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Myanmar's Banking Sector in Stormy Waters

Staying on the reform course before
and amidst COVID-19 crisis



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On behalf of

the German Federal Ministry for Economic Cooperation and Development (BMZ)

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Reliability and consistency of data

Data in Myanmar is scarce, not always reliable, and inconsistent. This holds especially true for the financial sector. Most financial institutions do not publish their annual reports or disclose data. Transparency is, however, increasing, as are the efforts towards improving disclosure of financial data. Since December 2016, the Central Bank of Myanmar publishes key banking data in quarterly reports. Legal reforms that are being implemented are, furthermore, intended to help ensure a consistent application of international financial reporting standards.

This report uses data from official Myanmar sources, international organizations, and individual financial institutions. Additionally, the GIZ has conducted surveys and interviews with national and international finance experts and representatives of the Myanmar financial industry. Whenever data is presented, the source is clearly stated. The GIZ, nevertheless, cannot guarantee the accuracy of this data. Most data should be treated carefully.

The GIZ in Myanmar

The Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH is a German federal enterprise that supports the German government in international cooperation for sustainable development via technical advice and capacity development. GIZ provides its services in over 120 countries with more than 22,000 staff members worldwide. For over 50 years, our diverse expertise has been applied to areas including economic development and employment promotion, energy and environment, and peace and security. Together with our partners in national governments worldwide and cooperation partners from the worlds of business, research and civil society, we work flexibly to transform ideas into concrete plans and implement them, offering people better prospects and sustainably improve their living conditions.

GIZ Myanmar works from the grassroots up to our embedded presence in government. We aim to align private and development goals to support the creation of a harmonious society and inclusive, sustainable economic growth. Transparent, neutral and partner-centered, we are recognized for our technical expertise and strategic approach.

We focus on three interconnected thematic areas:

- GIZ Business
- GIZ Skills
- GIZ Food & Nutrition

Our work is funded by the German and other national governments, the European Union and the private sector.

The GIZ Banking and Financial Sector Development (BFSD) Program in Myanmar falls under the GIZ Business thematic area. It started in autumn 2012 and is financed by the German Government. The current project will continue until March 2021. It is based on four complementing pillars:

1. GIZ supports the Central Bank of Myanmar (CBM) in creating, enforcing and promoting stable framework conditions for banks. This includes the support of human capacity development within the CBM as well as offering it specific technical advice.
2. GIZ supports Myanmar key stakeholders in strengthening the legal framework and the enforcement of adequate standards in the area of financial reporting and auditing. This includes the support of human capacity development of the relevant stakeholders, such as the CBM, the Banks and Monetary Affairs Development Committee of the Lower House of the Myanmar Parliament, the Myanmar Accountancy Council (MAC), the Office of the Auditor General (OAG), and the Myanmar Institute of Certified Public Accountants (MICPA).

-
3. GIZ supports training providers for the banking sector in the development of human resources in the banking industry. In this context, the GIZ assists in the development of adequate and demand-oriented qualification and training measures at the Yangon University of Economics. Furthermore, the GIZ facilitates cooperation and the exchange of information concerning human capacity development among Myanmar banks.
 4. GIZ supports the banking industry directly in developing adequate structures, processes, and products for SME finance and the application of International Financial Reporting Standards (IFRS). Two Myanmar partner banks are being supported by the GIZ in the development of tailor-made financial services for SMEs, with the goal of increasing their respective SME-loan portfolio, and three Myanmar partner banks have been supported to implement financial reporting standards.

For more information, please visit <https://www.giz.de/en/worldwide/17772.html>



Acknowledgement

The year 2020 was a challenge for us all. With the outbreak of the Covid19-pandemic crisis countries were hit in an unpredictable way. The economies have dropped sharply and governments made their utmost efforts to stabilize national economies. In Myanmar, which is amid the transition process to liberalize its economy and its finance sector, it became a difficult task to successfully maneuver through these stormy times. This report, now in its fifth edition, took emphasis on the year 2020 but also kept a view of the development over the past two years since our last report has been launched in December 2018. We want to take this opportunity to thank everyone who has contributed to our fifth edition of the Myanmar Banking Report. It was a joint and fruitful effort with valuable contributions from many experts and institutions.

Firstly, we would like to express our gratitude to the Central Bank of Myanmar, the Yangon University of Economics and the wider Myanmar banking community for their inputs and comments. Furthermore, we want to thank Dr. Klaus Maurer, Former Chairman of the Board at Finance in Motion and senior consultant based in Berlin who is an expert with deep insights of the financial sectors in the ASEAN region; in the last chapter of this report headlined “Outlook” he provided his discerning opinion about the future of the Myanmar banking sector and necessary steps to be taken for its transformation. Staff members of the GIZ Banking and Financial Sector Development (BFSD) Program, namely Mr. San Thein, Ms. Htay Htay Aye and Ms. Kyi Tha Maw conducted thorough research for the report and put their findings into intelligible words. In addition, Ms. Ei Ei Phyu, Ms. Phyu Phyu Baw, Ms. Chue Wai Phyo and Mr. Eliab Figueroa performed much of the supporting analysis for the report. Our great thanks go to the editor of this report, Mr. Helmut Grossmann. With his profound knowledge of the Myanmar banking sector he helped us with his comments to achieve a comprehensive overview of the current situation of the Myanmar finance sector.

To all of them and those who remain unnamed, working in the background on so many different tasks that must be completed to publish a sound report, we say a big THANK YOU!

ကျေးဇူးတင်ပါတယ်



Armin Hofmann
GIZ-BFSD Program Director

Foreword

Myanmar is amid turbulent times. Since 2012 the country has started to transform its political and economic system. The recently held elections on 8 November 2020 have confirmed the strong will of the Myanmar people to move on with this transformation process by providing a clear mandate to the present Government under the lead of the NLD.

Indeed, with the outbreak of the Covid-19 pandemic in early 2020 – in addition to the political repercussions in the aftermaths of the Rakhine crisis – the implementation of the Government’s reform agenda was constrained. The economy was hit hard, in particular by travel and trade restrictions. In April 2020 the Myanmar Government responded quickly with the Covid-19 Economic Relief Plan (CERP). Despite the limited resources available, a massive loan program with reduced interest rates was provided for small and medium enterprises (SME) in the agriculture and service sectors as well as for light manufacturing. This immediate and very helpful support was highly welcomed by the local business community. However, it also created additional risks for the stability of the financial sector. The Ministry of Planning, Finance and Industry as well as the Central Bank of Myanmar (CBM) need to monitor their efforts for recovery of the economy and at the same time assure that the transformation process of the financial sector will not be derailed.

Despite the ongoing crisis the Myanmar Government continues with its reform agenda. With the merger of the Myanmar Economic Bank (MEB) and the Myanmar Agriculture Development Bank (MADB) it has already taken the necessary steps to consolidate the state-owned banks. Moreover, the financial sector has been further opened to foreign investors and the insurance sector has been liberalized to some extent by allowing foreign companies to offer life insurance products and general insurance companies to buy stakes in local insurances. Furthermore, financial institutions have entered the transition to International Financial Reporting Standards (IFRS) and the Central Bank of Myanmar has set up a clear timeline in order to get all the banks to meet the IFRS regulations by the end of the fiscal year 2023.

In these difficult times support to the SME sector – the engine of growth of the Myanmar economy – is essential. Since 2012, GIZ has been providing substantial development assistance to this sector in the country. With its private sector support program, GIZ will be committed to continue this assistance for another three years. In addition, GIZ will continue to support the Financial Institutions Supervision Department of the CBM to achieve the reporting requirements for commercial banks and help to build a sound financial sector. GIZ will also carry on with assistance to the Yangon University of Economics (YUE) to enhance academic and post-graduate skills for the banking industry. The ongoing support of GIZ to the Myanmar Parliament with its Banking and Monetary Affairs Development Committee (BMADC) will also help to facilitate the process of legislative reforms needed for the transformation agenda.

This report, now in its fifth edition, focuses on reform and relief efforts before and during the Covid-19 pandemic crisis and the impact of the transformation agenda on the banking sector. It provides an updated overview of the sector's statistics, regulatory framework and status of regional integration based on data from a variety of sources. The report seeks to fill an important information gap as data is precious and notoriously scarce in Myanmar and the financial sector particularly stands out for its discreteness. The final chapter of this report endeavors to provide an outlook elaborated by the senior analyst Dr. Klaus Maurer who has ample insights into the finance sectors of the ASEAN region.

We see this report as a foundation for improving disclosure of financial information in Myanmar. We are confident that the stakeholders in the financial sector will build on our findings for a stable and prosperous economy.



Dr. Petra Mutlu
Country Director, GIZ Myanmar

Abbreviations and Acronyms

AAT	Association of Accounting Technicians	EU	European Union
ABIF	ASEAN Banking Integration Framework	EUR	Euro
ACCA	Association of Chartered Certified Accountants	FATF	Financial Action Task Force
AGD	Asia Green Development Bank	FDI	Foreign Direct Investment
AMC	Asset Management Company	FFMs	Form Filling Machines
AML	Anti-Money Laundering	FISD	Financial Institutions Supervision Department
ASEAN	Association of Southeast Asian Nations	FPB	First Private Bank
ATM	Automated Teller Machine	FRD	Financial Regulatory Department
AYA	Ayeyarwady Bank	FSV	Forced-Sale-Value
AYB	Asia Yangon Bank	GAP	Good Agricultural Practices
BCGE	Business Coalition for Gender Equality	G Bank	Glory Farmer Development Bank
BMADC	Banking and Monetary Affairs Development Committee	GDP	Gross Domestic Product
BFRIC	Banking Sector Reporting Standards Implementation Committee	GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
BFSB	Banking and Financial Sector Development	GTB	Global Treasure Bank
CB	Co-operative Bank	HR	Human Resources
CBM	Central Bank of Myanmar	IASB	International Accounting Standard Board
CCI	Chamber of Commerce and Industry	IBFT	Inter-bank Fund Transfer
CEO	Chief Executive Officer	IBSB	Insurance Business Supervisory Board
CERP	COVID-19 Economic Relief Plan	IFC	International Finance Corporation
CFA	Chartered Financial Analyst	IFRS	International Financial Reporting Standards
CFT	Combating of the Financing of Terrorism	IMF	International Monetary Fund
CHIDB	Construction, Housing and Infrastructure Development Bank	INNWA	Innwa Bank
CMLL	Control of Money Laundering Law	ISA	International Standards on Auditing
CMP	Cut-Make-Pack	IT	Information Technology
COO	Chief Operating Officer	JICA	Japan International Cooperation Agency
COVID-19	Corona Virus Disease 2019	KBZ	Kanbawza Bank
CPA	Certified Public Accountant	KfW	Kreditanstalt für Wiederaufbau
CSO	Central Statistical Organization	LCCI	London Chamber of Commerce & Industry
CRM	Cash Recycling Machine	MAB	Myanmar Apex Bank
DHT	Directorate of Hotels and Tourism	MAC	Myanmar Accountancy Council
DICA	Directorate of Investment and Company Administration	MADB	Myanmar Agricultural Development Bank
DISI	Directorate of Industrial Supervision and Inspection	MBA	Myanmar Banks Association
		MBF	Master of Banking and Finance
		MCA	Myanmar Coffee Association



MCB	Myanmar Citizens Bank	NIM	Net Interest Margin
MD Bank	Mineral Development Bank	NLD	National League for Democracy
M&E	Monitoring and Evaluation	NOP	Net Open Position
MEB	Myanma Economic Bank	NPL	Non-Performing Loans
MERRP	Myanmar Economic Recovery and Relief Plan	NDB	Nay Pyi Taw Development Bank
MFI	Microfinance Institution	OAG	Office of Auditor General
MFRS	Myanmar Financial Reporting Standards	OMO	Open Market Operation
MFS	Mobile Financial Service	ORB	Offshore Remittance Business
MFSP	Mobile Financial Service Provider	ORM	Organic Roots Myanmar
MFTB	Myanma Foreign Trade Bank	PIE	Public Interest Entity
MFVP	Myanmar Fruit, Flower and Vegetable Producer and exporter association	POS	Point Of Sale
MIB	Myanmar Institute of Banking	PUM	Passbook Update Machine
MICB	Myanma Investment and Commercial Bank	QM	Queue Machine
MICPA	Myanmar Institute of Certified Public Accountants	RDB	Rural Development Bank
MIFER	Ministry of Investment and Foreign Economic Relations	REER	Real Effective Exchange Rate
MMB	Myanmar Microfinance Bank	RFDA	Regional Farmers Development Association
MMK	Myanmar Kyat	RoA	Return on Assets
MNOs	Mobile Network Operators	RoE	Return on Equity
MNTH	Myanmar National Telecom Holding Public Ltd.	RTGS	Real Time Gross Settlement
MOB	Myanmar Oriental Bank	SAFI	Sustainable Aquaculture and Food Quality Initiative
MoC	Ministry of Commerce	SCPL	Seasonal Crop Production Loans
MOLIP	Ministry of Labour, Immigration and Population	SME	Small and Medium Enterprise
MOPFI	Ministry of Planning, Finance and Industry	SMEDB	Small and Medium Enterprises Development Bank
MPT	Myanma Posts and Telecommunications	SOB	State-Owned Bank
MPU	Myanmar Payment Union	STM	Smart Teller Machine
MSA	Myanmar Standards on Auditing	SWIFT	Society for Worldwide Interbank Financial Telecommunication
MSDP	Myanmar Sustainable Development Plan	TCB	Tun Commercial Bank
MSME	Micro, Small and Medium Enterprise	TOT	Training of Trainers
MTB	Myanmar Tourism Bank	TSL	Two-Step-Loan
MWD	Myawaddy Bank	UAB	United Amara Bank
MySFA	Myanmar Sesame Farmers Association	UNCDF	United Nations Capital Development Fund
NAG	Network Activities Group	USD	United States of America Dollar
NBFI	Non-Bank Financial Institution	YCB	Yangon City Bank
NGO	Non-Government Organization	YNDB	Yadanabon Bank
		YOMA	Yoma Bank
		YUE	Yangon University of Economics

Executive Summary

Chapter 1 – Introduction

Myanmar is a lower middle-income economy with strong economic growth over many years, which also translated into substantial poverty reduction. Nevertheless, the country is still considered one of the least developed nations in the world.

The Myanmar economy is severely affected by the COVID-19 pandemic. The World Bank estimates that Myanmar's GDP growth rate will fall from 6.8 percent in FY 2018/19 to 0.5 percent in FY2019/20. Low-income households and micro, small and medium enterprises (MSMEs), in particular, are the hardest hit.

The Myanmar government released the COVID-19 Economic Relief Plan (CERP) in April 2020 to mitigate the economic impacts posed by the corona crisis. According to the CERP, several relaxations in the banking regulations have been made as part of the economic stimulus program together with supporting funds allocated to ease the impact of the pandemic on both businesses and banks.

The impact of the current crisis adds to the longer term and systemic challenges in the Myanmar banking sector, which struggles to fulfil its role as a fully-fledged financial intermediary. Banks have grown rapidly in size during the last decade but, of course, the momentum of growth is now slowing down due to the economic impact of the COVID-19 pandemic.

Chapter 2 – Regulatory and Supervisory Framework

Since the Financial Institutions Law came into effect in 2016 the Central Bank of Myanmar (CBM) issued some remarkable regulations and directives in order to upgrade the local banking system which would match international standards, while the private banks had to make painful adjustments to meet the requirements demanded by these regulations and directives.

In order to further develop the financial sector, the government of Myanmar is currently engaged in an on-going process of drafting and enacting new laws, notably the Foreign Exchange Management Law, the Insurance Business Law, the National Payment System Law, and the Secured Transaction Law. In 2019 and 2020 the Central Bank of Myanmar (CBM) issued various regulations and directives to further promote the banking sector. However, most of the directives released in 2020 intend to mitigate the worst effects of COVID-19 on the economy.

In the course of the year 2020, the CBM reduced the key annual interest rates three times to strengthen the economy. As of November 2020, the CBM rate stands at 7%, the minimum deposit rate 5%, the maximum collateralised lending rate 10%, and the unsecured lending rate 14.5%. The CBM also temporarily lowered the minimum reserve requirement from 5% to 3.5% of total deposits until 31 March 2021, and allowed banks to calculate the liquidity ratio with 90% of the total value of treasury bonds having a remaining maturity of over one year, instead of 50%. In addition, the CBM extended the date for meeting the requirements of four key regulations issued in 2017. Hence, the deadline for full compliance



with prudential regulations on capital adequacy, NPL, liquidity ratio and large exposure limit is extended by three years until 31 August 2023. Furthermore, the IMF provided some emergency funding to the Myanmar government in response to the crisis and suggested CBM to monitor the NPL of banks and consider a comprehensive NPL resolution strategy.

In its efforts to open the local banking market, the CBM allowed foreign equity ownership of up to 35% in licensed banks in January 2019, and announced a third round of foreign bank licensing applications for branch or subsidiary licenses in November 2019.

With the aim to expand the local credit market and create more housing for a growing population, the CBM permitted the local banks in 2019 to allocate 5% of their total loan portfolios towards mortgages exceeding three years.

In January 2019, the CBM issued the Subordinated Debt Directive, which allows banks to include subordinated debts in the supplementary capital or Tier 2 capital up to a maximum 50% of Tier 1 capital, provided the subordinated debt meets the eligibility criteria of this directive.

In January 2019, the CBM also allowed the banks with Authorized Dealer Licenses to conduct international settlements in Japanese Yen and Chinese Yuan denominations. This directive intends to reduce the sole reliance on the US Dollar in trade, to attract more foreign direct investments (FDI) and promote exports. One month later, the CBM issued a directive that obliges the banks with Authorized Dealer Licenses to maintain not more than 20% of core capital of long or short positions of any foreign currency in order to avoid liquidity shortage problems.

In February 2019, the CBM announced that starting on the next day the daily Reference Exchange Rate based on transactions in the foreign exchange market will be published daily on its website at 4:00 pm. This new system replaces the old approach of the CBM, which used the previous working day's weighted average rate to set the reference rate and therefore caused a misalignment when there were long holidays.

In order to strengthen corporate governance in the banking sector CBM issued five detailed directives in March 2019. The directives cover related-party transactions, regulations that bank directors shall follow, fit and proper requirements for bank directors and senior officials, having internationally recognized external auditors, and the acquisitions of substantial interests.

In their effort to curb money laundering, the CBM issued regulatory guidelines and instructions to enforce the Control of Money Laundering Law (CMLL 2014). In November 2019, a directive on Customer Due Diligence related to anti-money laundering and counter financing of terrorism was issued. In the same month, a notification was released to reduce illegal cross border remittances. Nevertheless, Myanmar was once again put on the "grey list" of the Financial Action Task Force (FATF), the global money laundering and terrorist financing watchdog, in February 2020, because of the failures in effectively controlling money laundering. In May of that year, the country was also put on the European Union's money laundering blacklist.

The CBM is carrying out the task of bank supervision through a "risk-based supervision" approach in order to ensure a safe and sound banking system. However, the full implementation of this approach will take many more years since CBM faces various challenges, in particular a lack of skilled employees.

Myanmar has decided to adopt the International Financial Reporting Standards (IFRS). In July 2018, the Myanmar Accountancy Council (MAC), the regulatory body for accounting and auditing standards in Myanmar, issued the Notification No. 18/2018 and 19/2018 for the adoption of IFRS and IFRS for SMEs. It is therefore mandatory for all Public Interest Entities and Small and Medium Enterprises to follow the International Financial Reporting Standards (IFRS) by the fiscal year 2022/23. Likewise, all auditors have to follow the International Standard on Auditing (ISA) by that time. While currently facing challenges – such as meeting prudential requirements, high NPL ratios and low profitability – banks can tangibly benefit from a transition to IFRS. For instance, bank data will become more reliable and transparent, and it can support management’s decision-making; also, banks will be in a better position to attract more investments, including international investors.

Chapter 3 – The Myanmar Banking Sector

Since 2010, the banking sector is one of the key reform areas of the Myanmar government. After 2015, significant reforms have been put on track to be in line with international standards, including accounting systems, digital banking and financial inclusion for both, SMEs and unbanked people. The development of the banking system is considered a driving force for economic growth in Myanmar.

Although Myanmar’s banking sector has achieved fast growth during the past decade, it remains small both in terms of financial intermediation and inclusion compared to its neighboring countries and other ASEAN member states. For example, credit to the private sector stood at 26% of GDP in 2019, one of the lowest values in the region.

Myanmar’s banking sector today consists of four state-owned banks, 27 domestic private banks, 13 foreign bank branches, and 46 representative offices of foreign banks. As of December 2019, total bank assets amounted to 72 trillion MMK. Asset growth rates since 2012 have been impressive but volatile. Private banks account for roughly 60% of total bank assets, 69% of total deposits and 81% of total loans, reflecting their strong growth in recent years and dominant market position.

The market share of state-owned banks (SOBs), on the other hand, has decreased sharply over the past years. Nevertheless, SOBs still play an important role: MEB remains strong in SME lending, and MADB is the main provider of farmer loans. One of the strengths of the SOBs is their nation-wide outreach, especially in rural areas. In December 2019, the loans issued by SOBs to the agricultural sector amounted to over 70% of their total loans, while private banks held only about 2% of their outstanding loans in that sector.

Despite recent improvements, SOBs urgently need to be reformed to improve their financial performance and raise their competitiveness. They need to increase their loan-deposit-ratios, reduce NPL and focus on digitalization to make operations more efficient. The lack of skilled employees and poor corporate governance are key impediments to be overcome. The Ministry of Planning, Finance and Industry (MoPFI) is in the process to merge the four SOBs that have similar business scopes to facilitate more loans for micro, small and medium enterprises (MSMEs) and farmers. As a first step, MEB and MADB are going to merge to promote farmers’ access to finance.



Asset concentration in the private banking sector is high. In the FY 2018/19, the three largest banks held almost two thirds of total private banks' assets, while the top six practically made up the total market. In light of this situation, Myanmar might be considered overbanked because of the large number of small private banks; in contrast, the country has a low rate of financial inclusion with 74% of the population un-banked in 2019. Banks are highly concentrated in Yangon and Mandalay where most businesses are located.

Total loans of private banks amounted to 24.42 trillion MMK in December 2019. Between December 2012 and December 2019, the amount increased about eightfold. With 27%, the trading sector accounts for the largest share of loans, followed by construction (19%) and services (17%); agriculture (2%) and housing (1%) make up the rear of the growth.

Since the opening up of the economy in 2010, private banks took advantage of a booming private sector. However, a number of restrictions still hinder banks to increase their lending activities. In a fixed interest rate environment like Myanmar banks cannot price in their risks and hence tend to over-rely on "hard" collateral or generally restrict their lending. Following this logic, in December 2019 nearly 80% of collateral used to secure loans in Myanmar were land and buildings. This makes banks vulnerable to large losses in values of these properties and excludes those that do not own adequate assets from access to bank loans – such as most SMEs and private households.

Despite high collateral requirements the private banking sector of Myanmar is allegedly plagued by high NPL rates. One third of the banking sector's overdraft facilities might be considered bad loans under the CBM's strict regulations issued in 2017. Some banks may even face the risk of capital insufficiency and insolvency. Considering these problems, the relaxation of banking regulations in response to the COVID-19 crisis appears rather dangerous regarding the stability of the banking sector and the overall economy.

The local banking market has been opened gradually to foreign banks. Seven banks from various Asian countries were granted preliminary subsidiary or branch licenses in April 2020. As of September 2020, there are 13 foreign licensed banks and 46 representative offices of foreign banks in Myanmar. Since November 2018 foreign banks are allowed to engage in whole-sale banking permitting to lend to domestic businesses in foreign currency and in local currency in the forms of syndicated loans through a local bank. Other restrictions on foreign banks, however, are still in force, for example, not being allowed to accept immovable property – like land and buildings – as collateral. They are also not allowed to offer retail banking services, such as personal savings accounts, money transfers and card services, as well as fixed deposit accounts in local currency.

In January 2019, the CBM permitted that domestic private banks can accept an equity investment of up to 35% from foreign financial institutions. Accordingly, a significant movement can already be found in the banking sector. As of December 2019, foreign banks held over 11% of total assets, about 8% of total deposits, and 6% of total loans of Myanmar's banking sector. It is expected that these figures will soon increase as more foreign investments enter the country. This will facilitate knowledge transfer and the application of international best practices in the domestic banking sector. However, there is also a potential risk that domestic banks are not strong enough to withstand competition from foreign banks.

The supporting infrastructure for Myanmar banks is developing at a fast pace. This includes institutions like the Myanmar Banks Association, the Myanmar Payment Union and the emerging Myanmar Credit Bureau Limited, as well as numerous bank training and education providers such as the Myanmar Institute of Banking (MIB) and the Yangon University of Economics (YUE).

The fast growth of the banking sector translates into a huge demand for finance education and bank training. Several private training providers have been established to add to the rather low supply of university degree programs. However, the current supply of training is still not sufficient to meet the future needs of the sector. Moreover, ensuring the quality of offered programs remains a challenge as long as there are no national quality standards set by the respective authorities.

Chapter 4 – Services of the Banking Sector

The Myanmar banking sector offers an increasing variety of services. In terms of commercial lending, however, it still largely relies on overdrafts and loans secured by land or buildings. In late 2017, the CBM issued a directive that encourages banks to offer unsecured and partially secured credit facilities based on the expected cash-flow of a borrower, with the condition that banks establish proper credit risk management systems. While some progress can be seen in that respect, land and buildings as credit security still accounted for 77% of collateral in December 2019 – coming down from almost 90% in December 2017.

