein Sein government stated its intention to allow foreign insurers into the market at least as long ago as 2014, but dragged its feet on following through. The current administration has continued this trend, although recently there has been progress.

In late 2016 the regulator invited private insurers and the representatives of foreign insurance companies to the capital for discussion on how liberalization should proceed. The result was an insurance liberalization roadmap, which the regulator presented to the government in early 2017 — but has yet to make public.

Also in early 2017, the regulator issued foreign representative offices with updated licenses, and in March allowed foreign insurers to apply for a license to operate in Myanmar's special economic zones.

Thilawa SEZ — a joint-venture with Japan — is the only such zone operational. Three Japanese firms — Sompo Japan Nipponkoa, Tokio Marine & Nichido Fire Insurance, and Mitsui Sumitomo Insurance — were given licenses to operate in the zone in 2015.

Firms that wish to apply have to meet the requirements described in the IBSB issued Notification No. 3/2017.

SEZ INSURANCE LICENSE REGULATIONS

The IBSB issued Notification No. 3/2017 in March 22 2017, which laid out the license criteria for foreign companies:

- At least 10 years of operation
- Paid up capital of at least $1bn
- A minimum rating of B+ [from S&P]

Permit fee: $30,000
Renewal fee: $10,000

Note: some foreign insurers reported an unwritten requirement that the firm be operating already in two additional Asian countries.

At least one foreign insurer has applied for the SEZ license. There are only a few thousand employees in the Thilawa SEZ, although there are clear opportunities in products like marine cargo insurance.

Over the last two years, insurers have reported mixed messages and general indecision from the regulator as to the terms on which foreign firms will be allowed to enter the market. Many local insurers were adamant that the best route would be to allow international firms to operate only as part of a joint-venture with local companies. They point to the fact that local firms have been kept in a regulatory straightjacket for years, unable to set their own premiums, design their own policies, purchase their own reinsurance and received little regulatory guidance or support.

Their position is that allowing direct competition with foreign companies in a market built on an outdated insurance law and insufficient regulation, would drive many local firms out of business.

Unsurprisingly, some foreign insurers would like to be able to operate in both life and general insurance without taking on a local partner. This is by no means a uniform position, however, and insurers from some regional countries are far more open to joint-ventures or even actively favour that route.

In early 2018, senior members of the new Myanmar Insurance Association said that the government had formerly approved the regulator's plan to make foreign firms partner on general insurance, but allow them to operate independently in the life insurance segment. This approach has met with approval from MI and many of the private firms – including life insurers. In March, the FRD said that a public announcement confirming this plan would be announced "soon".

The fact that the existing life insurance products are unpopular, and that local firms lack the technology, skills and investment options to offer more attractive ones, means there has been minimal penetration from local companies. The importance of a modern life insurance market, and its relatively complex nature, therefore merits allowing in foreign companies.

In general insurance, on the other hand, local firms have made much more progress. But still shackled as they are by regulation, the argument is that they should not now have to compete directly against foreign rivals.

A licensing committee began meeting in late 2017 to work on the framework for allowing in international firms, but as of early April 2018 there had been no announcement on when applications would open. Private insurers note that foreign investors and insurers should be aware that capacity problems at the regulatory level are likely to continue to limit the pace of any liberalisation process.

The expectation in the market is that there will only be a small number of licenses granted to wholly foreign-owned life insurers, but that international firms will still have the option to partner with a local insurer in the life market.

As the application process has yet to open it is unlikely the market will see foreign firms open their doors in 2018. Some foreign insurers estimate it will take around nine months between formerly receiving a license to starting operations.

The majority of the brokers with offices in Yangon support international clients

Brokers

There is no broking license regime, meaning that firms are unable to engage in direct broking. There are however several local brokerage rep offices established by international firms, including Wills Towers Watson, Marsh and JPL, that engage in client support, though all direct broking is done through regional offices in other countries.

The majority of the brokers with offices in Yangon support international clients, who require insurance to be fronted by a local entity under the investment rules and laws. Under the current legal framework, foreign firms and investors can only use MI. In these cases, the brokerage firm and its regional office typically help find a foreign reinsurer and arrange a policy. They then take the policy to MI, which issues an identical policy and then often transfers the risk to the foreign reinsurer.