In 2017, the CBM instructed private banks to convert overdrafts to maximum three-year term loans and reduce the share of overdrafts in their portfolios to 20% by July 2020. Yet, it is estimated that overdraft facilities still contributed 70% of total private bank loans in December 2018 and there are concerns that many big companies are technically in default on their overdrafts. Furthermore, it must be assumed that the NPL ratio of the Myanmar banking sector is on the rise due to the severe impacts of the COVID-19 crisis.

Besides commercial lending Myanmar banks also offer various other loan products. Home loans experienced significant growth in recent years. Some banks started to provide short term as well as medium and long term project finance for companies on government contracts. Several financial institutions now offer invoice financing, also known as distributor finance. The technology companies Kyopay and Shwelan introduced digital invoice discounting platforms to the country.

Although the small and medium enterprise (SME) sector is considered the backbone of the Myanmar economy most SMEs still face difficulties to obtain formal financing. While the total SME loan volume of all SOBs and private banks in Myanmar increased from MMK 30 billion in December 2017 to over MMK 1,000 billion in December 2019, SME loans only make up 4.21% of the total loan portfolio of the Myanmar banking sector.

Due to the long tradition in collateral-based lending, the transition to risk and cash flow-based lending poses a challenge for the local banks. Large investments in human resources, product development and banking infrastructure are required. Regulatory encouragement from the CBM and financial and technical assistance to the banking sector – such as the JICA Two-Step-Loan (TSL) scheme and the SME lending program of the German KfW Development Bank – will not suffice to make a significant



improvement to SME financing in Myanmar. The capacities and financial management skills of SMEs also need to be improved to make them more “bankable”.

Agricultural finance is another area that urgently needs to be developed in Myanmar. While 70% of the country's population lives in the rural areas contributing about two third of the total employment, low income households and small enterprises in rural areas are rarely served by commercial banks due to the unpredictability of natural disasters and commodity price fluctuations. The state-owned Myanmar Agricultural Development Bank (MADB) is the largest agricultural lender of the country, providing seasonal crop production loans and term loans to farmers. However, farmers usually have to pledge formal land titles as loan collateral.

The Japanese development agency JICA and the state-owned MEB also make available agricultural loans under the Two-Step-Loan (TSL) scheme. Moreover, there are currently various pilot projects in agricultural finance, experimenting with unsecured farmer loans and weather index-based crop insurance. A few private banks have ventured into the agri-business sector, offering equipment finance, seasonal crop loans, contract finance, post-harvest loans for processors and local and international traders, input finance, payable and receivable finance, agricultural inventory discounting and pledge loans.

Trade finance is a service that is relatively new to the Myanmar banking sector. Today, many local banks offer fee-based services such as letter of credit, bank guarantees, and interest-bearing services including import financing and pre and post shipment export financing. Competition is stiff and banks often lack adequate human resources, IT capacities and risk management. Although foreign banks are permitted to conduct export and import trade financing they still face difficulties in serving local trade companies because these firms rarely have reliable and standardized financial records and statements. Moreover, the lack of credit bureau information makes it difficult for foreign banks to assess the creditworthiness of local traders. Since the beginning of the COVID-19 crisis in March 2020, declining international trade transactions and the fluctuations of the oil price have badly affected all banks' trade financing services.

Many Myanmar banks offer deposit services – fixed deposits, call deposits and current accounts. Deposit products are often tailored to serve different customer segments' needs, for instance, children's savings account, senior citizen savings account, wedding deposit account or foreign currency account. From FY 2014/15 to FY 2019/20 total bank deposits in the Myanmar banking sector increased nearly three times, with saving deposits contributing the bulk of total deposits.

Domestic and international remittances play a crucial role for Myanmar's economy and in particular for poverty alleviation. More than 5 million Myanmar nationals live abroad and regularly send back money to their families. In 2019, they remitted about USD 24 billion (3.2% of Myanmar's GDP). Today, Myanmar banks offer domestic inter-branch and inter-bank remittance services, telegraphic transfer and international fund transfer by SWIFT Code through corresponding banks, and international transfer through third party remittance service providers such as Moneygram or Western Union. Recently, there have been significant improvements in domestic remittance services by local banks through their e-banking and mobile payment platforms. Recent years have also seen some relaxations on outbound remittance restrictions, especially with third party remittance providers. While there are more options for international remittances in Myanmar these days, people still heavily rely on informal channels called 'hundi'. Increasingly, banks also face fierce competition from Mobile Financial Service Providers (MFSPs) such as OK Dollar and Wave Money.

Card services and digital finance are rapidly penetrating the market. Since the Myanmar Credit Bureau is still in the process of establishment, banks tend to issue credit cards only to their existing customers.

In 2016 the CBM, with the support of JICA, launched the Real Time Gross Settlement (RTGS) system, popularly known as CBM-Net. It provides a platform for large interbank payment transactions, including interbank trading in currencies and securities. It will help shifting from traditional cash-based to electronic cashless payment and settlement system. On November 16, 2020, CBM-Net 2, an updated version of CBM-Net was launched. It can work 24/7 for interbank transaction done in MMK as well as to handle large payrolls and utility bills. Very recently, Myanmar Payment Union (MPU) developed an inter-bank fund transfer (IBFT) service, which facilitates money transfers between banks.

Considering the huge unbanked population in Myanmar and the rapidly increasing number of mobile phones in the country, mobile financial services have become an important means for financial inclusion. Many private banks have launched mobile banking services and there are five licensed mobile financial service providers (MFSP), including Wave Money, today's largest MFSP in the country with more than 604,000 agents connecting to over 27 million customers.

MFSPs in Myanmar have proven to be very innovative and rapidly expanded their networks. Mobile financial services are extended to various functions including bill payments, commercial and business payments, e-shopping and donations. MFSPs also have established linkages to banks' e-banking platforms. Moreover, they try to provide their services to the agricultural sector. During the COVID-19 crisis MFSPs play a crucial role in delivering branchless financial services to customers, thereby increasing financial inclusion in the country. However, competition among MFSPs is tough and product differentiation becomes increasingly difficult for them.

Bancassurance is the latest addition to the financial services spectrum of Myanmar. It is a mutually beneficial partnership between an insurance company and a bank or a Microfinance Institution (MFI). The bank or MFI can earn additional revenue by selling insurance products to its clients while the insurance company gets access to a broader client base and can make sales promotion of its products more effective.

Chapter 5 – The Regional Perspective

Despite its rapid development, the Myanmar banking sector still remains the smallest market when compared with other Southeast Asian nations. Moreover, the profitability of Myanmar banks is comparatively weak and they face serious competitiveness challenges as foreign banks are gradually welcomed into the local market.

The performance and profitability of Myanmar banks is weak, both compared to other countries in the region as well as to other lower middle-income countries in the world. Net Interest Margin (NIM) was 2.91% in 2017; Return on Assets (RoA) averaged 0.36% in the third quarter of 2019; and the average Return on Equity (RoE) in the same time period was only 5.07%. The sector's low cost efficiency is expressed in a relatively high Cost-Income Ratio (approximately 80% in 2017).



A fixed interest environment limits the banks' potential profit margins and hinders them from increasing their lending activities. The notably low NIM ratio is also likely the result of high rates of defaults on interest payments. Improvements in banks' risk management might, therefore, be a precondition for interest rate liberalizations to be viable. In general, the banks' assets are not efficiently used to generate profits, as reflected by a comparably low RoA. Apart from a non-optimal use of deposits to create interest income, the low profitability of Myanmar banks also stems from high operational costs, primarily caused by the banks' vast networks of partly inefficient branches.

In terms of access to finance Myanmar is also at the rear in a regional comparison. The IMF's Financial Development Index for Myanmar shows that the country's financial institutions have slightly improved in terms of financial access, depth and efficiency during the period 2010 to 2018, but still lag far behind most of their ASEAN counterparts. Despite fast growth during the past decade, credit to the private sector stood at approximately 26% of GDP in 2019, one of the lowest values in the region. While Myanmar is recognized as among the top 20 improvers in the World Bank's Ease of Doing Business Index 2020, access to credit remains a major obstacle for businesses. One notable hurdle for better access to finance in Myanmar is the poor banking infrastructure, especially in rural areas.

Financial sector integration under the ASEAN Banking Integration Framework (ABIF) is scheduled to begin in 2020. Myanmar has to implement various measures to accelerate its integration into the ASEAN banking environment. While there are many potential benefits from integration – especially increasing trade and investment – the required reforms will most likely also be painful for most Myanmar banks. An effective regulatory framework and the improvement of the financial sector infrastructure including the efforts of all financial institutions are the crucial factors to reduce the gaps between the country's banking sector and its ASEAN counterparts.

Chapter 6 – Myanmar and the COVID-19 crisis

The outbreak of COVID-19 in early 2020 has prompted the Myanmar authorities to take immediate actions. In an attempt to secure people's livelihoods, the government has taken a bold step by launching the national COVID-19 Economic Relief Plan (CERP) on 27 April 2020. This plan consists of 7 Goals, 10 Strategies, 36 Action Plans and 76 Actions, covering a broad range of extraordinary monetary and fiscal measures.

In a further step, envisaging the COVID-19 crisis would be over soon, the Myanmar government has recently launched the Myanmar Economic Recovery and Relief Plan (MERRP) for the post-COVID-19 period. MERRP is an extension of the CERP and sets out a recovery plan aimed at rebuilding the economy over the long run. It will thus serve as a bridge between the CERP and the Myanmar Sustainable Development Plan (MSDP).

On 13 March 2020, the Myanmar government formed the COVID-19 Working Committee. Its main purpose is to alleviate the impact of COVID-19 on the trade and tourism sectors, to create new jobs for workers laid off due to the closure of factories and to provide them with vocational training, to find ways of procuring raw materials for the garment industry, to cooperate with the private sector to

establish a proper supply chain for the weaving, knitting, dying and sewing industries, to find ways for alleviating tax and other relief measures for MSMEs, and to provide cheap loans to the businesses affected by the pandemic. The Working Committee is also responsible for the development of the MERRP Monitoring Framework and for regular reporting on progress to the National-Level Central Committee on Prevention, Control and Treatment of COVID-19.

On 14 March 2020, a Task Force was formed under the Working Committee to oversee the disbursement of cheap loans to business entities badly hurt by the impact of COVID-19. The government allocated an initial capital of MMK 100 billion for the COVID-19 Fund to provide one-year working capital loans at an annual interest rate of 1.0% to severely affected businesses owned by Myanmar citizens. Garment enterprises, hotel and tourism services and SMEs were designated as priority sectors. The first tranche of the COVID-19 Fund was disbursed to 3,393 enterprises; almost 70% of the funds went to 2,550 restaurants and MSMEs including production and services enterprises, while more than 15% was disbursed to 340 hotels. The second tranche of another MMK 100 billion was disbursed to 2,241 affected businesses engaged in food processing (1,570), livestock breeding (182), import-substitution (153), and various other industries including marine products, exporters, agriculture, overseas job agencies and vocational training schools.

According to the CERP, the Central Bank of Myanmar was assigned to take relevant monetary measures to improve the macroeconomic environment through monetary stimulus – a kind of quantitative easing to quickly increase the domestic money supply and spur the economic activities. Significant measures that have an immediate effect on the banking sector are: (1) lowering interest rates, (2) lowering maximum reserve requirement, (3) relaxing the calculation of the liquidity ratio, and (4) postponement of meeting the requirements of four key prudential regulations until 31 August 2023.

Realizing the danger of ignoring the regulatory framework, the MERRP puts forward a strategy of strengthening the banking and financial system to promote financial system stability. The CBM shall develop specific and realistic timelines for each bank based on its special conditions to comply with key regulatory requirements. In the MERRP the authorities also consider problems of both low and high inflation in maintaining monetary stability. CBM and MOPFI were assigned as responsible agencies for establishing secondary and REPO markets. In addition, deposit and lending rates shall be gradually liberalized. Furthermore, a state-owned Asset Management Company (AMC) is to be established with the purpose of making temporary investment in bank collaterals (mostly land and landed property) of potentially non-performing loans, thus giving a breathing space to the banks and allowing them to maintain the momentum of credit growth.

The World Bank estimates that economic growth of Myanmar will drop from 6.8% in FY 2018/19 to 0.5% in FY 2019/20 due to the corona crisis. In the worst-case scenario, the onslaught of the pandemic and associated stringent measures taken to arrest the impact on the economy could cause not only a declining GDP growth rate, but also rising unemployment, high inflation, volatile exchange rates, and widespread defaults on bank loans.





DIGITALIZATION DRIVE

2ND WORLD SAVINGS DAY FORUM

Introduction

WHAT ARE YOU DOING FOR THE FUTURE?

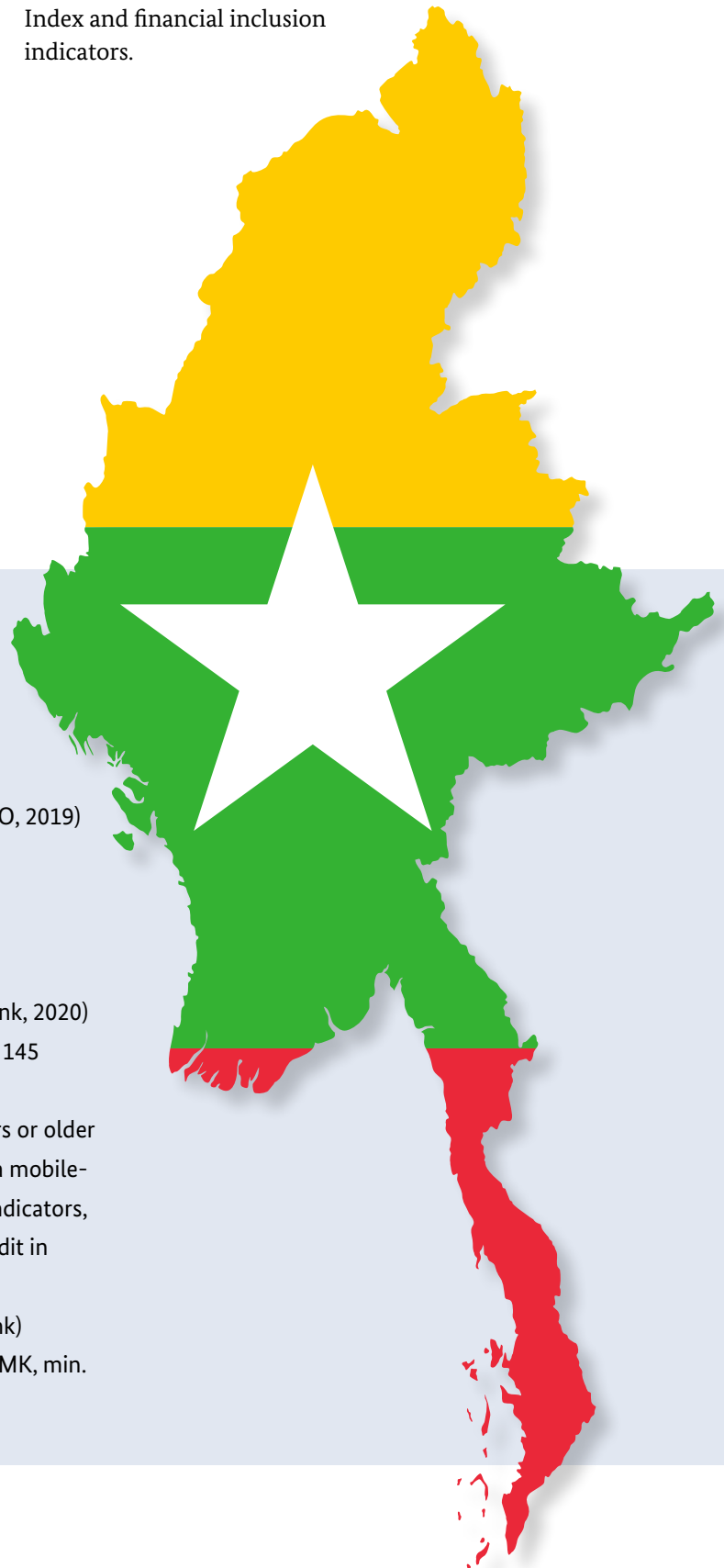
#SaveForFutureMyanmar

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A sound financial system is essential for the health of an economy. The financial sector plays a crucial role for economic development, in particular by creating money, mobilizing deposits, allocating capital, raising investment and providing modern payment and insurance services. An efficient and effective financial sector thereby reduces costs and risks in the real sector. Hence, the stability of the financial sector is of paramount importance for the wellbeing of a country and its people. And it is the chief responsibility of a central bank to ensure this very stability.

Myanmar is a lower middle-income economy with a GDP per capita of 1,407 USD in 2019 ¹. Strong economic growth over many years translated into a substantial reduction in poverty. Nevertheless, still more than 24.8% of the population lived below the national poverty line in 2017 ², and the country is

considered the poorest nation within the ASEAN region, with low Human Development Index and financial inclusion indicators.



Box 1: Myanmar in figures

Population (2019): 54.05 million

(World Development Indicators, 2020)

Surface area: 676,552.7 sq.km (Statistical Year Book, CSO, 2019)

Population growth (2019): 0.63%

(World Development Indicators, 2020)

GDP per capita (current USD, 2019): 1,407.81 USD

(World Development Indicators, 2020)

GDP growth (2019/2020): 0.5% (estimated by World Bank, 2020)

Human Development Index (2018): 0.584 / global rank 145

(Human Development Report, UNDP, 2019)

Financial inclusion: 26% of the population aged 15 years or older had an account at a formal financial institution or with a mobile-money-service provider in 2017 (World Development Indicators, 2020); 6.6% of small firms had a bank loan or line of credit in 2016 (World Bank, 2019)

Inflation rate (2019/2020): 7.5% (forecast by World Bank)

Exchange rate (October 2020): 1USD = max. 1314.40 MMK, min. 1279.50MMK (CBM)

Like other countries all over the world, the Myanmar economy also was and still is severely affected by the COVID-19 pandemic. The World Bank estimates that Myanmar's GDP growth rate will fall from 6.8 percent in FY 2018/19 to 0.5 percent in FY2019/20 due to the impact of both external and domestic factors ³. Wholesale and retail trade, tourism-related services, manufacturing and construction suffered the negative effects of the crisis. Low-income households and micro, small and medium enterprises (MSMEs), in particular, are being harmed.

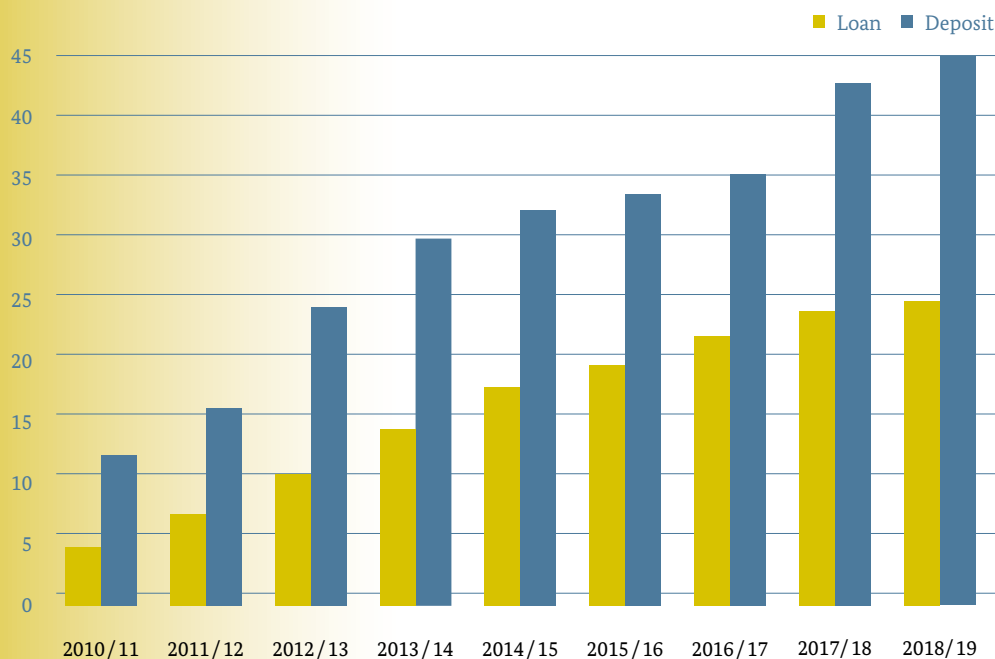
The COVID-19 Economic Relief Plan (CERP) was released by the government of Myanmar in April 2020 to mitigate the economic impacts posed by the COVID-19 crisis. According to the CERP, several changes of regulations in the banking sector have been made and supporting funds allocated to ease the impact of the

pandemic on both businesses and banks. These issues are discussed in more detail in the next chapters.

While in the year 2019 the inflation rate reached a peak of slightly over 10% in July and August, it has gradually declined since March 2020 and stood at 4.16% in June 2020.

The modest inflation resulted from lessening demand due to the negative impact of the COVID-19 pandemic on economic activities. The Myanmar Kyat (MMK) appreciated against the US Dollar and other currencies since the beginning of the COVID-19 outbreak ⁴ due to the slowing down of the economy and the decreasing local demand for the currency. In an attempt to stabilize the exchange rate, the Central Bank of Myanmar (CBM) has increasingly been purchasing US Dollars.

Financial intermediation



Source: GIZ, 2016 and 2018, and World Bank 2019

Figure 1 Financial intermediation (Loans and deposits in % of GDP)

The impact of the current crisis adds to the longer term and systemic challenges in the banking sector. Due to its history the financial sector of Myanmar is dominated primarily by commercial banks. The sector struggles to fulfil its role as a fully-fledged financial intermediary. In March 2016, the banking sector still held 92% of total financial sector assets (about 42.4 trillion MMK). The remaining 8% was comprised of Insurance, Securities, Finance Companies and Micro Finance Institutions (GIZ, 2018). Banks have grown rapidly in size in the last decade; both deposits and loans as a ratio of GDP increased remarkably within the past 10 years, but the momentum of growth is now slowing down due to the economic impact of the COVID-19 pandemic.

A brief look at the history of the Myanmar banking sector can help to explain the current situation. The modern banking sector of Myanmar went through

five distinct phases: the British colonial era until 1948; the post-independence period from 1948 to 1962; the military-socialist regime from 1962 to 1988; the military regime after 1988 with far-reaching economic reforms starting in 2010; and finally, the reforms initiated under the new NLD government since November 2015. In the British colonial era from 1826 to 1942, the banking system of Burma, as the country was called then, was entirely shaped by the British rulers. The first central bank emerged in 1939 out of the Rangoon branch office of the Reserve Bank of India. By the end of the colonial era, a total of 20 banks operated in the country, most of them with headquarters overseas.

During the Japanese occupation from 1942 to 1945 the previous financial system collapsed entirely. Instead, the Japanese created several financial institutions whose sole purpose was to extract

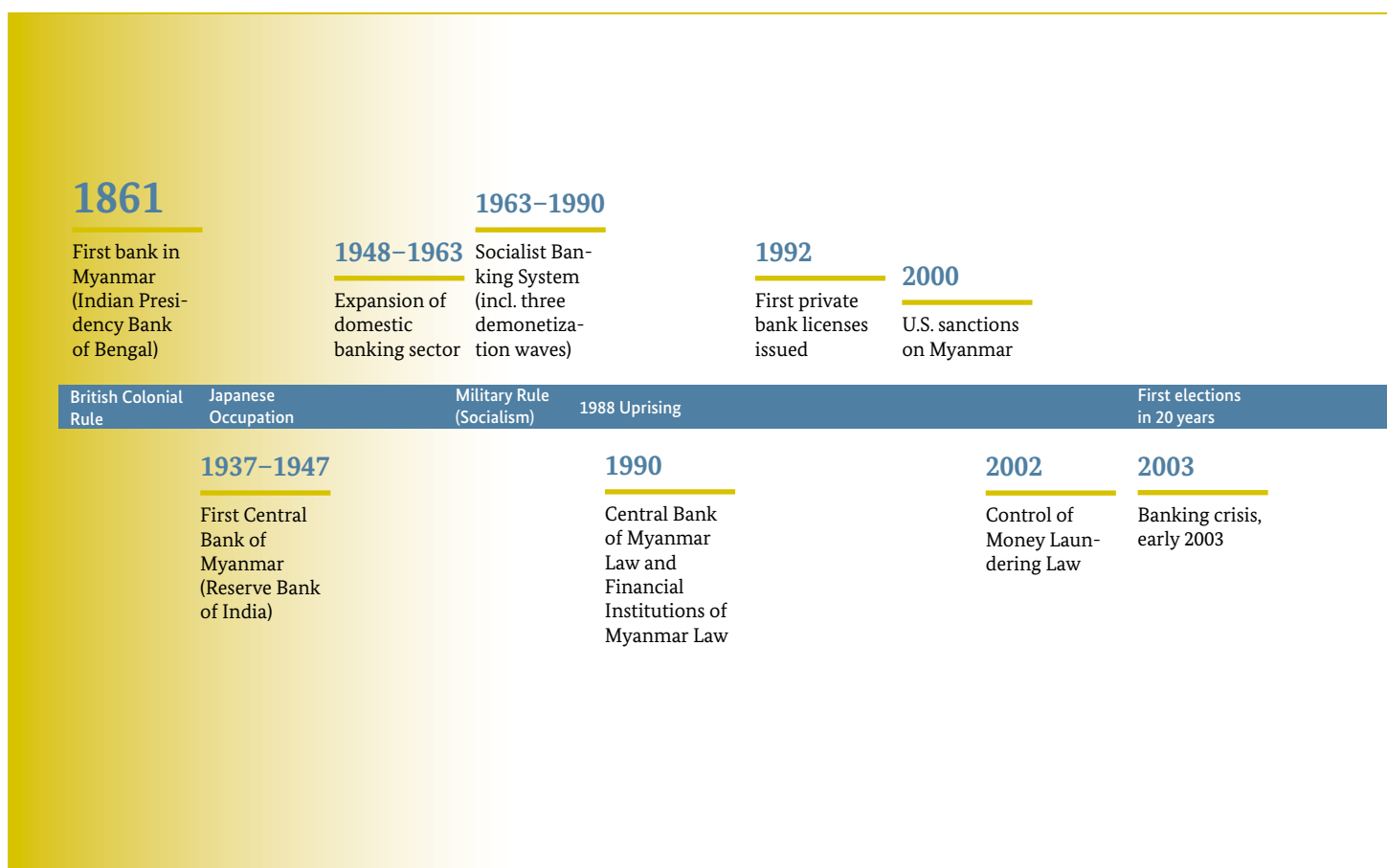


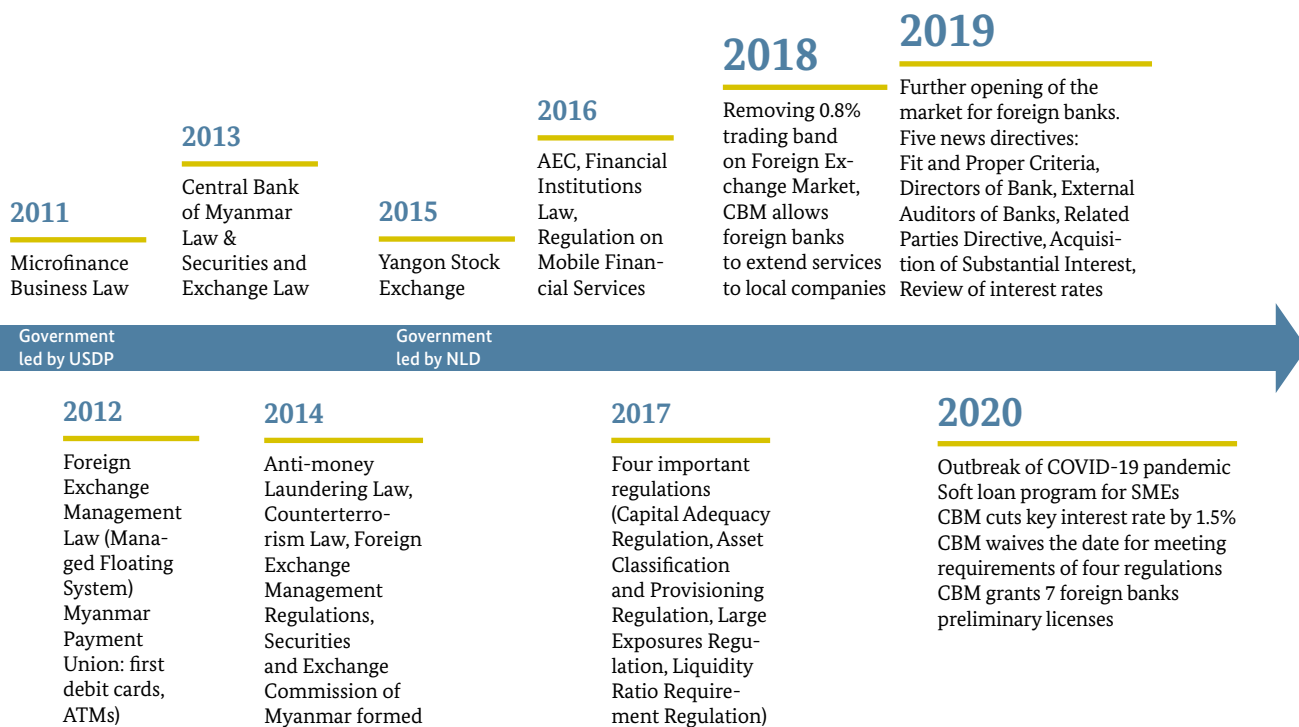
Figure 2 Major developments in the Myanmar Banking Sector (1861-2020)

resources from Burma. After the defeat of the Japanese, however, the foreign banks returned, and the Union Bank of Burma took over the role of a central bank. In 1948, Burma became independent and the banking sector flourished under the new parliamentary democracy. At that time the banking industry contributed more than one third to Burma's gross domestic product and the Burmese banking sector was considered to be the most developed in the region.

In 1963, one year after the military seized control of the country, all banks were nationalized and soon amalgamated into the Peoples Bank of the Union of Burma. However, the economic policies of the military-socialist regime failed badly and in 1988 the State Law and Order Restoration Council took over power. This military junta chose a more market-oriented approach. With the Financial Institutions

of Myanmar Law it started to liberalize the financial sector, resulting in the re-emergence of private banks in 1992. However, after a decade of rapid growth a serious banking crisis hit the country in 2003, resulting in an economic recession. Three major banks collapsed, and the central bank introduced stringent prudential measures to reel in the crisis.

After the 2010 election, a quasi-civilian government embarked on a series of political and economic reforms. Prudential regulations were eased, and the central bank was given full autonomy. In January 2016, the new Financial Institutions Law, based on international best practices, was enacted. Several new private banks were granted licenses.



The political reforms culminated in the free general elections of November 2015, which saw the opposition party NLD win a large majority in parliament. Since then, the new government accelerated the various reform projects of the previous government. In summary, after almost five decades of harsh restrictions under military rule and stringent international sanctions the former granary of Southeast Asia has become the poorest country of the region.

Furthermore, the banking sector of Myanmar, once a front runner during the 1950s, is today the least developed in the ASEAN region. However, the Myanmar government has started to reverse this negative trend. Since 2011, various ambitious financial sector reforms have been kicked off, in particular through the new Financial Institutions Law enacted in 2016. Significant banking sector reforms were launched in July 2017 when the CBM released necessary regulations known as the “four regulations” (capital adequacy, asset classification and provisioning, large exposure and liquidity ratio). With this effort Myanmar's Central Bank sets the stage for a Basel II Framework in the banking sector.

In August 2018, the Central Bank announced that it has removed a 0.8 percent trading band around the Myanmar kyat, thus liberalizing the foreign exchange market. It also announced the liberalization of foreign banks to extend their banking services to local corporates which aims to improve access to funding for local businesses. In 2019, the Myanmar market was further opened up to foreign banks, granting them permission to hold up to 35% of equity in local banks. Moreover, a new license for foreign banks was launched allowing them to apply

either for a branch or for a subsidiary license. In April 2020, preliminary licenses to seven foreign banks have been granted to fulfil their business plan within nine months. This further liberalization of the Myanmar banking sector may bring about benefits for the local economy as well as more competition for local banks.

With the outbreak of the global pandemic, the Myanmar banking sector experienced substantial changes. The key interest rate decreased by 1.5% in April 2020 and the maximum lending rate with collateral and the minimum deposit rate were lowered to 10% and 5% respectively. In addition, the CBM has waived the date for meeting the regulatory requirements of the “four regulations” – i.e. capital adequacy ratios, asset classification and provisioning, large exposure, and minimum liquidity – from 31 August 2020 to 31 August 2023 to ease the impact of COVID-19 on both businesses and the banks.

Soft loans are now being disbursed to small and medium enterprises (SMEs) in several affected industries, including “cut-make-pack” (CMP) garment manufacturers, hotel and tourism businesses, as well as restaurants. In the first phase of the COVID-19 support fund for businesses, the Myanmar Economic Bank (MEB) takes over the main role to disburse loans. The loan period is one year and the annual interest rate is 1%. In addition, loans with a 3-year period are disbursed via microfinance institutions (MFIs) to small tea shops and food sellers at a maximum annual interest rate of 9% with collateral and 11.5% without collateral. In the second phase, MEB cooperates with eight private banks to disburse loans.



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Regulatory and Supervisory Framework

2

Extensive regulatory reforms have been launched in Myanmar since 2011 to bring the country's banks closer to internationally accepted standards of operation and to promote the optimum allocation of financial resources for economic development. Since the Financial Institutions Law came into effect in 2016 the Central Bank of Myanmar (CBM) issued some remarkable regulations and directives in order to liberalise the local banking sector and match international standards, while the private banks had to make painful adjustments to meet the requirements demanded by these regulations and directives.



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Since the start of the global COVID-19 crisis in early 2020, not only national economies all over the world but also people's livelihoods and social welfare systems have been affected severely. Governments are trying to ease the impacts on their economies by implementing a multitude of measures. The Myanmar government released the COVID-19 Economic Relief Plan (CERP) on 27 April 2020, thereby making an unprecedented effort to mitigate the pandemic's impacts. Based on this relief plan, numerous changes have been made to the regulatory framework of the banking sector in order to support both, businesses and banks.

Financial sector legislation

Banking law is essentially a specialized branch of administrative law for banks and other financial institutions that lays out the state's requirements for running their businesses ⁵. Since it is difficult to include all aspects of banking regulation in the primary legislation, government entities or banking regulators typically are given the authority to issue a variety of secondary legal instruments, such as regulations, by-laws, or directives to effectively implement the law. The contemporary legal framework for Myanmar's financial sector consists of laws and amendments passed by the Union Parliament, and regulations, directives and instructions that are issued by the Central Bank of Myanmar (CBM) ⁶. Major laws affecting the banking sector of Myanmar are listed in the below box.

Box 2: Laws affecting the financial sector of Myanmar

- Auditor General of Union Law 2010
- Foreign Exchange Management Law 2012
- Amended Foreign Exchange Management Law 2015
- Central Bank of Myanmar Law 2013
- Anti-Money Laundering Law 2014
- Myanmar Accountancy Council law 2015
- Financial Institutions Law 2016
- Myanmar Companies Law 2017

The most formative laws for the contemporary banking sector are the Central Bank of Myanmar Law 2013, the Financial Institutions Law 2016, the Foreign Exchange Management Law 2015 and the Anti- Money Laundering Law 2014.

In order to further develop the financial sector, the government of Myanmar is engaged in an on-going process of drafting and enacting new laws. To enlarge the international economic relationships and cooperation and improve foreign exchange management, the bill of Foreign Exchange Management Law had been submitted to the Union Parliament on 27 December 2019 for review and enactment. To effectively supervise the insurance market and further develop the financial market in line with international standards, the bill of Insurance Business Law is currently being discussed in Parliament. To establish a modernized, secured and efficient payment system, including effective supervision, the National Payment System Law is now under discussion among respective stakeholders. The Secured Transaction Law is necessary to establish a modern and formal credit market that loans can be taken using movable assets as collaterals. The bills of Insurance Business Law, National Payment System Law, and Secured Transaction Law are expected to be submitted in the next Parliament sessions. GIZ has been supporting BMADC – the Parliamentary Committee for Banking and Monetary Affairs Development – by reviewing all the above draft laws; findings and recommendations of consultants are being discussed at the BMADC.

Box 3: Laws drafted by the respective ministries in 2019 and 2020

- Insurance Business Law (drafted by FRD, MOPFI)
- Foreign Exchange Management Law (drafted by CBM)
- National Payment System Law (drafted by CBM)
- Secured Transactions Law (drafted by CBM)

Recent CBM regulations and directives

In 2019 and 2020 the CBM issued various regulations and directives to further liberalize and develop the banking sector. However, most of the directives released in 2020 intend to mitigate the worst effects of COVID-19 on the economy. Below is a summary of the most important CBM regulations and directives issued in recent times.

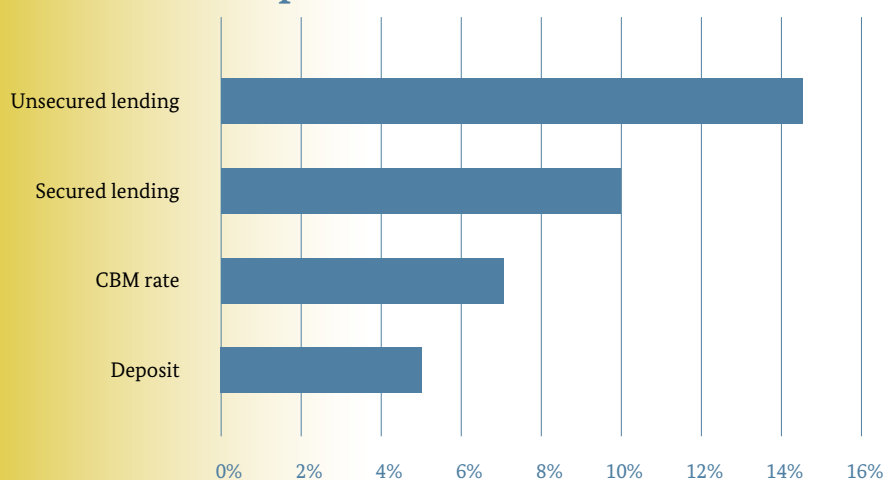
Interest rates

The CBM Directive No. (1/2019) issued on 15 January 2019 amended the lending rate with effect from February 2019. According to this directive, private banks are permitted loan disbursements at a maximum annual interest rate of 16% without collateral or with collaterals other than those defined by the CBM. There are no changes in the CBM rate (10% p.a.) and the maximum lending rate (13% p.a.) for loans with CBM-specified collaterals. The amendment of the interest rate is recognized as a further liberalization in the banking sector to move towards cash-flow based lending.

Being a high-risk loan, the interest rate on credit cards was raised from 13% to 20% p.a. in April 2019 ⁷. The credit card can be considered as a type of interest-free loan within a period of 45 to 50 days depending on the issuing bank, and in the past the interest rate was the same as for collateral-based loans. The problem is that many credit card users make efforts to pay their credit card bills only after issuing announcements to settle their debts ⁸. The change of interest rate on credit cards helps banks to hedge the risk of late repayments.

Based on the economic relief plan, the CBM issued the Directive No. (1/2020) on 12 March 2020 reducing the key interest rates by 0.5%. According to the directive, the minimum bank deposit rate is lowered from 8% to 7.5%, while the maximum lending rate is lowered from 13% to 12.5% for collateralized loans and from 16% to 15.5% for non-collateralized loans. The CBM Directive No. 2/2020 issued on 13 March 2020 put forward the effective date for the interest rate changes from April 1 to March 16. Since the Myanmar economy has slowed down due to the global pandemic crisis, the interest rate has been reduced by an additional 1% on 24 March 2020 ⁹. Starting from April 1, the bank rate was fixed at 8.5%.

Interest rates in the Myanmar banking sector in September 2020



Reference: CBM, 2020

Figure 3 Interest rates in the Myanmar banking sector in September 2020

and the deposit rate was reduced to a minimum of 6.5%, while the lending rate must not exceed 11.5% for collateralized loans and 14.5% for unsecured loans.

After about one month, the bank rate has been slashed by another 1.5% for the purpose of stimulating economic growth ¹⁰. Hence, the CBM rate decreased from 8.5% to 7%, the deposit rate was changed from 6.5% to 5%, while the lending rate went down slightly to 10% for loans with collateral. However, the lending rate for unsecured loans remains at 14.5%. Due to the interest rate cuts made by the CBM during the COVID-19 period the lending-deposit spread becomes 9.5% for unsecured lending.

More open local market

In January 2019, the CBM allowed foreign equity ownership of up to 35% in licensed banking institutions ¹¹. This permission is covered by the Companies Law that came into force on 1 August 2018, which allows up to 35% foreign equity ownership in Myanmar-registered companies. Local banks that want to accept an equity investment from foreign banks shall notify the CBM, and they have to comply with and proceed according to the provision of section 61 of the Financial Institutions Law. This move may well improve the access to capital for undercapitalized local banks and facilitate knowledge transfer to the domestic banking sector (GIZ, 2018).

The CBM made the next step to welcome foreign banks in the domestic banking market in November 2019, announcing a third round of foreign bank licensing applications for branch or subsidiary licenses ¹². The entry of foreign banks can bring both benefits and challenges for the host country: on the one hand, the domestic market can receive qualified financial services, but on the other, domestic banks will have to compete with international banks.

Housing loans

With the aim to expand the local credit market and create more housing for a growing population, the CBM permitted the local banks in 2019 to allocate 5% of their total loan portfolios towards mortgages exceeding three years ¹³. For other loans exceeding three years, the banks must submit proposals to the CBM for approval on a case-by-case basis, together with terms and conditions of the respective loan.

Subordinate debt

Under Section 34 on maintenance of capital funds and Section 184 of the Financial Institutions Law, the CBM issued the Subordinated Debt Directive ¹⁴. According to this directive, a bank may include, after receiving the CBM's approval, subordinated debts in the supplementary capital or Tier 2 capital up to a maximum 50% of Tier 1 capital, provided the subordinated debt meets the eligibility criteria of this directive.

Moreover, the directive states that a bank must submit certain information to obtain the approval of the CBM such as the description of the terms of the issuance of the debt, the date of the funds and the amount, and a copy of the final debt note and agreement. The criteria which all subordinated debts must meet are also set out in the directive.

International settlement and foreign exchange rate

With the aim of facilitating border trade, the CBM allowed the banks with Authorized Dealer licenses to conduct international settlements in Japanese Yen and Chinese Yuan denominations ¹⁵, although opening personal accounts or legal entities in the two foreign currencies are not permitted. This directive intends to reduce the sole reliance on the US Dollar in trade, to

attract more foreign direct investments (FDI) and promote exports. However, some people in the banking sector pointed out that there still will be problems like official border trade agreements between the Myanmar government and China, and banking services to facilitate trade despite permitting these currencies for international settlements ¹⁶.

On 4 February 2019, the CBM announced that starting on the next day the daily Reference Exchange Rate based on transactions in the foreign exchange market will be published daily on its website at 4:00 pm ¹⁷. This new system replaces the old approach of the CBM, which used the previous working day's weighted average rate to set the reference rate and therefore caused a misalignment when there were long holidays.

Net Open Position

To avoid liquidity shortage problem, the CBM issued the directive No. (6/2019) on 11 February 2019. According to the directive, the banks with Authorized Dealer License must maintain not more than 20% of core capital of long or short positions of any foreign currency, and if the position exceeds the CBM's limit for three consecutive days, they need to report on corrective actions.

Corporate governance

On 25 March 2019 the CBM issued five detailed directives to banks to improve corporate governance in the local banking sector. The directives cover related-party transactions, regulations that bank directors shall follow, appropriate standards for bank directors and senior officials, having internationally recognized external auditors, and the acquisitions of substantial interests.

The fit and proper criteria must be met by directors and senior officers of a bank, including external auditors. The criteria apply in the on-going process as well as for

initial nominations, appointments or approvals of substantial shareholders, directors and senior officers, while the board of directors has full responsibility for ensuring that all directors and officers are fit and proper. The minimum qualifications being relevant to professional areas – like Director, Chief Executive Officer (CEO), Chief Operating Officer (COO) and so forth – are clarified in detail for assessment.

Anti-money laundering and cross-border remittances

In their effort to curb money laundering, the CBM issued regulatory guidelines and instructions to enforce the Control of Money Laundering Law (CMLL), enacted on 14 March 2014 (GIZ, 2018). The CBM issued the directive on Customer Due Diligence related to anti-money laundering and counter financing of terrorism to the banks licensed and supervised by the CBM on 15 November, 2019 ¹⁸. According to the directive, banks must take precautions with customers with suspicious sources of income and keep the complete data and information on wire and digital transfers including cross-border transfers, and must provide these data upon request of the Myanmar Financial Intelligence Unit or the recipient bank. Moreover, the CBM instructed non-bank institutions, in particular licensed money changers and mobile service providers to follow the directive on Customer Due Diligence related to anti-money laundering and counter financing of terrorism ¹⁹.

To reduce illegal money transfers, the CBM issued the Notification No. (21/2019) regarding cross-border remittances on 15 November 2019. Under this regulation, the applicant company for a cross-border remittance license must have registered in accordance with the Myanmar Companies Act and have placed a certain amount of deposit. They must follow the rules of anti-money laundering and counter financing of terrorism.



Myanmar was removed from the money laundering watch list of the Financial Action Task Force (FATF) in June 2016 based on the progress the country made in this respect. This included introducing legislative measures to curb money laundering and new regulations for its cash-based remittance system ²⁰. However, in February 2020 the FATF decided to place Myanmar back on its “grey list” because of the failures in controlling money laundering ²¹. The financial activities of Myanmar are subjected to more monitoring as a result of being included in the “grey list”.

On 7 May 2020 the next challenge to Myanmar's economy and financial system was posed when the country was put on the EU's money laundering blacklist ²², which has to be submitted to the European Parliament and Council for approval. However, the higher scrutiny will only apply from October 2020 onwards, due to the current global coronavirus pandemic.

Financial reporting and supervision

Apart from the laws and their secondary instruments with regard to corporate financial reporting, the following laws play an important role in the legal and statutory framework: Auditor General of Union Law 2010; Myanmar Accountancy Council Law 2015; and the Myanmar Companies Law 2017.

In order to successfully implement the various laws in the banking sector, the CBM issues regulations and directives as secondary instruments. Some of these instruments define prudential requirements in the form of key ratios and limits to be met by all banks. Apart from private banks, CBM's Financial Institutions Supervision Department (FISD) also is responsible for the supervision of State-Owned Banks (SOBs) even though they are regulated by the Financial Regulatory Department (FRD) of the Ministry of Planning, Finance, and Industry (MoPFI).

The CBM is carrying out the task of bank supervision through a “risk-based supervision” approach in order to ensure a safe and sound banking system. However, the full implementation of this approach will take many more years since CBM faces various challenges, in particular a lack of skilled employees ²³. The FISD of the CBM is responsible for the supervision and monitoring of local and foreign banks in the country. It issues necessary instructions and conducts both, on-site examination and off-site monitoring. Off-site monitoring entails that the banks report their financial performance to the FISD regularly (daily, weekly, monthly, quarterly and annually). On-site supervision is conducted at least once in two years and covers announced visits to the banks' headquarters and branches in order to assess their internal control systems, corporate governance, financial data, AML/CFT measures, and other compliances. If a bank is not in line with the CBM's prudential ratios and limits, a penalty can be charged on the shortfall of required reserves.

Adherence to accounting and auditing standards is a cornerstone of a sound and stable banking system. As the business world becomes more global, common financial reporting standards reflecting the actual performance of a business are essential for auditors, supervisors, investors, business owners and shareholders to properly assess how it is progressing and to allow comparison with peers. Acknowledging the importance of common financial reporting standards, the International Accounting Standard Board (IASB), an independent accounting standard setting body, has developed the International Financial Reporting Standards (IFRS), which are widely recognized as the common global financial reporting standards. Myanmar has decided to adopt IFRS standards in its banking sector to promote modernization and transparency in its banking sector.

The Myanmar Accountancy Council (MAC), the regulatory body for accounting and auditing standards in Myanmar, officially issued a series of notifications on Myanmar Financial Reporting Standards (MFRS) and Myanmar Standards on Auditing (MSA). The MFRS for

Box 4: IFRS Transformation in Banks

IFRS adoption for Myanmar banks is not a million miles away from its deadline of the 2022-23 financial year. According to MAC's notification No.18/2018, all Public Interest Entities have to comply with IFRS regarding financial reporting by the 2022-23 financial year. The Banking Sector Financial Reporting Standards Implementation Committee (BFRIC) together with the technical support of GIZ-BFSD selected and assisted two local private banks (IFRS pilot banks) from 2017 to 2019 to develop IFRS accounting policies, and receive tailor made training and methodological guidelines / tools to be able to prepare their IFRS financial statements.

The challenges met and lessons learnt during the full scope transformation of the pilot banks were made accessible in July 2019 via a BFRIC Industry Dissemination event for the whole banking sector to benefit. The representatives from all local and international banks of Myanmar attended this event where the pilot banks presented their achievements and challenges faced with regards to IFRS transformation. In addition to this, the technical guides and illustrative documents that will help the banks in preparing IFRS financial statements were distributed to the Myanmar banking sector. This event also helped raise awareness in the banking sector regarding practical challenges in key areas of IFRS transformation and solutions to tackle these challenges.

In April 2019, BFRIC together with the support of GIZ-BFSD conducted a survey amongst thirty local banks and thirteen foreign banks for a better understanding of the status of IFRS implementation in the Myanmar banking sector. The survey was followed by face to face interviews with some banks. The survey and the interviews covered areas such as the banks' IFRS transformation team and transformation plan, their budget, IT system, the capacity of human resources (HR), preparation of some specific IFRS and so on. The result of the survey was shared at the board of directors meeting of the Myanmar Banks Association in October 2019. The analysis shows that the senior management of most of the banks are committed to complying with the 2022 IFRS deadline. Due to the strengths and weaknesses of the individual banks, however, the banks are in different positions along their IFRS implementation journey. The major challenges banks face are related to HR (getting qualified and experienced personnel), IT (IFRS modules and IT systems to perform complex IFRS calculations) and high cost for IFRS transformation projects.



SMEs were issued in 2009 ²⁴ and one year later for financial institutions, public companies and accountants ²⁵. MAC announced the Myanmar Standards on Auditing (MSA) in 2009 ²⁶, followed by a second notification in 2010 ²⁷ legally requiring all Certified Public Accountants (CPA) to follow the stipulated standards. In effect, MFRS and MSA are adaptations of their international counterparts, International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) respectively.

In July 2018, MAC issued the Notification No. 18/2018 and 19/2018 for the adoption of IFRS and the IFRS for SMEs. Hence, all SMEs must apply IFRS or IFRS for SMEs and all Public Interest Entities (PIE) must apply IFRS – i.e., the latest versions of IFRS issued by the International Accounting Standards Board. It is mandatory for all auditors to follow the International Standard on Auditing (ISA) by the fiscal year 2022–23. Early adoption of IFRS and of the IFRS for SMEs is permitted.

Therefore, IFRS will become fully applicable in reporting systems by the fiscal year 2022–23. While currently facing challenges – such as meeting prudential requirements, high NPL ratios and low profitability – banks can tangibly benefit from a transition to IFRS. For instance, bank data will become more reliable and transparent, and it can support management's decision-making; also, banks will be in a better position to attract more investments, including international investors.