Brokers expect that only once the regulator establishes its license regime for foreign insurers will it then develop a licensing regime for local brokers. The FRD reports that it plans to issue licenses for brokers together with licenses for foreign insurers.

Local insurers and representatives from foreign brokers believe there is scope to collaborate on creating suitable policies and products for the local market. Insurers are also eager to have another source of reinsurance brokerage, other than MI. Brokers are likely to be far more active in the general insurance market, where policies are larger and more lucrative.

List of brokerage firms with local offices:

- Willis Towers Watson
- JLT
- Marsh
- K. M. Dastur
- Ageas
- Lockton
- Pana Harrison

Myanmar Insurance Association

In January 2018, the Myanmar Insurance Association formally opened its office in Yangon. The formation of an industry association had been under discussion for years, but insurers said the previous government had prevented this from happening. Some private insurers had hoped that representatives from the foreign insurers with offices in Myanmar would be members of the association. But they report that only once foreign insurers receive licenses will they be allowed to join.

IBSB member U Win Myint Han is chair of the association and Dr Sandar Oo — also managing director of MI — is deputy chair. The MIA will be in charge of training and licensing insurance sales agents and will help establish an insurance training school for this purpose.

Within the association there are working groups for different issues, each with their own chair — typically the senior executive of one of the private firms.

The association has signed MOUs with the General Insurance Association of Japan (GIAJ), Insurance Institute of India (III), Malaysia Insurance Institute (MII), the Australian and New Zealand Institute of Insurance & Finance (ANZIIF).

New products, new pricing

There is unlikely to be much latitude on policy wording or pricing until the issue of foreign participation is settled. One MIA member suggested that when foreign insurers are allowed to operate they will use their own policies, which local Myanmar firms can then adopt.

A related issue is that MI still retains a monopoly on many products. Some insurers report that the MoFP had previously promised that private insurers would be allowed to sell any product or policy that MI issues. However the state-run firm retains a monopoly on 14 of the 29 products that it currently offers, including profitable segments such as liability insurance, construction risk and some types of health insurance.

The nascent state of the Myanmar market and the lack of long-term domestic assets in which to invest means that new life insurers are likely to focus on short-term endowments for general kinds of protection. Short-term endowments of between five and 10 years are already popular life insurance products in other regional markets, and are often used as savings vehicles. Joint-ventures in the general insurance market will lead to better designed, tailored policies across various segments.

The question of setting premiums and managing liabilities focuses the debate on two key problems.

Investment opportunities

Insurers have long complained to the regulator about the lack of investment opportunities. They do not receive interest on their deposits with state-owned banks, and the only investment product open to them is government treasury bonds. These do not pay a market based interest rate [see Capital Markets section], and the longest maturity is five years. Local firms say it is critical to receive direction on where and how they can invest their funds.

One possibility is the YSX, although the exchange suffers from a chicken-and-egg problem. Interest in listing among public companies is low, as is public interest in trading. Institutional investors like banks and insurers would likely help trading, but are only likely to participate once there are more listed firms and greater liquidity.

Another option would be for firms — local and foreign — to invest in long-term assets overseas. This, however, creates a currency risk problem, and would likely require approval from the regulator and have to be done in compliance with the new Companies Act.

Actuarial data is non-existent.

Data and data sharing

There is a general lack of data on which to base risk analysis. In many parts of the economy, the regulatory infrastructure that would help inform risk assessment is absent or lacking. One example is motor insurance, where road rules and enforcement are poor. Another is the construction sector, where safety regulations in the workplace are again either insubstantial and/or rarely enforced. Actuarial data is non-existent.

The regulator has reportedly made progress in collecting data from insurers. Private firms report that most of them contribute to a data sharing process, but that some remain reluctant. There is, however, no central database for industry data that firms can access, which means that firms have to rely on their own claim ratio data.

Local insurers report that in order to properly set their own premiums they will need industry level data. Foreign insurers eyeing the market echo that data sharing will be crucial for the sector going forward, but also that the regulator has to ensure that firms are collecting and reporting data correctly.

Insurers are adamant that the regulator should prioritise constructing and maintaining an insurance industry database, and make it clear exactly what data firm's need to report and how such data should be collected. This raises the issue of how able the regulator is to help support the industry's development.