Regulations in response to the Covid-19 crisis

The COVID-19 pandemic causes a deep recession on the global economy and the financial system faces dire challenges, for instance to sustain the flow of credit and to manage increasing risks ²⁸. To mitigate the consequences of the pandemic not only monetary and fiscal policies but also prudential regulations and other financial policies have been launched ²⁹.

It is undeniable that the banking sector plays a critical role to lessen the severe macroeconomic and financial impacts of the corona crisis. In Myanmar, significant regulatory and supervisory actions have been taken in the banking sector to support the economy. As mentioned above, the CBM reduced the interest rates since March 2020 to facilitate more liquidity for businesses. For the same purpose the CBM temporarily lowered the minimum reserve requirement from 5% to 3.5% of total deposits (this regulation was effective until 30 September 2020) ³⁰. In addition, banks have been allowed to calculate the liquidity ratio with 90% of the total value of treasury bonds having a remaining maturity of over one year, instead of 50% ³¹. In September 2020, the CBM extended the period of the above two directives to 31 March 2021 in response to the on-going crisis ³².

Furthermore, the CBM has waived the date for meeting the requirements of four key regulations issued in 2017 to align the banking sector with international standards ³³; this waiver is valid from 31 August 2020 until 31 August 2023. Hence, the deadline for full compliance with prudential regulations on capital adequacy, NPL and large exposure limit is extended by three years. Furthermore, the IMF provided some emergency funding to the Myanmar government in response to the crisis and suggested CBM to monitor the NPL of banks and consider a comprehensive NPL resolution strategy ³⁴.

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The Myanmar Banking Sector

3

Banking Sector Development

Since 2010, the banking sector is one of the important reform areas of the Myanmar government. After 2015, significant reforms have been put on track to be in line with international standards, including accounting systems, digital banking and financial inclusion for both, SMEs and unbanked people. The development of the banking system is considered a driving force for economic growth in Myanmar.

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Although Myanmar's banking sector has achieved fast growth during the past decade, it remains small compared to its neighboring countries and other ASEAN member states. Credit to the private sector stood at 26% of GDP in 2019, one of the lowest values in the region. As shown in the figure below, the indicator fell remarkably during the 2003 banking

crisis and only reached its pre-crisis level (the red dotted line) in 2012. From then on, credit growth gained momentum, which increasingly raises concerns regarding the stability of the sector, especially because the banks' risk management capabilities have not increased to the same extent as their credit exposure.

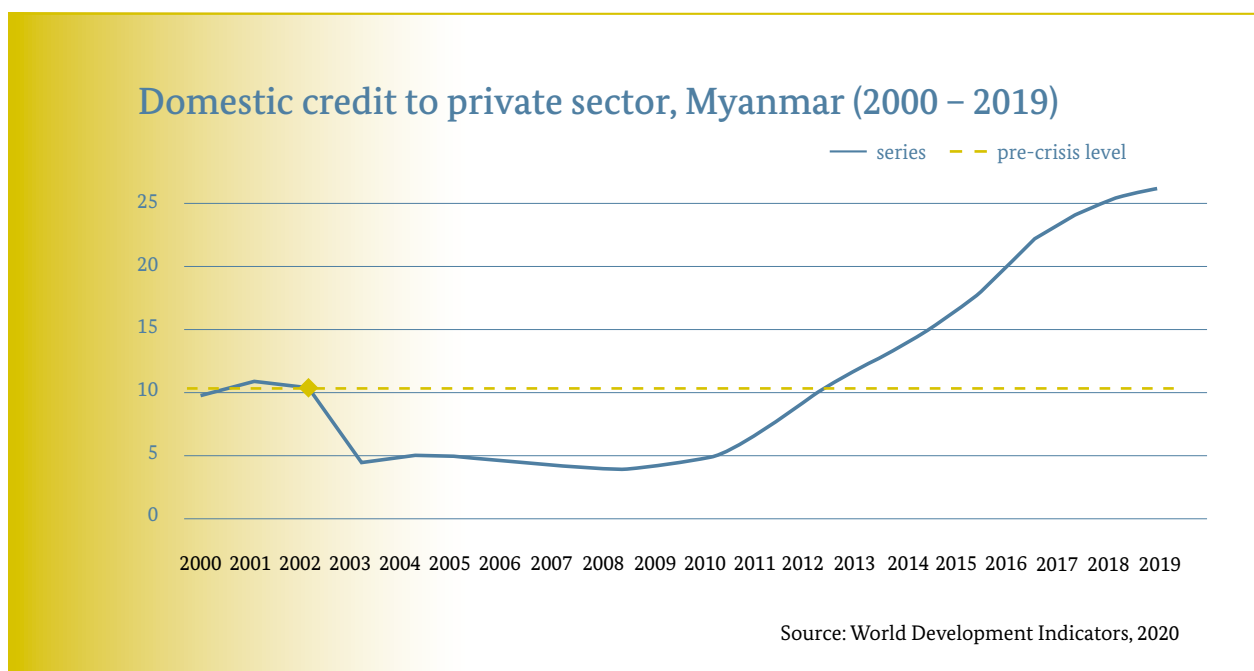


Figure 4 Domestic credit to private sector (% of GDP), Myanmar (2000-2019)

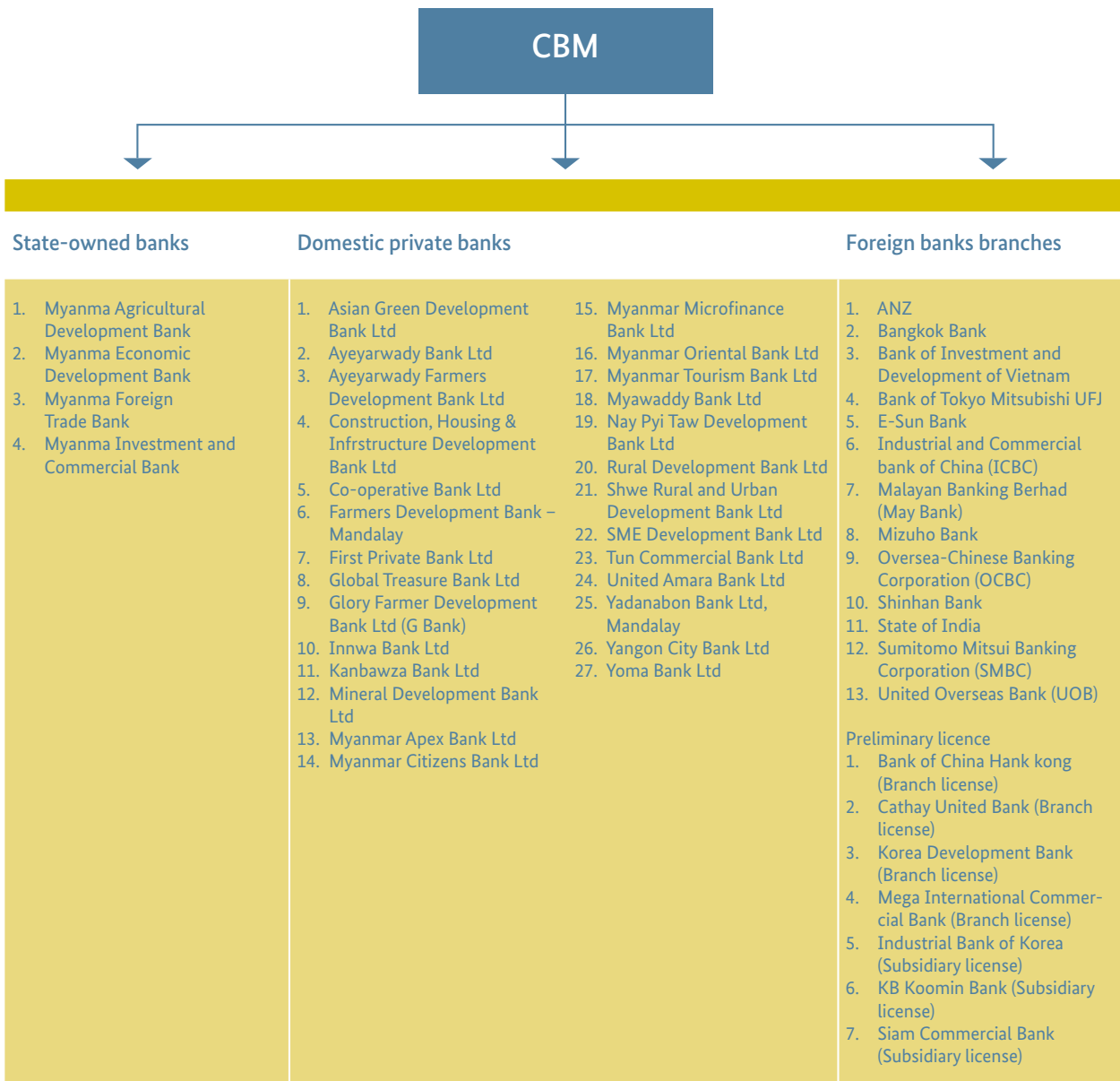
Myanmar's banking sector today consists of four state-owned banks, 27 domestic private banks and 13 foreign bank branches. In addition, there are 46 representative offices of foreign banks listed on the website of the CBM. Figure 5 provides an overview about the country's banking market.

During 2020 there were minor changes in the Myanmar banking market. The banking license of the locally incorporated Asia Yangon Bank Ltd (AYB) was revoked by the CBM on 16 March 2020 because AYB did not meet the minimum requirements for paid-up capital. AYB became the first local bank

cancelled after the banking crisis of 2003. Yet, there are still 27 domestic private banks as of September 2020 since the Farmer Development Bank – Mandalay received a banking license in February of that year.

The process of opening up the local banking market continued in 2020. While the first licenses to nine foreign banks were granted in 2014, and four Asian banks were given licenses in 2016, seven banks were granted preliminary licenses in April 2020, namely:





Source: CBM, 2020

Figure 5 Banking market of Myanmar

Bank of China (Hong Kong), Taiwan’s Cathay United Bank, Mega International Commercial Bank, Industrial Bank of Korea, KB Koomin Bank, Korea Development Bank, and Siam Commercial Bank of Thailand ³⁵. Among them, three banks were granted subsidiary licenses whereas the other four received

branch licenses. Moreover, the CBM granted the approval for an equity participation of Kasikorn Bank in Ayeyarwaddy Farmers Development Bank Limited (A Bank). Since the foreign banks that recently entered the Myanmar banking sector originate from Asian countries that are main trade partners and



investors in Myanmar their presence in the country can foster the development of trade and investment between Myanmar and its Asian partner countries.

As of December 2019, total bank assets amounted to 72 trillion MMK. The growth rates since 2012 are impressive, with the highest rate of 45.2% in 2016. However, growth was also very volatile, as can be seen in the figure below. Due to slowing the growth of private bank assets (approximately 10%), the growth rate of total bank assets went down by about 11% between December 2016 and December 2017, while the growth rate picked up again to 13% between 2018 and 2019.

As of December 2019, private banks accounted for roughly 60% of total bank assets, 69% of deposits and 81% of loans, reflecting their strong growth in recent years (see Figure 7). The market share of state-owned banks (SOBs), on the other hand, has decreased sharply over the past years. In terms of assets, it fell from 72% to 30% between December 2012 and December 2019, which illustrates the long term impact of market liberalization (see Figure 8).

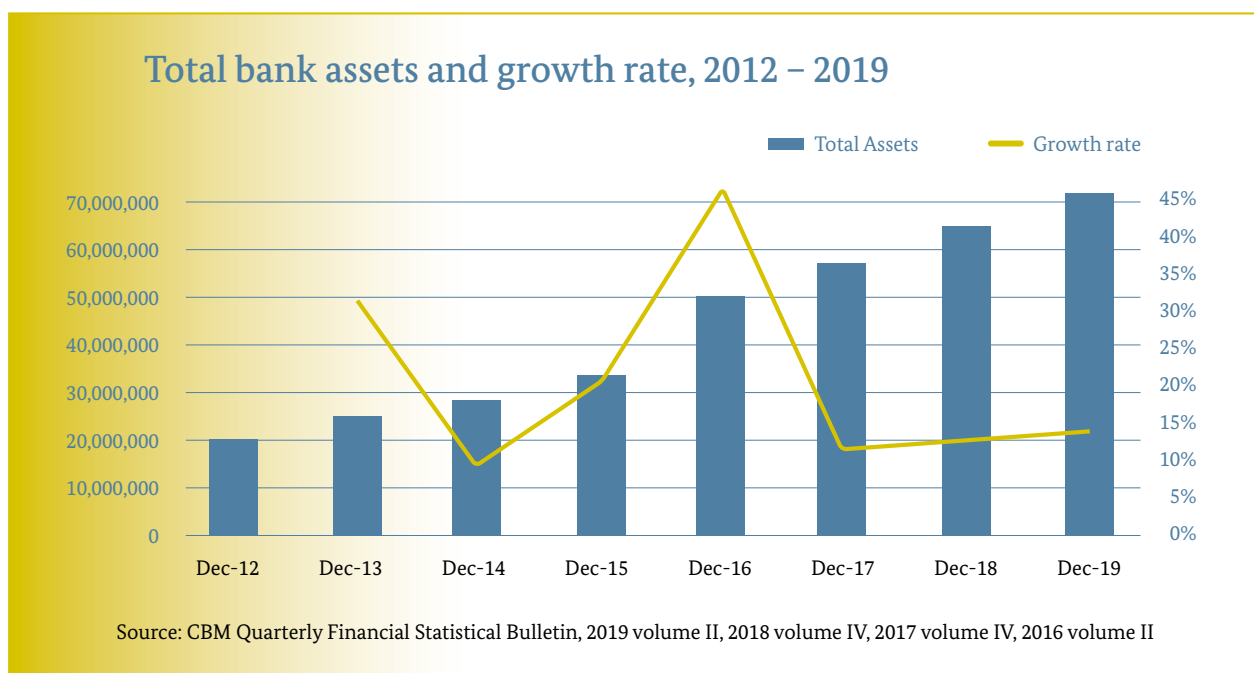


Figure 6 Total bank assets (in million MMK) and growth rate (in %), 2012 – 2019



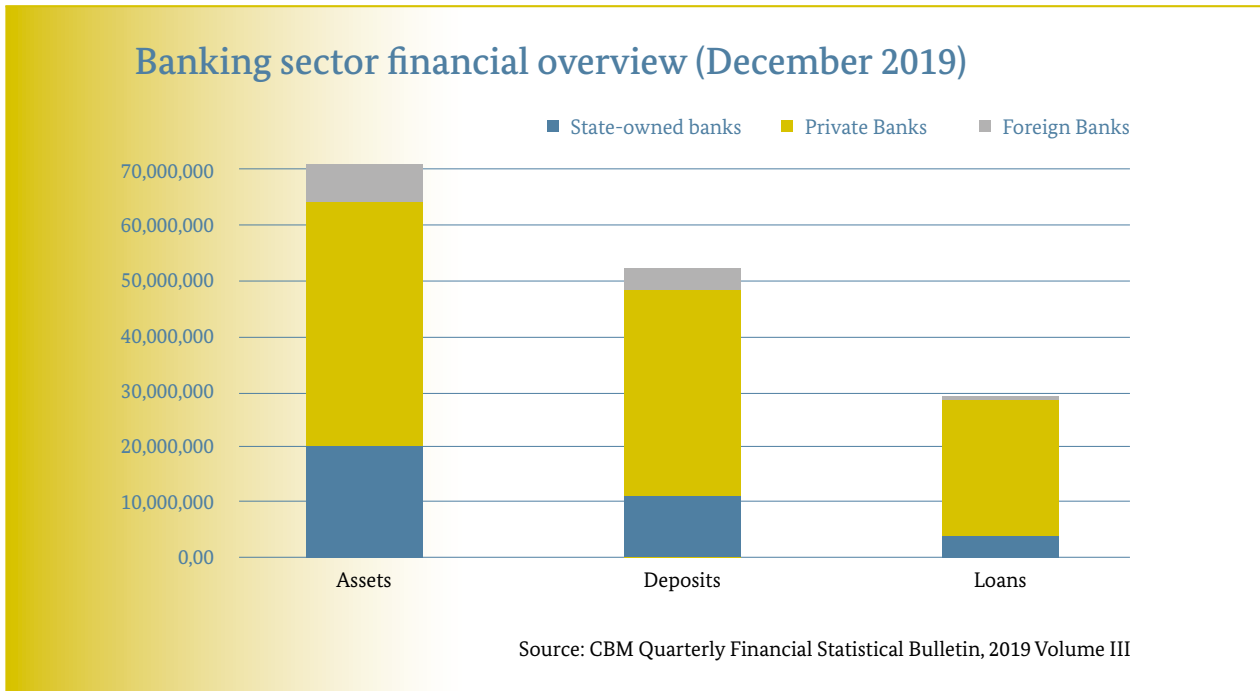


Figure 7 Banking sector financial overview (in million MMK, December 2019)

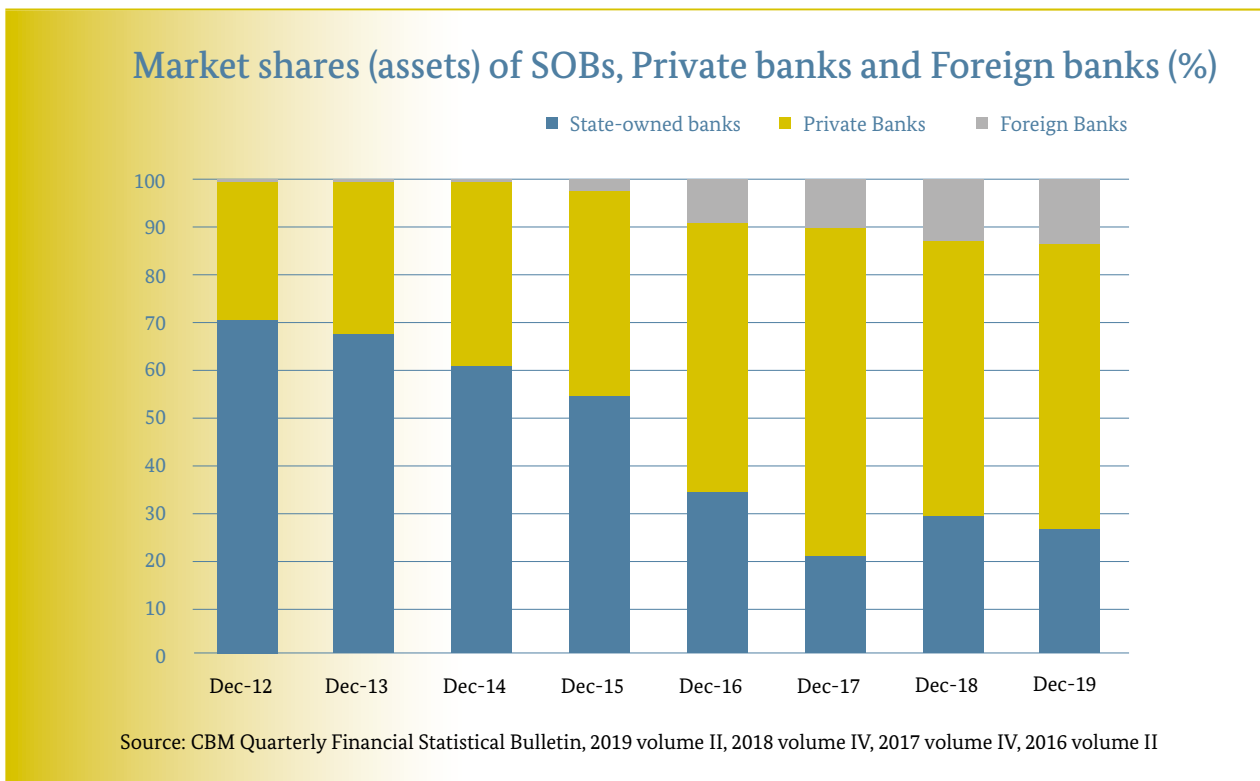


Figure 8 Market shares (assets) of SOBs, Private banks and Foreign banks (%)





State-owned banks

There are four state-owned banks (SOBs) in Myanmar: the Myanmar Agricultural Development Bank (MADB), the Myanmar Economic Bank (MEB), the Myanmar Foreign Trade Bank (MFTB) and the Myanmar Investment and Commercial Bank (MICB). Although private banks today are more prevalent, SOBs still play an important role in Myanmar. While the MEB is still strong in SME lending, the MADB is the main provider of loans to farmers, a market segment that is rarely served by commercial banks (GIZ, 2018). However, SOBs urgently need to be reformed to improve their financial performance, raise their competitiveness and thus support the development of the Myanmar banking sector.

In the past – especially after the bank crisis of 2003 – SOBs used to benefit from a lack of public trust in private banks (GIZ, 2018). In December 2012, they held almost 60% of total deposits and well over 35% of total loans. Up to December 2019, however, these numbers have fallen to less than 23% of deposits and

approximately 12% of total loans. Nevertheless, SOBs' deposit and loan market shares became more stable on a low level since 2017, and this seems to depict that there is still an important place for them in the Myanmar banking sector (see Figure 9).

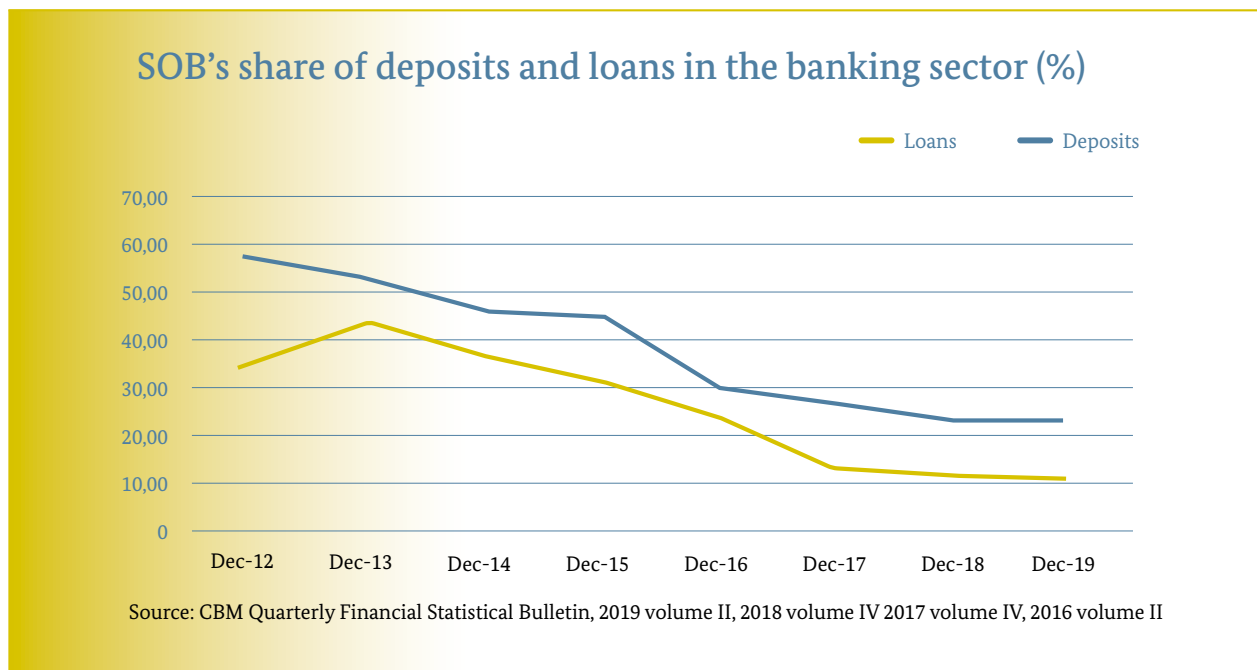


Figure 9 SOB's share of deposits and loans in the banking sector (%)

One of the strengths of the SOBs is their nation-wide outreach. They operate a total of 517 branches and 93 ATMs in the whole country. The four SOBs still offer most standard banking services to key sectors that would be otherwise underserved by the private sector, in particular the agricultural sector. In December 2019, the loans issued by SOBs to the agricultural sector amounted to over 70% of their total loans, while private banks held only about 2% of their outstanding loans in that sector. ³⁶

As of December 2019, the loan-deposit-ratio of SOBs was only 29.4%, compared to 65% at private banks ³⁷. Moreover, SOB lending to the private sector – except the agricultural sector – is disproportionately small

compared to their overall market share. Therefore, SOBs are still struggling to compete profitably with the private banks.

Moreover, SOBs face rather high NPL ratios (but accurate data is not available). According to the Union Auditor General's report for the six months between April and September 2018, the NPL of SOBs totaled 262.9 billion MMK ³⁸. The amount of MEB's NPL alone was 133.7 billion MMK, i.e. about 6% of the bank's loan book, while the NPL ratios for MADB and MICB were more than 9% and 8% respectively. The high NPL at the MADB mainly resulted from problems faced by farmers, such as fluctuations of crop prices and bad weather conditions, weaknesses



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in group insurance and loans, and difficulties in collecting repayments in conflict areas. Proper monitoring and urgent reforms should be undertaken to lessen the NPL problems of SOBs and upgrade the banking sector's stability (UNCDF, 2018). Furthermore, SOBs need to focus more on digitalization to make operations more efficient and to catch up with the private banks; however, the lack of skilled employees and poor corporate governance are key impediments to be overcome ³⁹.

Despite the weaknesses observed in SOBs there are remarkable improvements that can help to meet market demands. MEB, for instance, launched mobile pension services in March 2019 partnering with Wave Money, the leading mobile financial services provider in Myanmar. This service gives government pensioners more convenience when withdrawing their pensions and increases the efficiency of the bank ⁴⁰. To take another example, MADB started a cooperation with Myanmar Insurance and Sampo

Japan Nipponkoa Insurance Inc. in December 2018 to test a weather index-based crop insurance product that protects farmers from losses due to adverse weather conditions ⁴¹.

Reforming the SOBs is considered one of the key measures to promote economic growth in Myanmar. Improved operations and greater efficiency of SOBs will increase competition in the banking sector and ensure financial sector stability. The Ministry of Planning, Finance and Industry (MoPFI) therefore plans to merge the four SOBs that have similar business scopes to facilitate more loans for micro, small and medium enterprises (MSMEs) and farmers. This reform project – implemented with guidance from the World Bank – may result in the development of important economic sectors which still lack access to loans, notably the agricultural sector ⁴². As a first step, MEB and MADB are going to merge to promote farmers' access to finance.





Private Banks

As of December 2019, there were 27 domestic private banks operating in Myanmar. These banks held assets worth 42.44 trillion MMK, about 60% of total bank assets. Private banks are the drivers for innovation and growth in Myanmar's banking sector. However, asset concentration is high and most private banks are still struggling to meet the new regulatory requirements.

While private banks' loans and deposits grew substantially between 2012 and 2019, the growth rates slowed down since 2016 (see Figure 10).

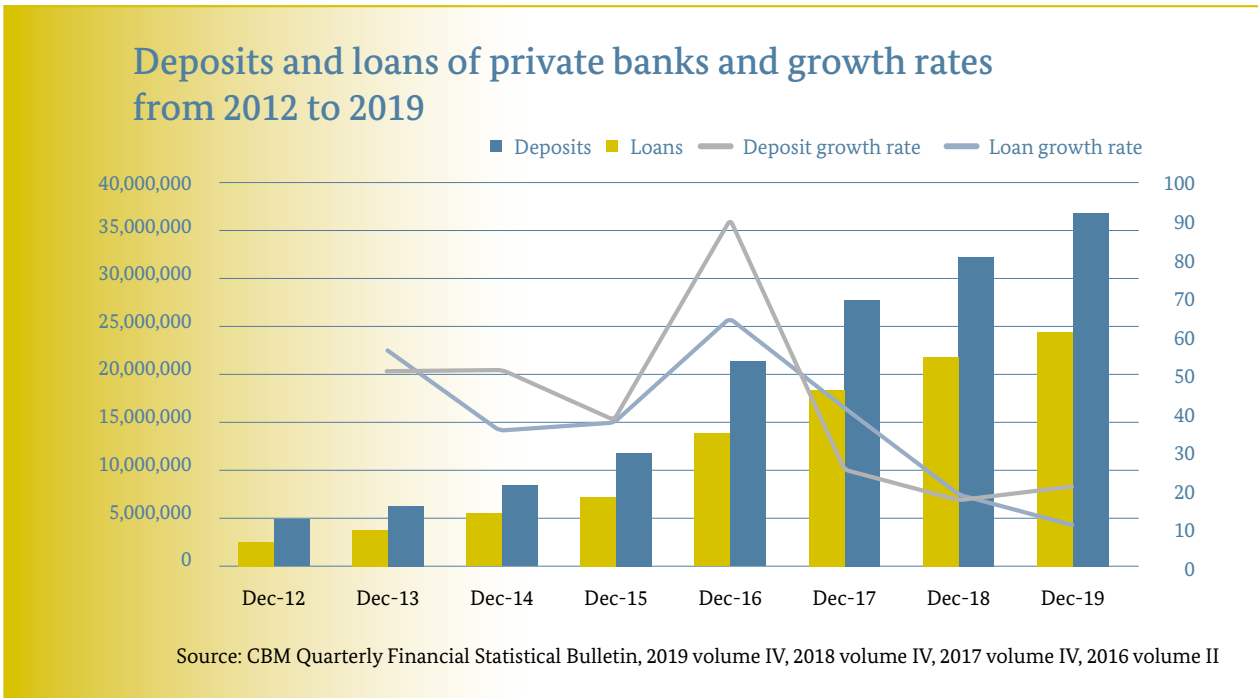


Figure 10 Deposits and loans of private banks (in million MMK) and growth rates (%) from 2012 to 2019

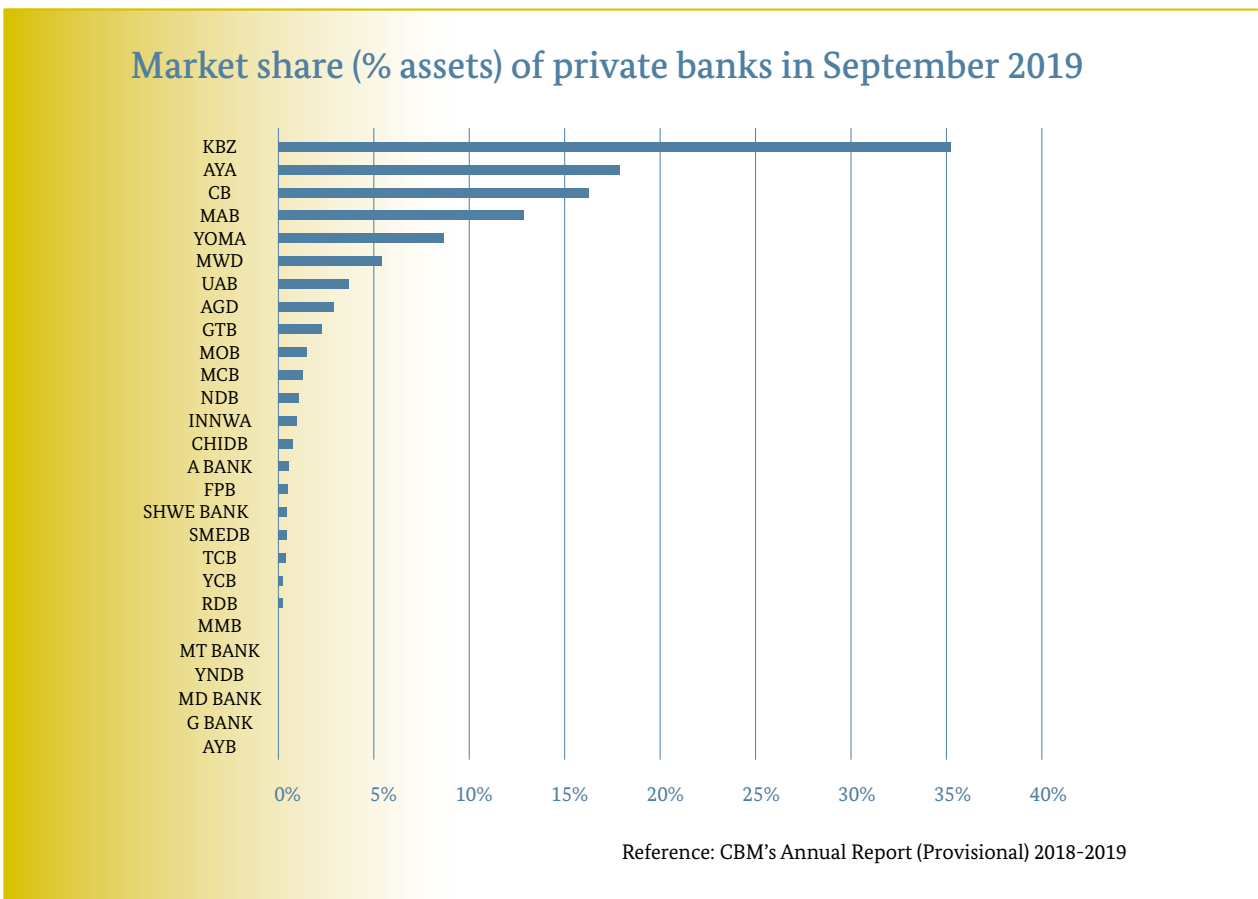


Figure 11 Market share (% assets) of private banks in September 2019

In the financial year 2018-2019, the three largest banks held almost two thirds of total private banks' assets, while the top six practically made up the total market. KBZ, the largest bank of the country, owned well over 35% of total assets in 2019 (see Figure 11). In light of this situation, Myanmar might be considered overbanked because of the large number of small private banks; in contrast, the country has a low rate of financial inclusion with 74% of the population un-banked in 2019 ⁴³.

As of March 2020, private banks in Myanmar operated 1,940 branches. Yet, the amount of bank branches in relation to the population is still low and explains the high rate of financial exclusion. In 2019, Myanmar counted 5.6 bank branches per 100,000 inhabitants, compared to 11.2 in Thailand, 9.2 in the Philippines

and 10.1 in Malaysia ⁴⁴. In addition, branch coverage is very uneven across the regions, leaving especially rural populations widely unserved by private banks, although they keep increasing their branch numbers. However, while extensive branch networks are still considered a pivotal factor favoring financial inclusion, it might become less important in the future as digital financial services become more and more popular in Myanmar.

The problem of financial exclusion is further illustrated by the geographic distribution of private banks' loan disbursements, which are highly concentrated in Yangon and Mandalay where most businesses are located. Companies and households in other states and regions have far less chances to get bank loans (see Figure 12).

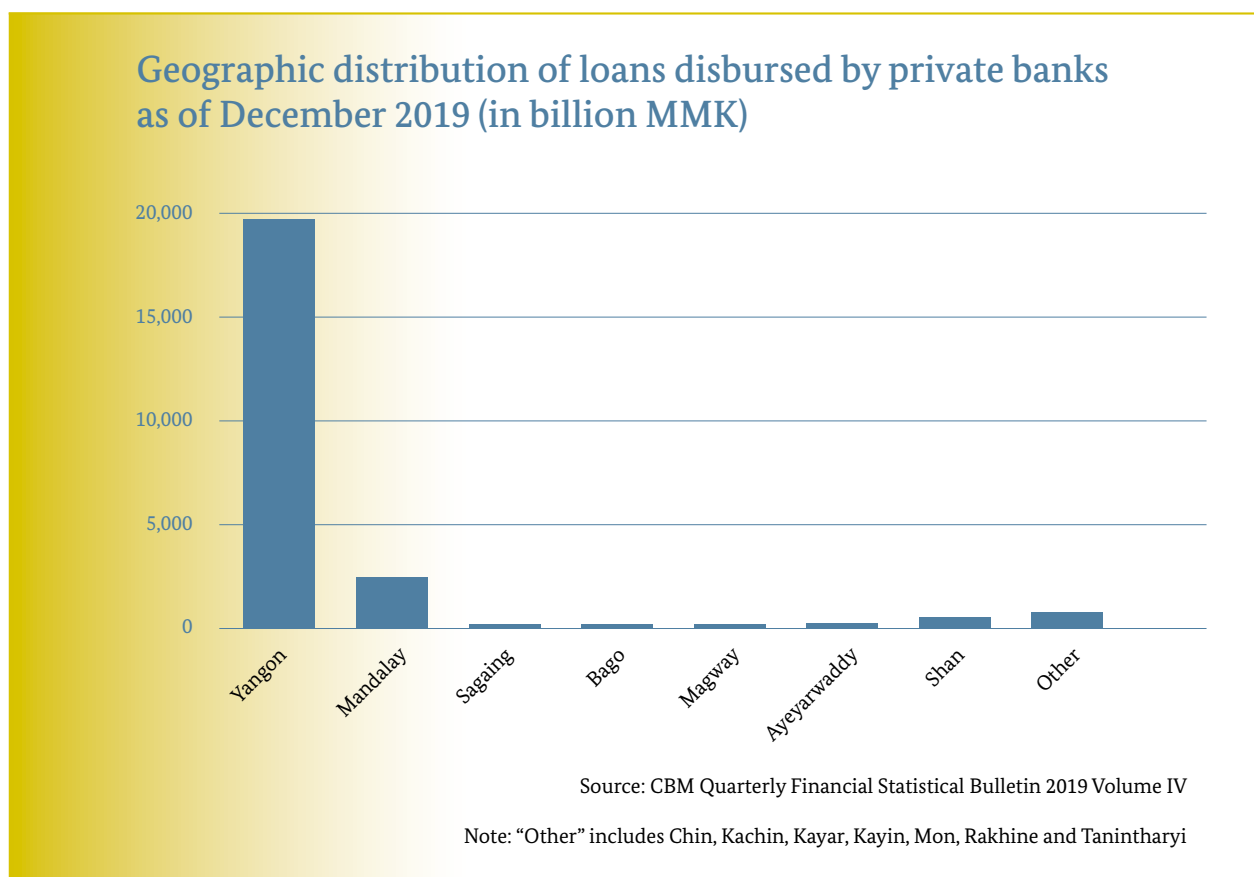
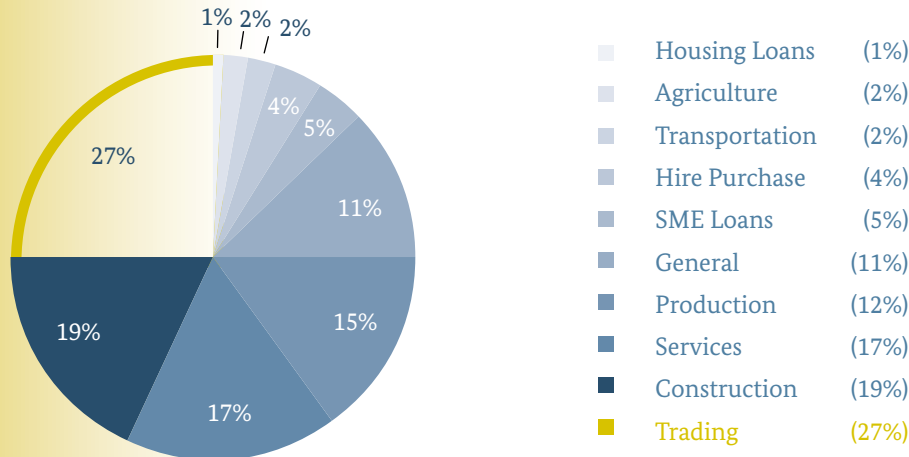


Figure 12 Geographic distribution of loans disbursed by private banks as of December 2019 (in billion MMK)



Sector distribution of private bank loans, as of December 2019



Source: CBM Quarterly Financial Statistical Bulletin, 2019 Vol IV

Figure 13 Sector distribution of private bank loans, as of December 2019

Total loans of private banks amounted to 24.42 trillion MMK in December 2019. Between December 2012 and December 2019, the amount increased about eightfold. With 27%, the trading sector accounts for the largest share of loans, followed by construction (19%) and services (17%). Agriculture (2%) and housing (1%) make up the rear (see Figure 13). This situation also depicts the long lasting structure of sectoral distribution in private bank lending.

Since the opening up of the economy in 2010, private banks took advantage of a booming private sector. However, a number of restrictions still hinder banks to increase their lending activities. Usually, it is a bank's task to appraise the risk of potential clients and set the prices accordingly. In a fixed interest rate environment like Myanmar, however, banks cannot price in their risks and hence tend to over-rely on "hard" collateral or generally restrict their lending. Following this logic, nearly 77% of collateral used to

secure loans in Myanmar as of December 2019 were land and buildings (see Figure 14).

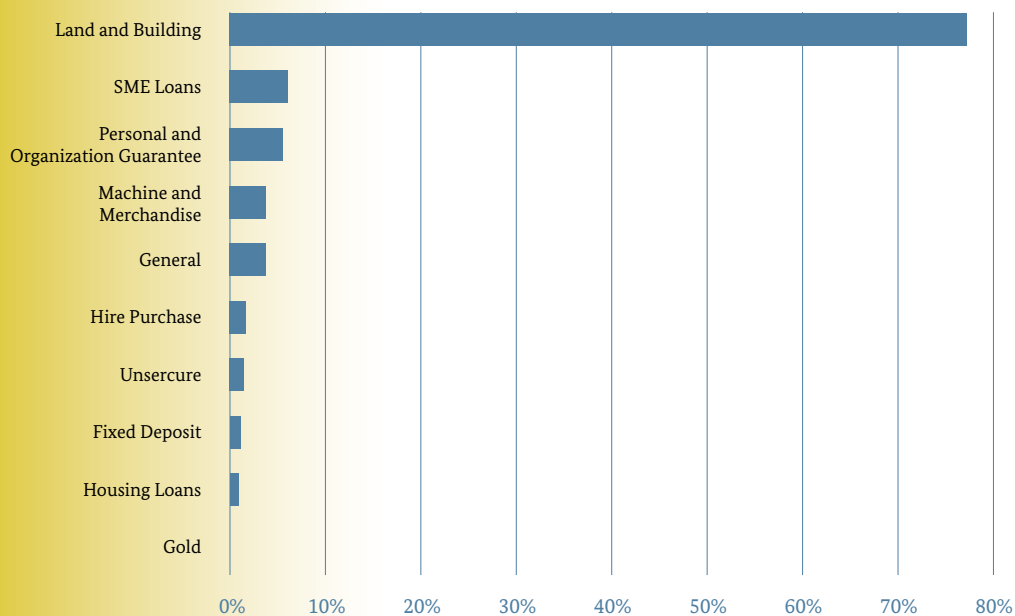
There are two direct consequences resulting from this overreliance on real estate as loan collateral. Firstly, it makes banks vulnerable to large losses in values of these properties. As banks tend to only lend a maximum amount of 50 to 70 percent of the collateral value, this may, however, not be a major concern in the short and medium term. Secondly, prevalent collateral requirements make it especially hard for those that do not own adequate assets to access bank loans – such as most SMEs and private households.

Despite high collateral requirements the private banking sector of Myanmar is allegedly plagued by high NPL risk (but accurate data is not available). According to a report of the CBM, the banking sector's NPL ratio in the 2018-2019 fiscal year will be higher than that of the previous year due to the CBM

Instruction 17/2017 lowering the past due date for NPL to 180 days and because banks started financing based on movable assets ⁴⁵. Moreover, one third of the banking sector's overdraft facilities might be considered bad loans under the CBM's strict regulations issued in 2017. Some banks may even face the

risk of capital insufficiency and insolvency ⁴⁶. Considering these problems, the relaxation of banking regulations for the purpose of economic recovery in the current global pandemic crisis appears rather dangerous regarding the stability of the banking sector and the overall economy.

Private bank loans by collateral types (%), as of December 2019



Reference: CBM Quarterly Financial Statistical Bulletin, 2019 Vol III

Figure 14 Private bank loans by collateral types (%), as of December 2019



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Foreign Banks

After the nationalization of the banking sector in 1963, foreign banks were not allowed to operate in Myanmar. It was only in 1990 that the government of Myanmar re-admitted foreign banks into the country. Since then, the number of licensed foreign banks has steadily grown, particularly over the last five years. As of September 2020, there are 13 foreign licensed banks and 46 representative offices of foreign banks in Myanmar.

In the past, foreign banks were only allowed to lend to foreign enterprises in foreign currency, but CBM Directive No. (6/2018) issued in November 2018 permitted foreign banks to lend to domestic businesses in local and foreign currency. Interest rates for Kyat loans by foreign banks abided by the maximum bank lending rate of 13%, while foreign currency loans could be priced at market rates. In the current pandemic crisis, foreign banks also have to implement the directive of interest rate reduction aimed at encouraging low-interest loans to businesses.

Other restrictions on foreign banks are still in force, for example, not being allowed to accept immovable property – like land and buildings – as collateral. They are also not allowed to offer retail banking services, such as personal savings accounts, money transfers and card services, as well as fixed deposit accounts in local currency. Foreign banks may accept foreign currency deposits but there is still no decision whether interest may be paid on such accounts.

The local market has been opened gradually to foreign banks. In January 2019, the CBM permitted that domestic private banks can accept an equity investment of up to 35% from foreign financial institutions⁴⁷. Accordingly, a significant movement can already be found in the banking sector. IFC, for instance, converted its loan to Yoma Bank to a 5% equity shareholding in June 2019, making Yoma Bank the first private bank in Myanmar with a foreign equity stakeholder⁴⁸. The Ayeyarwaddy Farmers Development Bank (A Bank) was the second bank that received foreign investment, when in April 2020, Kasikorn Bank acquired a 35% equity stake⁴⁹.

Since November 2019 a third round of foreign bank licensing has been ongoing, enabling foreign banks to apply either for a Branch or a Subsidiary License⁵⁰. In April 2020, seven Asian banks were granted preliminary licenses⁵¹. Among the seven new banks, three banks are from Korea (state-run Korea Development Bank, Industrial Bank of Korea and KB Kookmin Bank), two are from Taiwan (Cathay United Bank and Mega International Commercial Bank), one from Thailand (Siam Commercial Bank), and one from Hong-Kong (Bank of China). Industrial Bank of Korea, KB Kookmin Bank, and Siam Commercial Bank have been granted subsidiary licenses, while the others obtained branch licenses. Under a branch license, a range of wholesale banking activities is allowed, whereas under a subsidiary license, both wholesale and onshore retail banking services are allowed from January 2021.

As of December 2019, foreign banks held over 11% of total assets, about 8% of total deposits, and 6% of total loans of Myanmar's banking sector. It is expected that these figures will soon increase as more foreign investments enter the Myanmar banking sector. This will facilitate knowledge transfer and the application of international best practices in the domestic banking sector. However, there is also a potential risk that domestic banks are not strong enough to withstand competition from foreign banks.





Capacity Development and Supporting Institutions

Backed by the banks' strong demand as well as by political and economic liberalization, the supporting infrastructure for Myanmar banks is developing at a fast pace. This includes institutions like the Myanmar Banks Association, the Myanmar Payment Union and the emerging Myanmar Credit Bureau Limited, as well as numerous bank training and education providers such as the Myanmar Institute of Banking (MIB) and the Yangon University of Economics (YUE).

The fast growth of the banking sector translates into a huge demand for finance education and bank training. Several private training providers have been established to add to the rather low supply of university degree programs. However, the current supply of training is still not sufficient to meet the future needs of the sector. Moreover, ensuring the quality of offered programs remains a challenge as long as there are no national quality standards set by the respective authorities.

The Myanmar banking sector is developing fast and requires an increasing number of qualified staff to ensure its long term viability. Banks begin to offer more sophisticated products and services, the range of skills needed will diversify and international best practices will become more and more relevant. In order to close the skill gap and take advantage of a growing market opportunity, numerous private training providers have emerged that offer training courses as well as undergraduate and graduate degrees through partner organizations. Private training institutions such as the Myanmar Institute of Finance, John Partner Academy, PS Business School, the Myanmar Institute of Business and the Strategy First Institute are offering general business training courses also attended by bankers. Some of the private training providers offer internationally recognized certifications such as AAT (Association of Accounting Technicians), ACCA (Association of Chartered Certified Accountants), CFA (Chartered Financial Analyst), and LCCI (London Chamber of Commerce & Industry) through their affiliations with accredited international institutions. However, assessing the quality of courses and certifications provided by local providers is difficult, and the absence of clear national quality standards and quality assurance mechanisms remains a challenge that influences the reputation of these programs.

Only three higher education institutions – Yangon University of Economics, Meiktila University of Economics and Monywa University of Economics – offer degrees in Business Administration, Commerce, Economics, Statistics and Public Administration, and only the Yangon University of Economics runs a Master of Banking and Finance program.

The state-owned Yangon University of Economics (YUE) has been offering a three-year part-time Master of Banking and Finance (MBF) program since December 2012. Many local bank professionals have attended the MBF program and the demand for the courses far exceeds the available spaces. The GIZ supports YUE in developing the MBF curriculum and for training courses to MBF lecturers and students. In addition, GIZ supports YUE regarding their cooperation with Frankfurt School of Finance and Management to set up a banking education program which will offer certificate courses on various topics, including leadership, SME finance and IFRS-based accounting. Furthermore, an e-learning approach was established in 2020 offering courses of six months duration on four topics (risk management, SME finance, digital finance and agricultural finance). In January 2019, Meiktila University of Economics launched an MBF program in Nay Pyi Taw so that government employees have the opportunity to continue their studies and improve their skills and knowledge regarding banking and finance ⁵².

The Myanmar Banks Association (MBA) was established in April 1999 to provide a dialogue and lobbying platform for the domestic banking industry. MBA also cooperates with associations and banks on an international level. It currently has 31 member banks, including all four state-owned banks. Until early 2013, the MBA was chaired by the CBM Governor, while representatives of local banks assumed



vice-chairperson and secretary functions. In September 2013, for the first time since its inception, the MBA elected a board of directors that is independent from the CBM. The current chairman of MBA is also the chairman of CB Bank. The Myanmar Institute of Banking (MIB) was established in 2002 and is a quasi-department within the MBA. The MIB provides bank training, particularly for entry to mid-level management. Various training courses on general banking topics are being conducted at the MIB center in Yangon. Courses include Diploma in Banking, Certificate Level of English for Banking and Finance, Principles of Practice of Bank Auditing, Certificate in International Trade and Finance and other banking related training courses.

The Myanmar Payment Union (MPU) was established by Myanmar banks in the year 2011 to stand as a National Payment Switch for Myanmar, i.e., a system supporting non-cash payments originating from electronic channels such as ATMs, POS terminals, mobile banking, etc. Since 2013, banks and other stakeholders have been working together on expanding payment services, including internet and mobile banking. In January 2016, CBM-Net, Myanmar's first real-time gross settlement (RTGS) was implemented. Large payment transactions can be made through CBM-Net, while the MPU provides the facilities for retail payments.