Regulatory capacity

A common complaint among insurance executives is that there is very limited knowledge or understanding of how an insurance system should work across the FRD and IBRB. For the market to liberalise and insurers to take on increasing freedom to design and price policies, the regulator clearly has to have sufficient understanding and capacity to oversee the process. Local insurers are sceptical that this is currently the case.

JICA is planning on dispatching two additional insurance experts to the ministry in 2018, one to advise on setting premium rates and the other to advise on insurance products. As the new insurance association is keen to establish a committee on insurance products, the JICA expert may liaise directly with the association.

The World Bank is also providing support and capacity building to help the FRD improve its ability to oversee the insurance and microfinance sectors.

Myanma Insurance reform

Myanma Insurance was created in 1952 as a life insurer before expanding into non-life insurance. The state-owned insurer has 39 branches in addition to its Yangon headquarters and more than 800 staff.

Ahead of the insurance sector's anticipated liberalisation, the state-owned insurer is going through its own internal changes. It still operates on a manual system but reports it is in talks with local IT firms to upgrade its operations onto an automated system. The Myanma Insurance Law is also being amended to allow the state-owned insurer to form partnerships and joint-ventures with local and foreign entities if necessary.

At the organisational level MI is in the process of restructuring, which includes introducing new positions and new departments, and has sent its plans to the government for approval. The insurer also reports it is working on developing new products to suit the local market with foreign development partners from Japan, Australia and Malaysia. Some of these will be focused on agriculture, and could include crop and weather index insurance. MI expects to begin bringing out new products in 2018.

The insurer is also working with the MIA to collaborate on a countrywide education campaign to raise awareness and understanding of insurance.

MI's approach to reinsurance is also changing. Until December 2017, the insurer transferred the vast majority of insurance risk off its books to international reinsurers. From January 1 2018, however, MI reports it has been retaining up to 30% of insurance policies it writes for a value up to $8m, as mandated by the IBSB.

This is likely to have an implication for some brokers, because their fees are often a percentage of the policy. The larger share that MI retains, the smaller their contract fee is.

The state-owned insurer said that this 30% retention is partly in preparation for local insurers being allowed to conduct reinsurance on their own. Under this plan, a private insurer would be able to find its own reinsurer for 70% of the risk, while MI will reinsure the other 30%.

This arrangement has been anticipated for several years. Law firm Clyde & Co reported in 2013 that the Ministry of Finance was evaluating the 30%/70% split between the state-owned and foreign insurers.

The state-owned firm still has a monopoly on 14 products, though private insurers are theoretically free to apply to the regulator for permission. The state-owned insurer expects to see private firms expand into these remaining product lines. The only product that MI expects to retain a monopoly on in the medium term is third-party liability.

Investment options, data and regulatory capacity are by no means the only issues the insurance industry faces

Credit Guarantee Insurance

Myanma Insurance offers CGI allowing commercial banks to lend to SMEs without collateral [see Banking chapter]. A drafting committee is in the process of creating a dedicated Credit Guarantee Corporation Law, and it is unclear whether the government will continue to allow CGI through a dedicated entity like Myanma Insurance or allow private insurers into this market.

Challenges

Investment options, data and regulatory capacity are by no means the only issues the insurance industry faces. The regulatory regime on products and pricing has made expansion difficult, but local insurers uniformly point to historic and cultural reasons for why insurance is not popular in Myanmar.

This includes a general lack of familiarity with the concept of insurance and the benefits of transferring and managing risk, which is understandable given recent history. Foreign insurers eyeing the market say that in order to begin operating, a new insurer will have to address both the limited distribution and sales channels, and the population's limited awareness of insurance products.

Decades of state monopoly has contributed to a lack of human resources and skilled insurance professionals at all levels. The MIA's plans to train and license sales agents is a positive step. But specialised insurance professionals such as actuaries will have to be recruited from abroad, which local insurers say will present a significant expense. An international standard risk-based capital framework will require IT systems that most insurers do not yet have in place, and could be financially challenging for smaller firms.

MI executives add that if Myanmar was to receive a sovereign credit rating then this could be used as a benchmark in the insurance industry. Private and foreign insurers agree this could be useful and would help "level the playing field", but that it is low down the hierarchy of needs.

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