The Myanmar Credit Bureau Limited was granted a license by CBM in May 2018 to become the first credit agency of the country. It is established as a joint venture between MB Investment Limited, a proxy company for the Myanmar Banks Association, and Asia Credit Bureau Holding Limited formally known as NSP Holdings Pte Ltd from Singapore, sharing 60:40 stakes respectively. With the relaxation of collateral requirements by CBM and banks moving towards cash-flow based lending, the Myanmar Credit Bureau can help increase access to finance and reduce credit risk to lenders. The Myanmar Credit Bureau works closely with the local private banks, the state-owned banks, and foreign banks branches operating currently in Myanmar including non-bank financial institutions being data providers for the credit bureau to capture consumer lending activities that are beyond formal lending activities of the banks. The Myanmar Credit Bureau has recently made impressive progress: the credit bureau software and services for consumer reports are almost ready to be launched, and the bureau's website will officially go on wire very soon. Although minor delays due to the corona crisis are to be expected a soft launch is scheduled for November 2020 (the bureau will start with the top 10 banks which contributed the required data and will get initial access to the system for familiarization purposes).



Services of the No. 1 Banking Sector

4

Commercial Loans

In terms of commercial lending, the Myanmar banking sector largely relies on overdrafts and loans secured by land or buildings (GIZ, 2018). Traditionally, banks in Myanmar were strictly instructed to extend only secured loans. However, in late 2017 the CBM issued a directive that encourages banks to offer unsecured and partially secured credit facilities based on the expected cash-flow of a borrower, with the condition that banks establish proper credit risk management systems ⁵³. While some progress can be seen in that respect, private banks still prefer conventional collateral for various types of loans. Land and buildings as credit security accounted for 77% of collateral in December 2019, coming down from almost 90% in December 2017 ⁵⁴.



Due to the high risks associated to overdrafts the CBM issued Directive No. (7/2017) in the year 2017, obliging private banks to convert overdrafts to maximum three-year term loans and reduce the share of overdrafts in the whole portfolio of individual banks by 50% in July 2018, another 30% in July 2019 and a final 20% in July 2020.

While accurate data are difficult to obtain, overdraft facilities still contributed an estimated 70% of total private bank loans in December 2018 ⁵⁵ and there are concerns that many big companies are technically in default on their overdrafts. Furthermore, it must be assumed that the NPL ratio of the Myanmar banking sector is on the rise due to the severe impacts of the COVID-19 crisis on almost all businesses.

Consumer and home loans

Besides commercial lending banks also offer consumer loan products to individuals. Since 2015 an increasing variety of consumer loan products catering to specific customer needs have been developed, including education loans, home loans, vehicle loans, and various personal loans, for instance to purchase mobile phones or laptop computers.

After many boom years the real estate market started to decline in late 2016, especially in the economic capital Yangon that is the main player in this market. This decline is due to excess supply and legal concerns such as the lack of clarity on foreign ownership, land use and building management committees in the Condominium Law ⁵⁶.

Since then, some construction companies and real estate developers have cooperated with banks to provide home loans to potential borrowers, in an attempt to revive the real estate sector. The Construction, Housing & Infrastructure Development Bank (CHIDB) is the most specialized bank in the home loan market. The Japanese government also provides two-step-loans (TSL) to CHIDB through JICA. Under this scheme, the bank has disbursed a total of 5,041 housing loan as of July 2020 ⁵⁷. Other banks such as AYA, CB, KBZ, MCB, UAB and YOMA also offer home loans to retail customers. Borrowers are usually required to contribute a 30 to 50 percent down payment; the loan duration is between 3 to 15 years for apartments, and up to 25 years for single houses and condominiums. The home loan product brings many benefits to all parties involved: customers become owners of real estate, while developers and banks generate stable revenues. As can be seen in the figure below, home loans experienced significant growth since 2016, with a sharp increase in 2019.

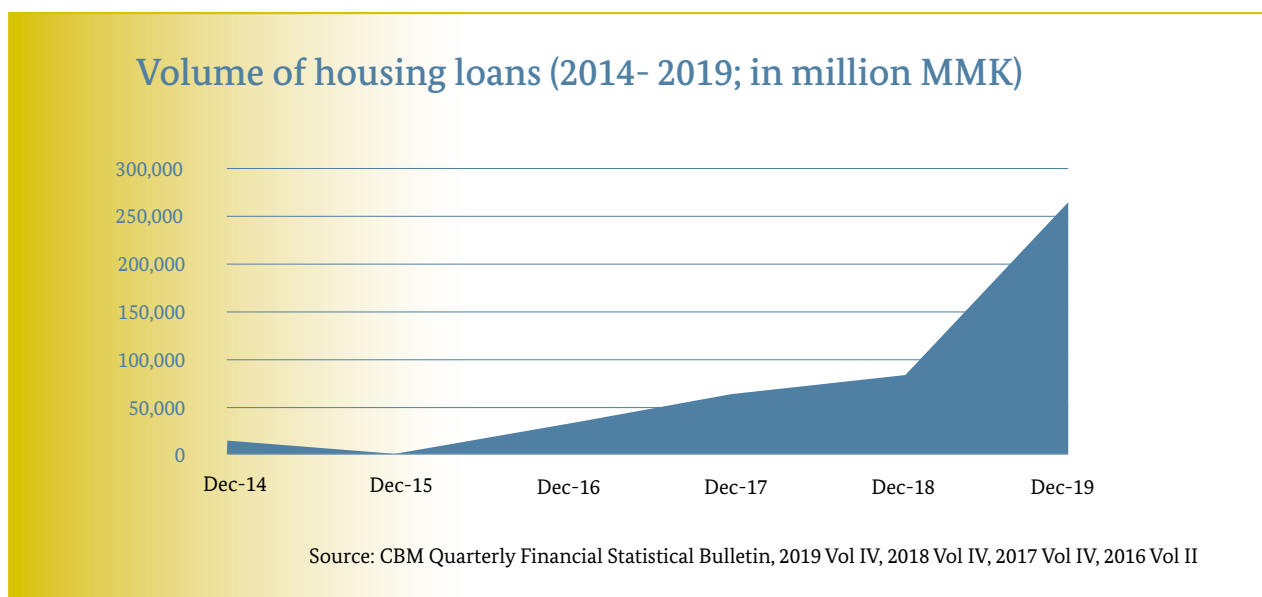


Figure 15 Volume of housing loans (2014- 2019; in million MMK)

Project finance

Being a developing country, Myanmar is highly in need of improving its infrastructure. The government practices an open tender system to fulfill that need. However, companies that won a public tender will normally receive a first instalment of the agreed budget only after completion of 25% of the project. Hence, most companies require capital to initiate the infrastructure project. Banks, on the other hand, may be keen to provide finance for companies on government projects, assuming a contract-based business between government and private companies to be low risk.

The provided project finance can be short term as well as medium or long term depending on the type and size of the project. Hence, project financing creates a lot of opportunities for banks to develop new products and win new customers. There are also obvious benefits for the business sector and the economy at large: easing the financial burden of companies and creating new business and job opportunities. Currently, CB, KBZ, MCB, AYA and some other smaller banks are offering project finance loans (also known as tender financing).

Factoring and invoice financing

There are various financial products that use company receivables as credit security, known under different terms such as factoring, invoice discounting, receivable finance or invoice financing. According to the Financial Institutions Law (2016), Section 2 (aa), factoring means the business of financing account receivables. It involves three actors: supplier, buyer and financial institution. The latter buys invoices from suppliers at a discounted rate or uses it as credit security. This product is particularly aimed at raw material suppliers and manufacturers that sell their goods to wholesale and retail traders (buyers) but usually do not receive cash immediately upon delivery (due to the agreed payment terms it may

take up to three months to settle bills). In the meantime, the supplier might face a cash flow problem to continue business operations (for example to purchase raw materials or pay wages).

In Myanmar, several financial institutions such as KBZ, CB, YOMA, MCB and AYA offer invoice financing, also known as distributor finance. The customers usually have to apply for bank loans by submitting their invoices either in physical or electronic form. The assessment process differs between the banks.

The technology companies Kyopay and Shwelan introduced digital invoice discounting platform to Myanmar. In this case, suppliers (mostly SMEs) have to submit their business-to-business invoices or receivables to an internet platform. As soon as the submitted invoices are verified the supplier will receive cash. There are two options here: either the platform operator purchases the invoices at a discounted rate or it disburses an initial advance to the supplier after the invoice is verified and the remaining amount once the buyer made full settlement (in this case the invoice is regarded as a reliable collateral). The business models of Kyopay and Shwelan differ slightly. While Kyopay engages directly with funders or investors, Shwelan cooperates with financial institutions. Kyopay entered the market in 2018 and has already served over 100 SMEs.

SME Finance

The small and medium enterprise (SME) sector is the backbone of the Myanmar economy and a crucial driving force behind the country's recent economic development. Registered small and medium enterprises accounted for 80% of total registered industrial enterprises in November 2019, and in March 2020 there were 75,452 SMEs listed at the SME Development Agency under the Industrial Supervision and Inspection Department of the Ministry of Planning, Finance and Industry ⁵⁸.

While the Myanmar government acknowledges the importance of SMEs for the national economy and

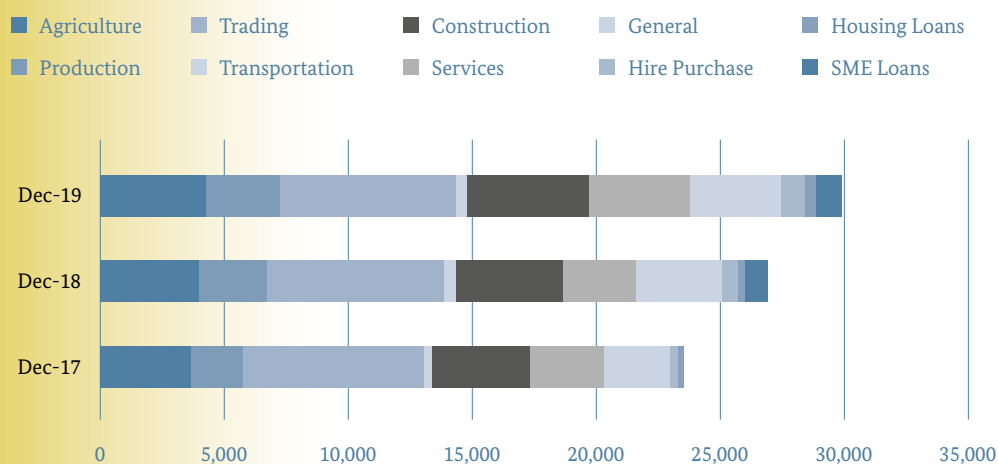


supports the development of the sector, for instance by facilitating access to new technologies and finance in cooperation with international organizations, SMEs still face difficulties to obtain formal financing. The total SME loan volume of all SOBs and private banks in Myanmar was about 30 billion MMK in December 2017 and increased to over 1,000 billion MMK in December 2019. Although a significant progress in SME lending is found, it only makes up 4.21% of the total loan portfolio of the Myanmar banking sector.

Collateral-based lending has been a decades-long practice in the Myanmar banking sector. The loan amount is based on the forced-sale-value of the collateral. Without a formal land title, however, getting a bank loan is very difficult, which impedes access to finance especially for smaller enterprises. Even though the CBM has encouraged banks to apply new lending practices and defined a spread

for unsecured lending, modern SME finance is still predominantly a new chapter for domestic banks. Due to the long tradition in collateral-based lending, the transition to risk and cash flow-based lending poses a challenge for the local banks. Thus, the role of technical assistance is becoming prominent to promote the use of international best practices in SME lending. Credit staff needs to be equipped with a new set of skills such as a deep understanding of different business models, business cycles, cash flow pattern, associated risks of the business and needs of the client as well as credit assessment skills. A huge investment in human resources is necessary. In addition, there is a need for more sophisticated products. Moreover, credit decision making has to be changed. While the credit decision process in modern SME lending is mostly decentralized, the existing technique in Myanmar requires almost all applications to go through high-level credit committees.

Loan portfolio break-down according to sectors in all Myanmar banks from 2017 to 2019 (in billion MMK)



Reference: CBM Quarterly Financial Statistical Bulletin 2019 Volume IV, 2018 Volume IV, 2017 Volume IV

Figure 16 Loan portfolio break-down according to sectors in all Myanmar banks from 2017 to 2019 (in billion MMK)



Despite obvious challenges the opportunities of a largely untapped SME finance market are luring. Some financial institutions have ventured into SME financing in the expectation of higher profit margins. For example, YOMA Bank designed a wide range of products for SMEs and some are offered digitally. The evolution of digital finance has the potential to make banks improve their SME services, particularly in terms of loan processing time and credit analysis methods.

Regulatory encouragement from the CBM and technical assistance to the banking sector, however, will not suffice to make a significant improvement to SME financing in Myanmar. The capacities and skills of SMEs also need to be improved. Many entrepreneurs lack financial literacy and management skills and therefore cannot provide the documents required by the banks in the process of credit appraisals, which is one of the major bottlenecks in getting credit ⁵⁹. This problem also hampers the implementation of the 100 billion MMK loan fund under the COVID-19 Economic Relief Program (CERP) provided by the Myanmar government. Loan processing is often delayed due to incomplete documents provided by the SMEs and it is suggested that financial management training should be given to them ⁶⁰.

As SMEs themselves rarely understand how to properly prepare financial statements, they have to pay chartered public accountants (CPA) to meet the banks' loan requirements. However, the reliability of financial statements prepared by CPAs is also a problem. Thus, this approach puts an extra burden on SMEs without ensuring loan approval. Therefore, banks may have to find new ways to avail the required business data. For instance, they could set up strong IT systems to analyze already available business data and develop industry-wide standard data sets to be applied for faster loan decisions. Alternatively to or in conjunction with a standardized data approach, banks may also benefit from strengthening their staff capacities to conduct on-site and off-site business assessments.

Although it is still difficult for SMEs to access bank loans, there are more financing opportunities these days, especially through the help of international organizations. The Japanese government agency JICA, for example, has provided concessional refinance to Myanmar to implement its Two-Step-Loan (TSL) scheme since 2015. TSL borrowers spend 80% of the loan amount on fixed capital investments and may use the remaining 20% for working capital. In the first phase more than 57 billion MMK were disbursed to 269 local SMEs. In the second phase, starting in 2018, JICA has committed over 143 billion MMK to MEB which on-lends to 11 selected partner banks: MCB, KBZ, MEB, CB, AYA, FPB, UAB, SMEDB, MOB, MAB and NDB are eligible to disburse loans to SMEs at 8.5% annual interest rate ⁶¹. In August 2020, the third tranche of loans amounting to 15 Billion yen (190 billion MMK) was officially approved by the Parliament. Since the CBM reduced the reference interest rate to 5% p.a. during March and April 2020, the interest rate of JICA's TSL was also reduced to 5.5% p.a.

In response to the COVID-19 crisis, the TSL also offers emergency loans to MSMEs, in addition to normal SME loans. Approximately 64 billion MMK have been earmarked for that purpose. The emergency scheme is scheduled from June 2020 to March 2021. Moreover, JICA has extended its TSL program to rural electrification by relaxing some credit conditions in early 2020. Large enterprises acting as mini-grid developers are now eligible under the expanded scheme ⁶².

Apart from JICA's TSL scheme, there are currently various other SME finance programs in Myanmar. On behalf of the German Federal Government, KfW Development Bank supports selected partner banks in cooperation with the Ministry of Finance in the field of SME finance. In the first phase, CB Bank was selected as the partner and EUR 4.45 million was provided for SME loans. The second phase was started in April 2018, with a fund of EUR 10.85 million. CB Bank and MAB were selected as partner banks and received funds at an annual interest rate of 3.5%, with 12 years grace period and three years repayment period. The banks are permitted to charge 8.5% interest per annum on loans to SMEs ⁶³.



Agricultural Finance

Being an agro-based country, 70% of Myanmar's population lives in the rural areas contributing about two third of the total employment. However, low income households and small enterprises in rural areas are rarely served by commercial banks, allowing space for microfinance organizations, non-bank financial institutions and informal financial service

providers, including money lenders, traders and village-based savings and credit groups ⁶⁴.

Most private banks in Myanmar are reluctant to offer agricultural finance because of the unpredictability of natural disasters and commodity price fluctuations. Therefore, farmers' credit access is very limited and typically offered by government institutions in the form of subsidized loans. The Myanma Agricultural

Types of Loans	Amount (billion MMK)	Duration of loan
2017-Premonsoon	16.36	January to March
2017-Monsoon	1,416.70	May to September
2017-Winter	272.22	October to January
2018-Premonsoon	18.78	January to March
2018-Monsoon	1,301.61	May to September
2018-Winter	366.26	October to January
2019-Premonsoon	16.50	January to March
2019-Monsoon	1,364.71	May to September
2019-Winter	362.20	October to January
2020-Premonsoon	17.96	January to March
2020-Monsoon	1,375.99	May to September

Table 1 Loans disbursed by MADB from 2017 to 2020 (in billion MMK)

Source: Ministry of Planning, Finance and Industry, 2020

Development Bank (MADB) is the largest agricultural lender of the country. MADB offers two types of loans: seasonal crop production loans (SCPLs) and term loans. SCPLs cover the working capital needs of farmers at the beginning of the agricultural season and are divided into three categories: pre-monsoon, monsoon and winter loans, with monsoon loans constituting the biggest number of loans. SCPLs generally have one-year maturity and farmers are expected to repay the full amount at harvest time. The loan amount is 150,000 MMK per acre for paddy and 100,000 MMK for other 22 crops. Farmers have to pledge a formal land title as loan collateral. In the 2020 monsoon period MADB disbursed almost 1.376 trillion MMK (see Table 1).

In addition to MADB, the Japanese government agency JICA and MEB also make available agricultural loans under the TSL scheme at annual interest rates of 5% and 6.5% respectively. According to JICA, farmers can apply for loans to purchase agricultural machinery, up to 50 million MMK as individual loans and up to 500 million MMK for cluster loans, depending on business size and repayment capability. ⁶⁵

There are currently various pilot projects in agricultural finance. One such project is implemented at Naypyitaw Council area since early April 2020 under the MEB and MADB, providing loans to MSMEs and agri-businesses. A total of 126 million MMK has been disbursed in loans to 13 borrowers. Under this project, the cash flow from the business is assessed, which is different from the traditional lending method that requires a formal land title as loan collateral. The maturity of loans is one to three years, and the interest rate is the same as at commercial banks. The pilot project will be extended to other states and regions and loans will be disbursed to individuals or groups in manufacturing and service industries, including MSMEs and agri-businesses ⁶⁶.

In 2019, A bank with the cooperation of Myint Myat Taw Win company implemented a large financing initiative for sesame farmers at Magwe Region, known as the oil bowl of Myanmar. The bank cooperated with local NGOs, the Network Activities Group (NAG) established a decade ago focusing on farmers' development in the Magway Region and the DaNa Facility.

Moreover, the regional government, parliamentary representatives, the General Administration Department, the Department of Agriculture, a private company (merchant) and the Regional Farmers Development Association (RFDA) supported the program's implementation. 3,471 farmers had applied for loans. The total loan amount disbursed is nearly 1 billion MMK, covering 16,149 acres, which averages 70,000 MMK per acre. Borrowers pay 13% interest p.a. plus 3% service charge, with a maturity of 6 months from April to September. Farmers who do not have a land title to pledge as loan security need to get a recommendation from the Department of Agriculture. Thus, farmers with or without official land ownership record (Form 7) are eligible to receive loans. The project was very successful due to a good production year and farmers fully repaid all their loans after harvesting. In addition, farmers received higher prices for their products due to collective selling and the application of good agricultural practices (GAP). This kind of business model could be extended to other crops and geographical areas, particularly to cluster groups.

YOMA Bank applies a different business model to serve the agricultural sector. The bank intends to disburse 5% of its total portfolio to this sector and developed many tailor-made products for farmers and agro-enterprises, including equipment finance, seasonal credit facilities for different crops depending on the location, contract finance, post-harvest loans to processors and local and international traders, input finance, payable and receivable finance, agricultural inventory discounting and pledge loans.

Crop and livestock insurance schemes are still in the experimental stage in Myanmar. In December 2018, Myanmar Insurance and MADB – with the support of Sompo Japan Nipponkoa Insurance Inc. – started a pilot project to test weather index-based crop insurance to protect paddy farmers from losses due to adverse weather conditions. The trial is implemented in Pyay Township, Bago Region, and Shwebo Township, Sagaing Region ⁶⁷. The results of the pilot project have not yet been published. However, the Myanmar Insurance plans to extend its insurance services to other regions and states with the approval of the government after the completion of the pilot project ⁶⁸.



Box 5: GIZ Financial Literacy Program

One of the projects of GIZ in Myanmar, the Sustainable Aquaculture and Food Quality Initiative, (SAFI) has implemented a financial literacy training of trainers (TOT) program together with its four implementing partners, Myanmar Sesame Farmers Association (MySFA), Organic Roots Myanmar (ORM), Myanmar Coffee Association (MCA), and Myanmar Fruit, Flower and Vegetable Producer and exporter association (MFVP). Ten members from each organization have been trained by an expert from the GIZ BFSI project to deliver financial literacy training to farmers of the respective organizations. Coaching sessions were conducted at village-based locations.

It is very clear that farmers lack proper financial record keeping resulting untraceable about their aggregated investment, total cost, profit and loss along the life of the plantation. The financial literacy training has filled all these gaps. After completion of the training, farmers gained financial literacy knowledge for the perennial crops as well as seasonal crops which increase their financial management skills. Under this TOT program, 10 trainers were successfully certified and they reached out to more than 400 farmers across Magway region and Shan State from 20 2019 to December 2020.





Trade Finance

The private banking sector was allowed to provide trade finance in 2012. Today, many local banks provide fee-based services such as letter of credit, bank guarantees, and interest-bearing services including import financing, and pre and post shipment export financing. Currently, however, five local banks – AYA, CB, KBZ, UAB, and Yoma Bank – are the main providers of trade finance in the Myanmar market.

Although trade finance is not a new function for the local bankers, they still lack local human resources with trade finance skills. Furthermore, there are weaknesses in IT capacities and risk management. Last but not least, there is stiff competition between the banks to attract suitable customers who are running export or import businesses.

In December 2017, the CBM gave permission to foreign banks to conduct export financing, and in August 2018 foreign banks were also permitted to start offering import trade finance services. Yet, foreign banks still face difficulties in serving local trade firms because these firms rarely have reliable and standardized financial records and statements. Moreover, the lack of credit bureau information makes it difficult for foreign banks to assess the creditworthiness of local traders. Hence, foreign banks usually extend trade financing facilities only to their long term corporate customers. Local exporters and importers, especially small and medium sized trading firms, therefore find it almost impossible to access trade finance facilities from foreign banks.

In Myanmar's international trade, the volume of imports is always higher than exports so that there is higher demand for import financing than for export financing. Since the beginning of the COVID-19 crisis in March 2020, declining international trade transactions and the fluctuations of the oil price have badly affected the banks' trade financing services.



A person wearing a blue uniform is holding a large stack of Myanmar banknotes. The top banknote is a 5000 Kyat note, featuring a central illustration of a traditional Myanmar scene with people and a horse-drawn cart. The text 'FIVE THOUSAND KYATS' is visible at the bottom of the note. The background is a soft, out-of-focus light blue and white.

Deposits

Myanmar banks offer fixed deposit, call deposit and current accounts. Deposit products are often tailored to serve different customer segments' needs, for instance, minor deposit account, children's savings account, senior citizen savings account, wedding deposit account or foreign currency account. Figure 17 shows the deposits amount in the banking sector from the fiscal years 2014-2015 to 2019-2020 (October to January). During this time period total bank deposits increased nearly 3 times, with saving deposits contributing the bulk of total deposits.

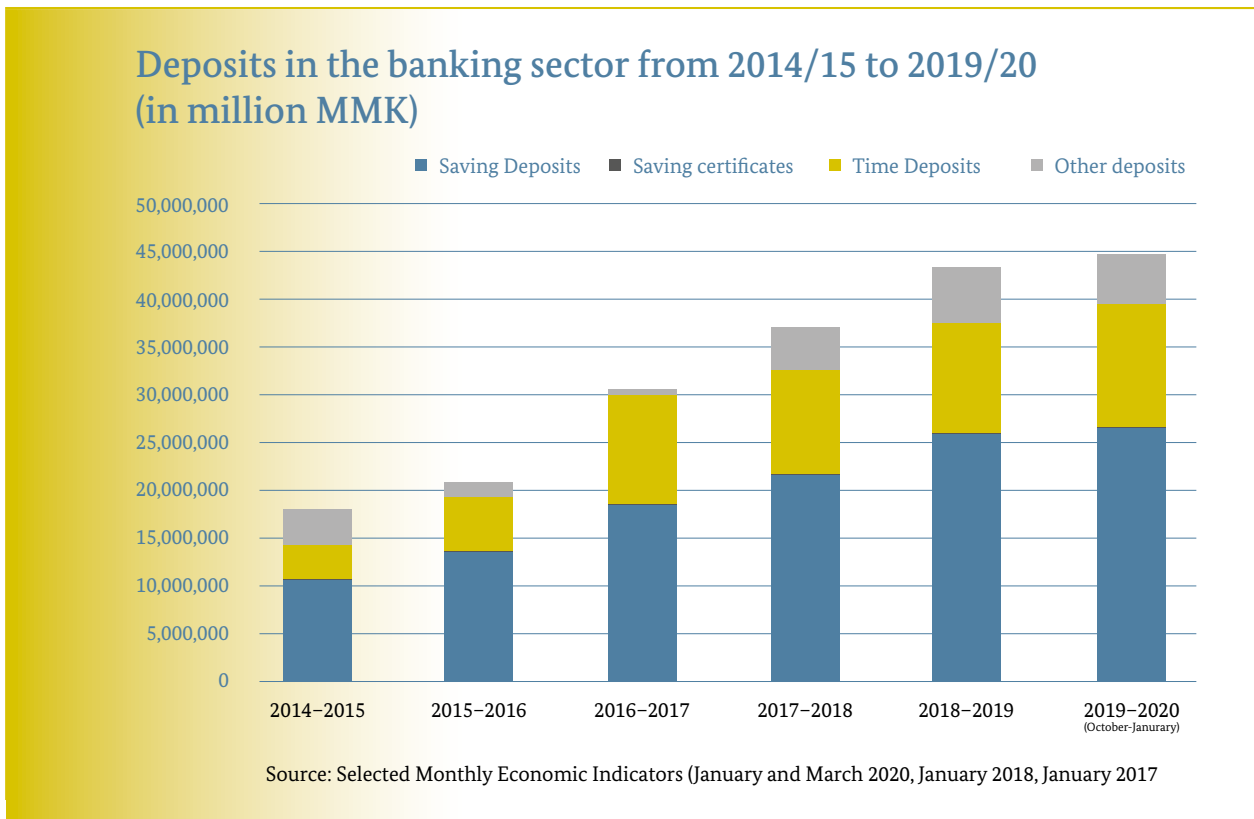


Figure 17 Deposits amounts in the banking sector 2014/15 to 2019/20 (in million MMK)

Terms for fixed deposit accounts (time deposits) typically range from 1 month to 3 years. Due to the COVID-19 crisis fixed deposit interest rates have been reduced and now range between 6.25% and 8.5%, while current accounts and foreign currency accounts generally do not bear any interest payments. For call deposit accounts banks offer between 2% and 5% interest, based on the account's day-end

balance. The interest rates on savings accounts range between 5% and 7%. In accordance with CBM rules, foreign currency accounts can only be opened for three currencies (USD, EUR or Singapore Dollar) and account holders do not receive interest but are usually required to pay up to 2% of the deposit amount as fees.



Remittances

More than 5 million Myanmar nationals living abroad sent back money to their families ⁶⁹.

They remitted about USD 2.4 billion in 2019, which was approximately 3.2% of Myanmar's GDP in that year ⁷⁰. Although the exact figures for remittances into and out of Myanmar are difficult to estimate as a large proportion is transferred through informal channels, domestic and international remittances play a crucial role for Myanmar's economy and in particular for poverty alleviation since people from poor rural areas are increasingly migrating for work either to big cities or neighboring countries and send back money to their families.

With the aim of reducing unofficial offshore remittances and to provide a legal framework for such activities, the CBM issued regulation on Offshore Remittance Business (ORB) licenses in November 2019 ⁷¹. The maximum level of funds receivable or transferable by the ORB licensee on behalf of an individual customer at a given time will be USD 1,000, and there is a transaction limit of USD 5,000 per person and month. The CBM expects that the new remittance license system will provide official remittance records.

Myanmar banks offer domestic inter-branch and inter-bank remittance services, telegraphic transfer and international fund transfer by SWIFT Code through corresponding banks, and international transfer through third party remittance service providers such as Moneygram, Western Union, Xpress Money, International Money Express, etc. Recently, there have been significant improvements in domestic remittance services by local banks through their e-banking and mobile payment platforms.

For international remittances, 21 Myanmar banks have joined the Society for Worldwide Interbank Financial Telecommunication system (SWIFT). Through SWIFT, local banks can make secure, efficient and reliable financial transactions with their foreign correspondent banks. Recent years have also seen some relaxations on outbound remittance restrictions, especially with third party remittance

providers. After four years of being active in Myanmar and providing only inward remittances, Western Union, for example, has launched outbound money remittance services in June 2016 – although with a transaction limit of USD 3,000 per day and maximum USD 10,000 per year and customer.

While there are more options for international remittances in Myanmar these days, people still heavily rely on informal channels called ‘hundi’ because migrant workers are often reluctant to go through official remittance channels due to their lack of legal immigration documents; hundi also is relatively cheaper and faster than official remittance channels.

Increasingly, banks also face fierce competition from Mobile Financial Service Providers (MFSPs) such as OK Dollar, Wave Money and M-Pitesan, as well as recent market entrants MytelPay and MPT Money which were granted their licenses in 2018 and 2019 respectively. Although under the 2016 Mobile Financial Service Regulations MFSPs are only allowed to provide domestic remittance services to the public, their simplified business model allows them to serve the large unbanked population of Myanmar (see next section for more details on MFSPs).





Card Services and Digital Finance

The Myanmar Payment Union (MPU) had a monopoly for issuing debit and credit cards for many years, but in January 2017 the government removed restrictions on international payment companies and allowed banks to issue co-branded cards with Visa, JCB, MasterCard and UnionPay International. The trend of online shopping is increasing remarkably in Myanmar, especially in the COVID-19 crisis period. In this business, both merchants and customers need to apply their MPU cards for online payments. Currently 12 out of 27 banks have applied for e-commerce and 21 out of 27 can issue MPU cards.

Today, local banks offer prepaid cards, debit cards and credit cards to the public. Credit cards are usually issued only to customers who meet certain monthly income requirements. Since the Myanmar Credit Bureau is still in the process of establishment, credit information on new customers is not available and most banks tend to issue credit cards only to their existing customers. Interest rates on credit cards are capped at 20% per year (as per CBM Directive No. 14/2019) but additional service charges, such as joining fees and annual fees, are generally imposed.

Since 2016 the CBM launched the Real Time Gross Settlement (RTGS) system, popularly known as CBM-Net, supported by JICA. It provides a platform for large interbank payment transactions, including interbank trading in currencies and securities. On 16 November 2020, the CBM launched phase 2 of CBM-Net, which includes connecting the core banking systems of banks to facilitate more digital interbank functions as well as RTGS of interbank obligations ⁷². Therefore, the CBM-Net now provides interoperability between all types of financial service providers to support more comprehensive digital payment systems. This facilitates the development of a cashless payment system ⁷³ and financial inclusion in Myanmar.

Very recently, Myanmar Payment Union (MPU) developed an inter-bank fund transfer (IBFT) service, which facilitates money transfers between banks; currently there are eight participating banks: Yoma Bank, Shwe Bank, CHIDB, MCB, uab, Myawaddy, MFTB and RDB.

Myanmar banks are trying to catch up with the fast digitization of financial services. CB is the first bank of the country that introduced a new flagship smart branch during the COVID-19 period. This branch is well-equipped with digitized infrastructure such as: ATMs and Cash Recycling Machines (CRMs); Form Filling Machines (FFMs) that allow customers to open electronic saving accounts and apply for debit and credit cards; Passbook Update Machines (PUMs) where customers can update their savings passbook transactions; Queue Machines (QMs) that issue queue and counter numbers to waiting customers; Smart Teller Machines (STMs); and 3D Hologram Machines where customers can view the bank's products. The

CB smart branch enables customers to operate desired services on their own, with minimal intervention from bank employees. In addition, customers can remit funds to local and foreign banks in Myanmar via CB Pay.

Considering the huge unbanked population in Myanmar ⁷⁴ and the rapidly increasing number of mobile phones in the country ⁷⁵, mobile financial services (MFS) have become an important means for financial inclusion. The CBM therefore issued several regulations on MFS and defined two models for operating MFS in Myanmar: Bank-led Mobile Banking Services and Mobile Financial Service Providers (MFSP).

In 2013, CBM allowed Myanmar banks to operate mobile banking services ⁷⁶. Under this model, banks are required to obtain a permission from CBM to operate mobile banking services, either on their own or in partnership with a mobile money business, using technological support from Mobile Network Operators (MNOs) and mobile banking solution providers to develop mobile banking products and platforms. Banks may engage with Non-Government Organizations (NGOs), governmental post offices and MNOs as their cash points, agents or business partners. CBM allowed banks to provide mobile banking services such as remittances, debiting and crediting of cash, and payments. Today, most Myanmar banks already operate mobile banking services and have linkages with Mobile Financial Service Providers (MFSPs). Currently, there are five major bank-led mobile banking services in Myanmar, as shown in the following figure.

Some banks also have their own branded e-banking platforms, namely: AGD Pay (Asia Green Development Bank), CB Pay (Cooperative Bank), KBZ Pay (Kanbawza Bank), and City Pay (Yangon City Development Bank). uab Bank started Sai Sai Pay and uabpay+ in 2020. These platforms are linked to customers' bank accounts and can provide remittances, cash in and out services, person-to-person payments within the bank, mobile top-up and bill payment services. The following figure shows current bank branded e-banking platforms in Myanmar.



Major Bank-led Mobile Banking Services

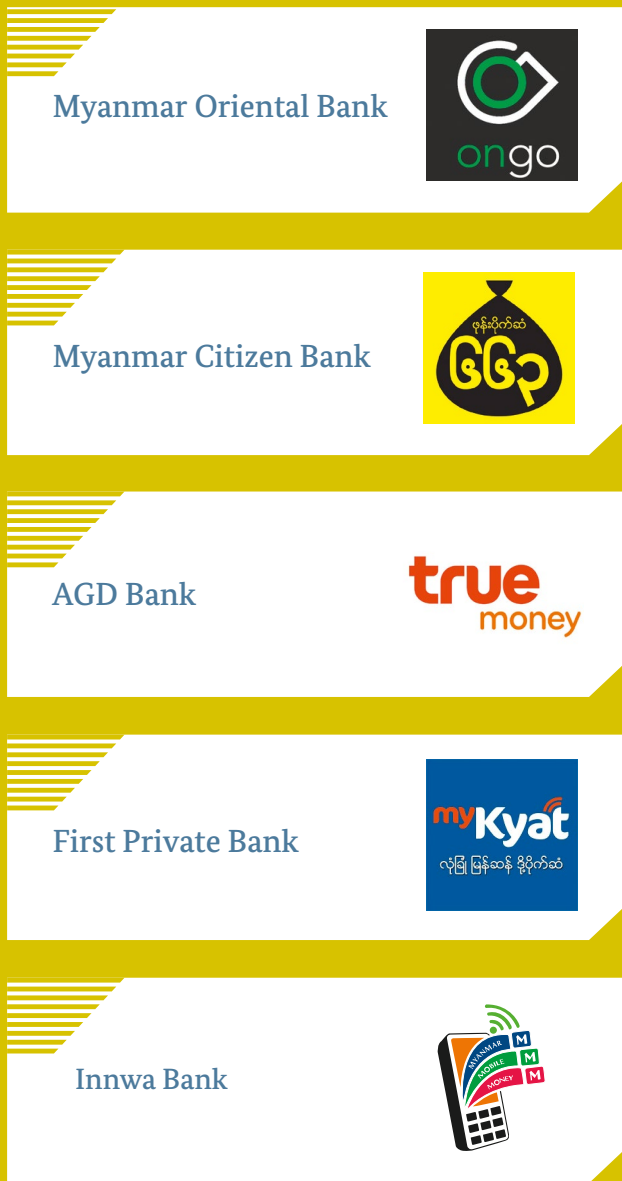


Figure 18 Major Bank-led Mobile Banking Services

Bank-branded e-banking platforms



Figure 19 Bank branded e-banking platforms

The regulation on Mobile Financial Services issued by CBM in 2016 laid out the foundation for the licensing and supervision of Mobile Financial Services Providers (MFSPs), which includes non-bank financial institutions and Mobile Network Operators (MNOs). MFSPs are required to directly apply for a Mobile Financial Service License from CBM, while in this model banks only serve as deposit taking institutions with additional cash and liquidity management services for MFSPs.

As of September 2020, there are five licensed MFSPs in Myanmar, namely Wave Money, OK Dollar, M-Pitesan, MytelPay, and MPT Money. In October 2016, Wave Money became the first MFSP to acquire a license under the non-bank financial institution licensing regime and today is the largest MFSP in the country. Wave Money's transferred value reached MMK 8 trillion (USD 5.9 billion) with 1.1 million 30-day active users between January and September 2020. As of September 2020, it has 89% coverage among 330 townships in Myanmar with more than 604,000 agents connecting to more than 27 million customers ⁷⁷. Wave Money provides safe and convenient mobile financial services via a nationwide agent network or via a Wave account on the customer's phone.

Wave Money has launched its mobile wallet application called 'WavePay' in 2018; it allows users to transfer money, top up airtime, pay utility bills, repay loans, buy travel and leisure tickets and make donations. WavePay is linked with Yoma Bank's SMART account and the mobile banking platforms of banks like KBZ, CB and AYA for cash-in services ⁷⁸.

OK Dollar was launched in 2017 and today is the second largest MFSP in Myanmar serving 2 million customers through its mobile phone apps and an extensive agent banking network ⁷⁹. This MFSP is partnering with various local banks for cash-in and cash-out services and bill payments.

M-Pitesan was launched by telecommunication provider Ooredoo in September 2017. By 2020, the network counted more than 2,500 Ooredoo M-pitesan agents in Yangon, Naypyitaw, Mandalay, Bago and Taunggyi. There also is a potential of adding another 8,000 agents

from rural areas across Myanmar ⁸⁰. The M-Pitesan phone application provides fund transfer services, airtime purchasing and utility payments.

MytelPay was launched in June 2019 by the telecommunication company Mytel, a joint venture between Vietnam's military-run Viettel Group and two Myanmar companies – Star High Public Co. Ltd. (a subsidiary of Tatmadaw-owned conglomerate Myanmar Economic Holdings Ltd.) and Myanmar National Telecom Holding Public Ltd. (MNTH) ⁸¹. This platform is providing fund transfer services, cash withdrawal, utility payments and mobile phone airtime top-up. According to information provided by MytelPay on their Facebook page their agent network covers 92% of all townships nationwide.

MPT, the state-owned Telecom, launched its digital money service MPT Money in 2020, offering a mobile wallet, money transfer, airtime top-up and data package purchases, bill payments, and cash-in and cash-out. Currently, MPT Money is offering services through its agent network of more than 27,000 agents located in over 280 townships nationwide ⁸².

MFSPs in Myanmar have proven to be very innovative and rapidly expanded their networks. Mobile financial services are extended to various functions including bill payments, commercial and business payments, e-shopping and donations. MFSPs also have established linkages to banks' e-banking platforms. Moreover, they try to provide their services to the agricultural sector. For instance, WavePay in partnership with MADB offers farmers access to loans through their digital disbursement program, while MTP Money is conducting a pilot project in cooperation with MADB to disburse loans to farmers in Patheingyi Township, Mandalay Region ⁸³.

During the COVID-19 crisis MFSPs play a crucial role in delivering branchless financial services to customers, thereby increasing financial inclusion in the country. However, competition among MFSPs is tough and product differentiation becomes increasingly difficult for them.



Box 6: Bancassurance

The dawn broke over Myanmar's insurance sector when in May 2013 the Insurance Business Supervisory Board (IBSB) granted operating licenses to eleven private insurance companies. Since then the state-owned Myanma Insurance (MI) started to release its monopolistic grip on the local insurance market. It was the first time in more than 50 years that the private sector was allowed to play a role in the insurance market where the penetration rate stood at just 0.07 percent of GDP – indicating a lot of potential for market development and a strong investment attraction.

As a first step of liberalizing the market to foreign insurers, three Japanese insurers, namely Tokio Marine & Nichido Fire Insurance Co Ltd, Sampo Japan Insurance Inc and Mitsui Sumitomo Insurance Co Ltd, were granted one-year temporary licenses in 2015 to operate three types of insurances – life, fire and motor – in Myanmar's special economic zones.

Further liberalization was made in April 2019 when five foreign insurance companies (British Prudential, Japanese Dai-ichi Life, Hong Kong AIA, US Chubb and Canadian Manulife) were authorized to establish wholly owned life insurance subsidiaries in the country; and in July of the same year several joint venture licenses for both life and non-life insurances were granted: Capital Life and Taiyo Life; Citizen Business and Thai Life; Grand Guardian Life and Nippon Life; AYA Myanmar and Sampo Japan; Grand Guardian General and Tokio Marine and Nichido Fire; and IKBZ and Mitsui Sumitomo.

As the liberalization gathers momentum, the Insurance Business Supervisory Board issues necessary directives and instructions to properly supervise the market. Among them, the Directive No. 2/2020 dated 4 March 2020 is on 'Bancassurance' which is a mutually beneficial partnership between an insurance company and a bank. The bank can earn additional revenue by selling

insurance products to its clients while the insurance company gets access to a broader client base and can make sales promotion of its products more effective.

In its directive, the IBRB permitted two types of institutions that can engage in bancassurance, namely banks and Microfinance Institutions (MFIs). The IBRB will issue Corporate Insurance Licenses to these financial institutions after getting permission from their respective supervisors – banks from the Central Bank of Myanmar and MFIs from the Microfinance Business Supervisory Committee. A financial institution applying for a corporate insurance agent license shall have at least three licensed insurance agents in its board or management team. To be able to engage in bancassurance, the financial institution shall have an agency agreement with the insurer and the number of agency agreements is limited to two with life insurers and three with general insurers. After getting a license from the IBSB, the financial institution can act as a corporate insurance agent for their partner insurer. There will be two types of distribution models for bancassurance: referral and direct sale. Referral means that a financial institution refers its customers to the partner insurer, whereas direct sale means that the financial institution sells insurance policies of its partner insurer directly to its customers. Hence, bancassurance also offers benefits to customers, one of which is convenience since the financial institution acts like a one-stop-shop for customers' financial service needs. At the same time, there may be a conflict of interest as the financial institution serves as insurance sales agent and financial advisor to its customers.

Acknowledging a very low level of knowledge and experience of insurance in the financial sector, the IBSB, in its directive, encourages insurers to organize training for insurance agents at the financial institutions.



Ins

"Insurance You

Life Assurance

Fire Insurance

Motor Insurance

Cash-In-Safe

Cash-In-Trans

Fidelity Insur

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7

IKBZ

The Regional Perspective

Performance of the Myanmar banking sector in a regional comparison

5

Despite its rapid development, the Myanmar banking sector still remains the smallest market when compared with other Southeast Asian nations. The profitability of Myanmar banks is weak, evidenced by low Net Interest Margins (NIM) and low non-interest revenues ⁸⁴. The fixed interest rate environment adds additional challenges such as the inability to price risk which results in shortfalls in interest income and very low loan-deposit ratios. Moreover, there is a lack of modern banking infrastructure and reporting transparency. These weaknesses become serious challenges for local banks' competitiveness as foreign banks are gradually welcomed into the local market. Additionally, this is particularly troublesome when considering the country's declarations to integrate into the ASEAN community.



KBZ
ATM

ငွေကူးထုတ်ယူရန်

AMPUL
VISA
UnionPay



မဟာဗုဒ္ဓဘုရားတော်
ကံစောင်းတန်း

စောင်းတန်း



The Net Interest Margin (NIM) depicts the difference between interest income and interest expenses of a bank, relative to the average of its interest-earning assets. It is considered a good indicator for the effectiveness of a bank's investment decisions. The figure below shows the average NIM ratios for banks

in selected countries of the region in 2017. Although the NIM of the Myanmar banking sector went up to 2.91% in 2017 from 1.85% in 2016, it is notably low when compared to other countries in the region (except Malaysia) and the average NIM of all lower middle-income countries (dashed red line).

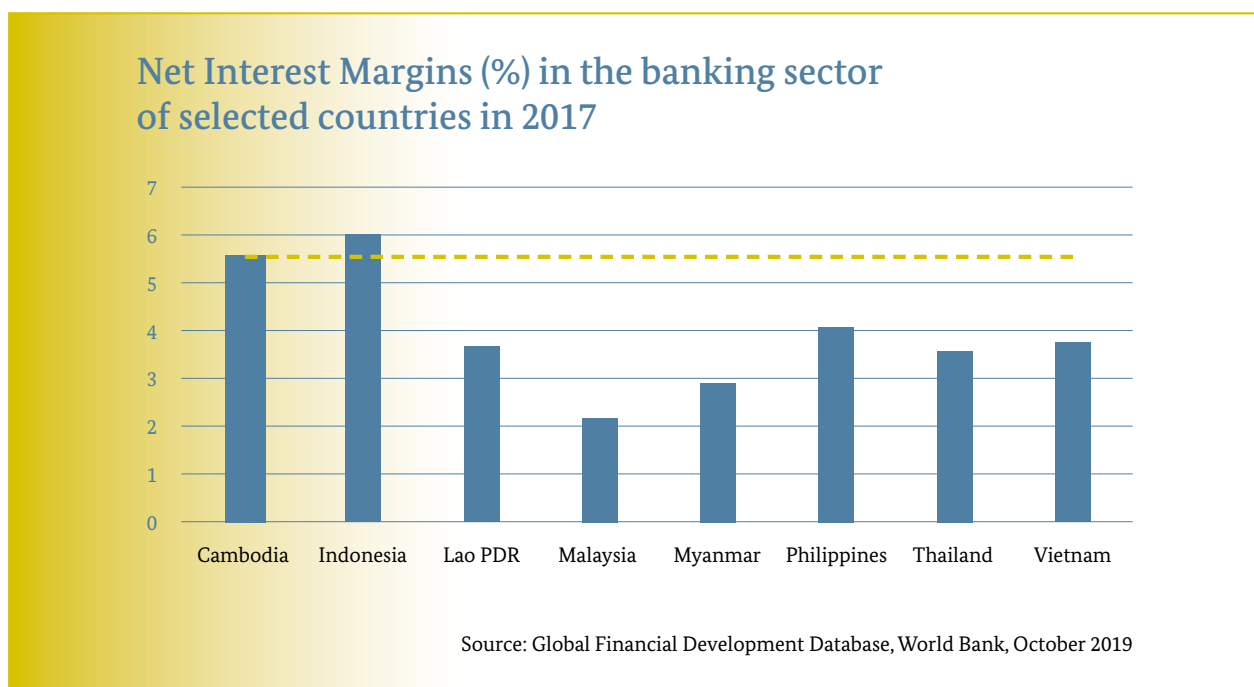


Figure 20 Net Interest Margins (%) in the banking sector of selected countries in 2017

The low profitability of the Myanmar banking sector is also illustrated by the Return on Assets (RoA) and the Return on Equity (RoE) ratios. In 2017, Myanmar commercial banks' RoA averaged below 0.5%, significantly less than the ratios of its ASEAN counterparts. With an average RoE of slightly above 10% Myanmar ranked third lowest, above Lao PDR and Thailand (see Figures 21 and 22). According to a report of the CBM ⁸⁵, the situation was even worse in the third quarter of 2019 when private banks' RoA and RoE were 0.36% and 5.07% respectively.

The fixed interest rate environment and a low spread between lending and deposit rates are often stated by Myanmar banks as major obstacles for profitability and reasons for low net interest margins. Indeed, a

higher spread between lending and deposit rates would increase the potential profit margins and very likely improve their NIM – ignoring for a moment the other important positive impacts a liberalized interest rate would have (especially to allow banks to price their own risks). The spread between the lending and deposit rate is fixed at 5% by CBM regulations. In response to the COVID-19 crisis the CBM reduced the deposit rate and the secured lending rate; the spread between the two rates, however, is being maintained at 5%. Although this value is lower than the average of 6.93% among lower middle-income countries worldwide ⁸⁶, it is still higher than the spread of other countries in the region (see Figure 23).



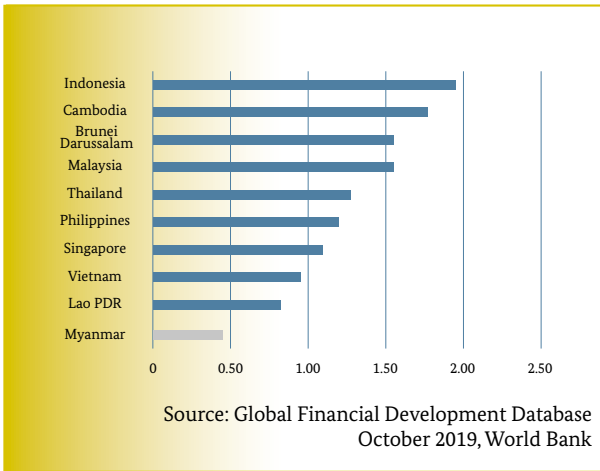


Figure 21 Bank return on assets (% , after tax, 2017)



Figure 22 Bank return on equity (% , after tax, 2017)

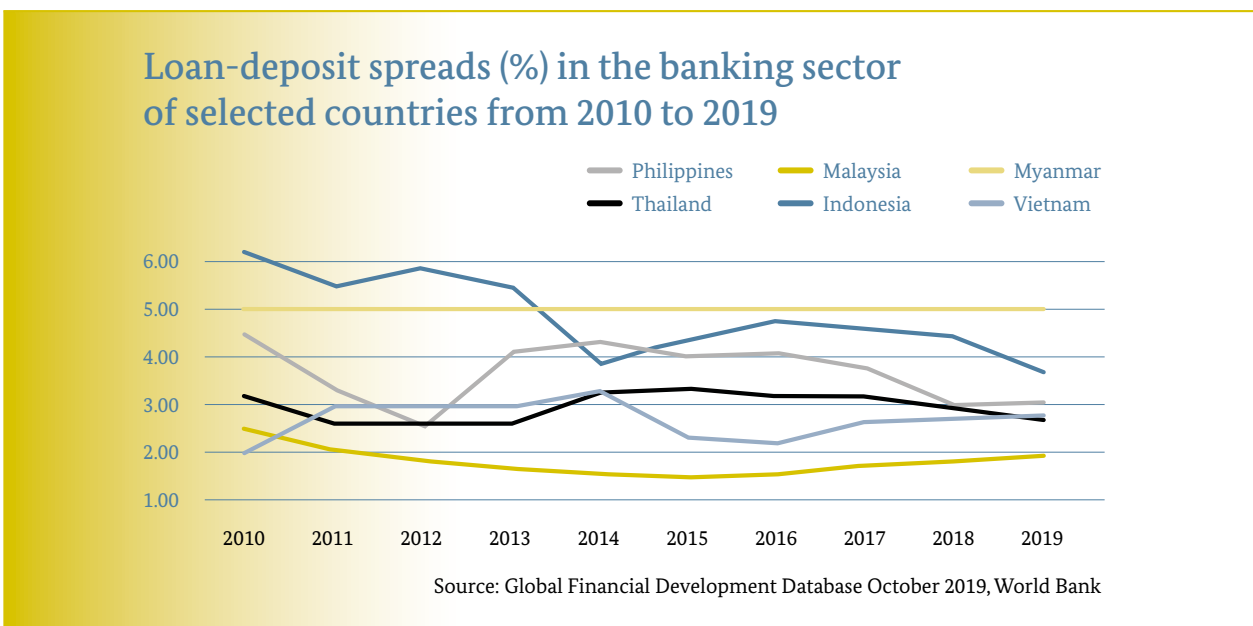


Figure 23 Loan-deposit spreads (%) in the banking sector of selected countries from 2010 to 2019

The real reasons for the notably low NIM ratio in Myanmar are likely to be low actually received interest payments and very low loan-deposit ratios. Since the majority of bank loans in Myanmar are still overdrafts and banks often do not collect interest payments on these facilities, the actual received interest payments are very low. Furthermore, defaults on interest payments directly decrease the banks’ net interest incomes and make the NIM ratio volatile since Myanmar banks still apply cash-based accounting, as opposed to accrual-based accounting.

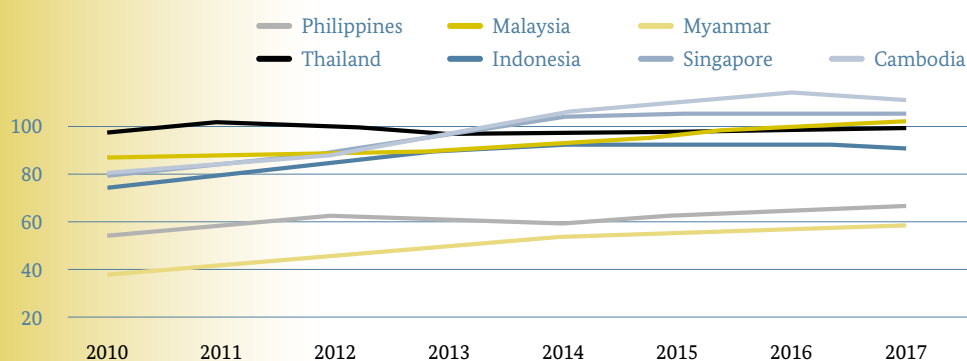
The loan-deposit-ratio of the Myanmar banking industry stood below 60% in 2017 (see Figure 24) showing the banks’ difficulties or unwillingness to convert deposits into loans. This low loan-deposit ratio does not only affect the banks’ profitability but also the economy’s potential for growth as it translates into less funds being available for investment in the private sector.



A decrease in loan default rates and an increase in loan-deposit-ratios would increase the profitability of Myanmar banks. So, would potentially also the liberalization of interest rates. In a country where a credit bureau is not yet in operation and financial figures provided by potential borrowers are often

inaccurate, lending is per se very risky for banks and the potential profit margins can quickly vanish due to a higher percentage of defaults on interest payments. From this perspective, it seems crucial to allow banks to appraise their own risk and charge higher interest rates for higher-risk borrowers.

Loan-to-deposit ratios (%) in the banking sector of selected countries from 2010 to 2017



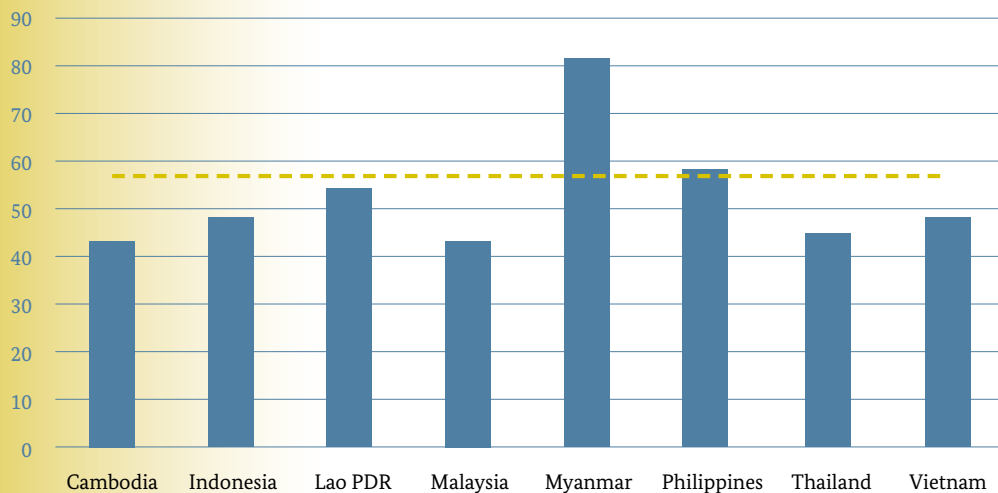
Source: Global Financial Development Database July 2018, October 2019

Figure 24 Loan to deposit ratios (%) in the banking sector of selected countries from 2010 to 2017

Yet, as the low NIM of Myanmar banks likely reflects large amounts of loans outstanding to customers who are not willing or able to pay due interest, there seem to be issues with respect to the banks' risk management also. In fact, an improvement in the risk management of banks and the processes for loan appraisals might be a precondition for a liberalization of interest rates to be viable, rather than the other way around.

All the issues mentioned above are also reflected in a very high cost-income ratio of Myanmar banks of more than 80% (indicating some banks must be loss making) compared to approximately 57% for other lower middle-income countries (the red dashed line in the figure below). In addition to problems on the income side, both with respect to interest and non-interest income, this high value also reflects the immense operating costs that result – inter alia – from an often vast network of branches.

Cost-income ratios (%) in the banking sector of selected countries in 2017



Source: Global Financial Development Database October 2019, World Bank

Figure 25 Cost-income ratios (%) in the banking sector of selected countries in 2017

To conclude, the performance of Myanmar banks is weak, both compared to other countries in the region as well as to other lower middle-income countries in the world. A fixed interest environment limits the banks' potential profit margins and hinders them from increasing their lending activities, the latter being further impeded by the focus on collateral for loan securitization. The notably low NIM ratio is also likely the result of high rates of defaults on interest payments which directly reduce net interest income. Under-reporting of NPL is also a significant factor to consider regarding the stability of the overall banking system. Improvements in banks' risk identification and management might, therefore, be a precondition for interest rate liberalizations to be viable. In general,

the banks' assets are not efficiently used to generate profits, as reflected by a comparably low RoA. Apart from a non-optimal use of deposits to create interest income, the low profitability of Myanmar banks also stems from high operational costs, primarily caused by the banks' vast networks of partly inefficient branches.



Access to Finance in a Regional Comparison

Access to finance for private households and enterprises remains a challenge for Myanmar. The contribution of the country's financial sector to the economy, measured in terms of credit to the private sector in 2010 and 2019, was still lower than in other countries of the ASEAN region and in lower middle-income countries worldwide, despite steady growth during the past decade (see Figure 26).

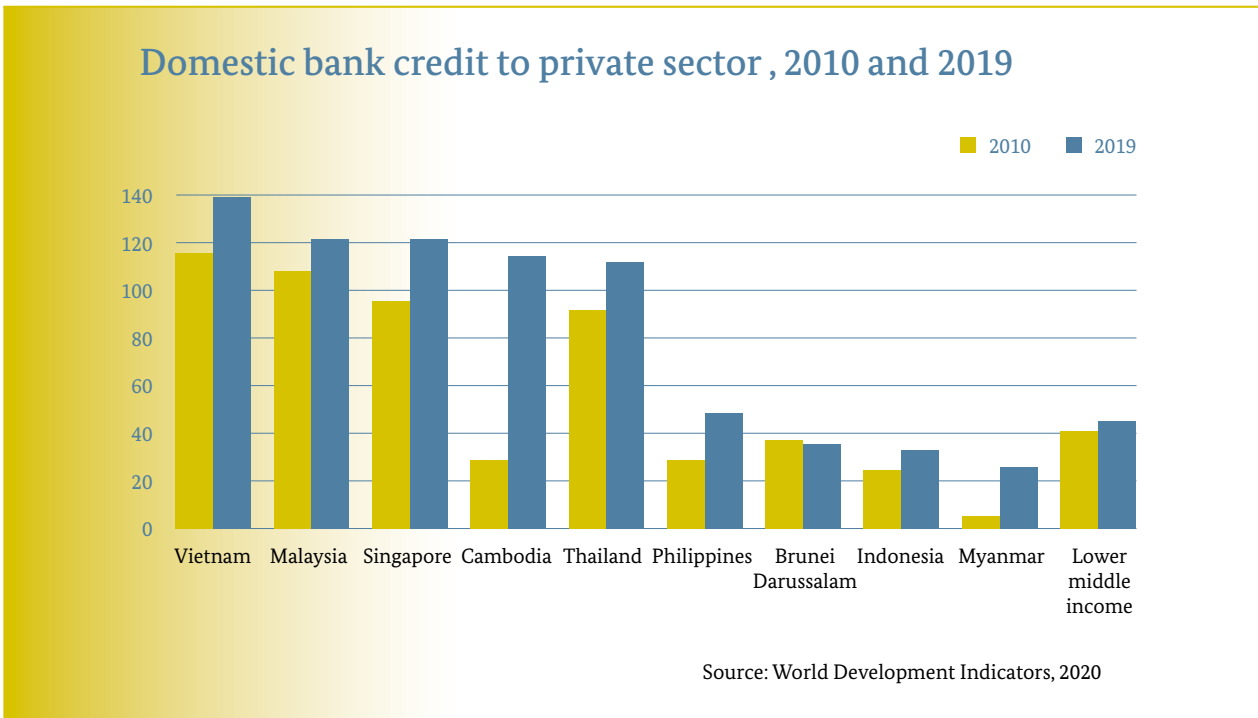


Figure 26 Domestic bank credit to private sector (% of GDP), 2010 and 2019

According to the World Bank report ‘Ease of Doing Business 2020’, Myanmar improved its international standing from rank 171 in 2018 to rank 165 in 2020. Myanmar is recognized as among the top 20 improvers in the World Bank’s Ease of Doing Business Index

2020. The improvement is due to the progress of five sub-indices, namely starting a business, construction permits, registering property, enforcing contracts and protecting investors ⁸⁷. The indices ‘trading across borders’ and ‘resolving insolvencies’ remained

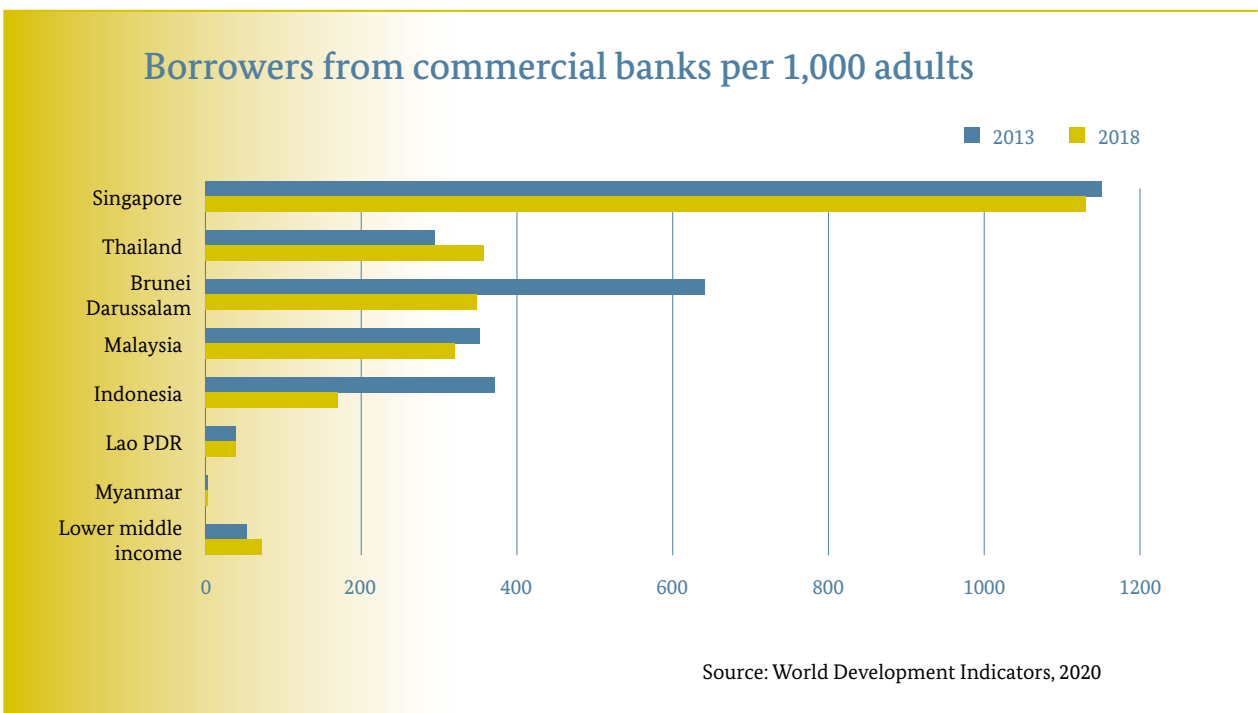


Figure 27 Borrowers from commercial banks per 1,000 adults in 2013 and 2018



unchanged, while three indices – getting credit, getting electricity and paying tax – declined. Hence, access to credit is one of the major challenges to improve the Ease of Doing Business index in Myanmar. This is further illustrated by Myanmar's low ratio of number of borrowers from commercial banks per 1,000 adults, which is still far below other ASEAN member countries, despite improvements in the last years (see Figure 27).

One notable hurdle for better access to finance in Myanmar is the poor banking infrastructure, especially in rural areas, as shown by the low ratio of Automated Teller Machines (ATMs) per 100,000 adults (see Figure 28).

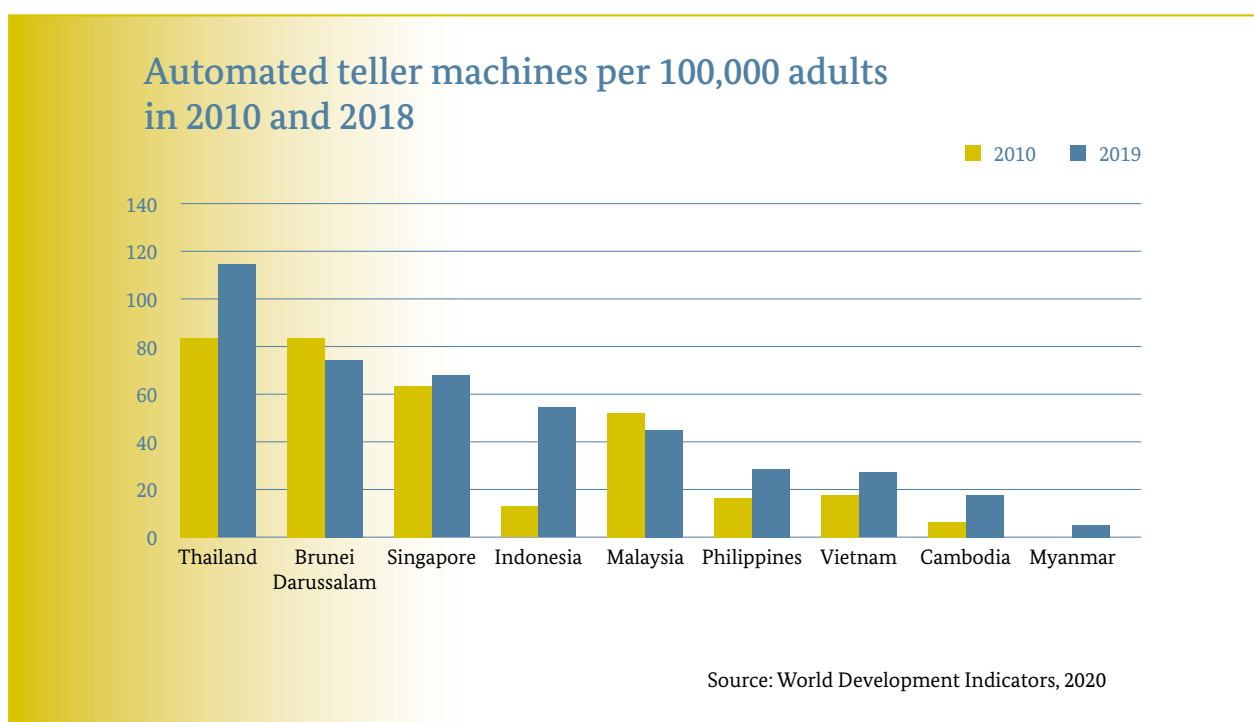


Figure 28 Automated teller machines per 100,000 adults in 2010 and 2018

All in all, Myanmar's financial sector is still the least developed in the ASEAN region. The IMF's Financial Development Index for Myanmar shows that the country's financial institutions have slightly improved in terms of financial access, depth and efficiency during the period 2010 to 2018, but still lag far behind most of their ASEAN counterparts (see Figure 29).

Financial sector integration under the ASEAN Banking Integration Framework (ABIF) is scheduled to begin in 2020. Myanmar has to implement various

measures to accelerate its integration into the ASEAN banking environment sector. While there are many potential benefits from integration – especially increasing trade and investment – the required reforms will most likely also be painful for most Myanmar banks. An effective regulatory framework and the improvement of the financial sector infrastructure including the efforts of all financial institutions are the crucial factors to reduce the gaps between the country's banking sector and its ASEAN counterparts.



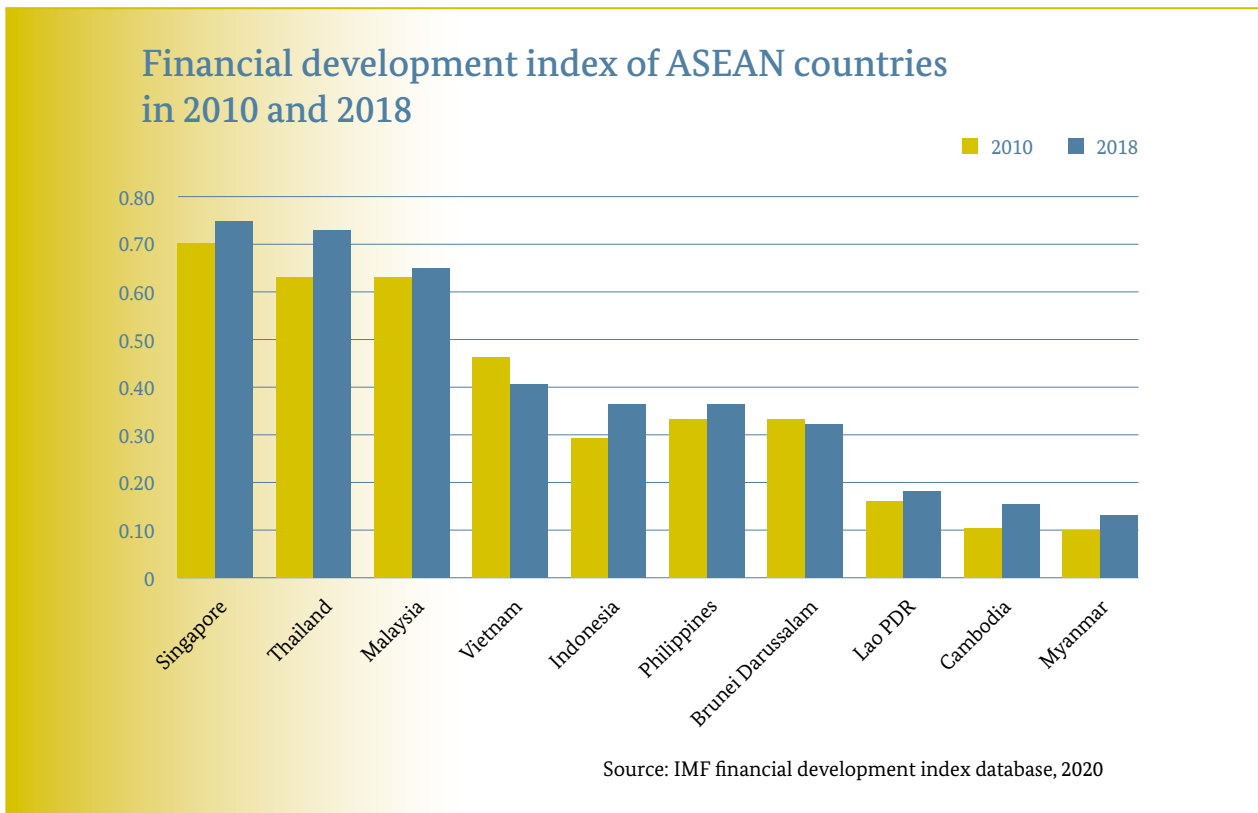


Figure 29 Financial development index of ASEAN countries



Myanmar and the COVID-19 crisis

6

CERP and MERRP: two sides of the same coin

The outbreak of COVID-19 has prompted the Myanmar authorities to take immediate actions for arresting its impact on the population and the economy. On 13 March 2020, the government formed a national-level central committee on prevention, control and treatment of the coronavirus disease (COVID-19) headed by the State Counsellor and with union ministers as its members ⁸⁸.



In an attempt to secure people's livelihoods, the government has taken a bold step by launching the national COVID-19 Economic Relief Plan (CERP) on 27 April 2020. In her statement the State Counsellor mentioned the objective of CERP as to mitigate the inevitable economic impact posed by the corona crisis, while establishing foundations that will facilitate Myanmar's rapid economic recovery, using all available policy instruments to the fullest possible extent, and as part of a coordinated whole-of-nation response. The CERP consists of 7 Goals, 10 Strategies, 36 Action Plans and 76 Actions, covering a broad range of extraordinary monetary and fiscal measures.

As the pandemic is affecting all sectors of social and economic life, the focal areas of CERP vary from the improvement of the macroeconomic environment to the well-being of individual workers and households in the country. Its first goal is to improve the macroeconomic environment through monetary stimulus followed by Goal 2: to ease the impact on the private sector through improvements to investment, trade and banking sectors; Goal 3: to ease the impact on laborers and workers; Goal 4: to ease the impact on households; Goal 5: to promote innovative products and platforms; Goal 6: to strengthen the country's health care system; and Goal 7: to increase access to COVID-19 response financing (including contingency funds).

In a further step, envisaging the COVID-19 crisis would be over soon, the Myanmar government has recently launched the Myanmar Economic Recovery and Relief Plan (MERRP) for the post-COVID-19 period. At an online seminar organized by AusCham Myanmar in October 2020, the Union Minister U Thaung Tun of MIFER said that the CERP was implemented as a short term response plan to mitigate the immediate impact of COVID-19 on households and businesses, while the MERRP is an extension of the CERP and sets out a recovery plan aimed at rebuilding the economy over the long run. The MERRP will thus serve as a bridge between the CERP and the Myanmar Sustainable Development Plan (MSDP).

The two responsible ministries (MOPFI and MIFER) coordinated in drafting the MERRP with the objective of making effective policy-based responses aimed at limiting the social and economic fallout caused by COVID-19. During this process of drafting comments and suggestions from various development partners were sought to be able to design quality policy guidelines within the framework of the national implementation capacities.

According to the Union Minister, the MERRP would focus on macroeconomic and financial stability and prioritizes sustainable growth strategies, such as investment in renewable energy sources. It will also include support for agriculture, infrastructure, human capital and innovation. The six goals of the MERRP reflect the needs of the time and Myanmar's overall reform trajectory:

- Goal 1: Strengthen the macroeconomic environment
- Goal 2: Strengthen private sector participation and promote private sector-led growth
- Goal 3: Promote inclusive rural growth through agricultural development
- Goal 4: Promote financial sector stability
- Goal 5: Facilitate reverse migration
- Goal 6: Mitigate economic shocks and after-shocks impacting most vulnerable groups

It is hoped that the adoption and implementation of MERRP would ensure Myanmar's resilient recovery and its transition towards a more inclusive and sustainable economy – in line with suggestions made by some development partners to put more emphasis on gender equality, environmental sustainability, conflict sensitivity and support for vulnerable people.





Working Committee and Task Force

To be able to effectively deal with the economic impact of COVID-19 a Working Committee was formed by the Myanmar government on 13 March 2020 ⁸⁹ on the same day when the national-level central committee headed by the State Counsellor was formed. The Working Committee was chaired by the Union Minister of the Ministry of Investment and Foreign Economic Relation (MIFER) and its members include heads of various economic ministries such as union ministers of MoPFI, MoLIP and MoC and the Governor of the CBM, as well as the deputy minister of the Ministry of Hotel and Tourism.

The main purpose of forming the Working Committee is to alleviate the impact of COVID-19 on the trade and tourism sectors, to create new jobs for workers laid off due to the closure of factories and to provide them with vocational training, to find ways of procuring raw materials for the CMP (garment) industry not only from China but also from other sources, to cooperate with the private sector to establish a proper supply chain for the weaving, knitting, dying and sewing industries, to find ways for alleviating tax and other relief measures for MSMEs, and to provide cheap loans to the businesses affected by the pandemic. The Working Committee is also responsible for the development of MERRP Monitoring Framework and for regular reporting on progress to the National-Level Central Committee on Prevention, Control and Treatment of COVID-19.

A Task Force was formed on 14 March 2020 under the Working Committee to effectively implement the task of providing financial assistance to severely hurt businesses. The deputy mayor of the Naypyitaw City Development Council is the chair of the Task Force, while Director Generals of important government departments are members. The main responsibility of

the Task Force is to oversee the disbursement of cheap loans to business entities badly hurt by the impact of COVID-19 under the economic stimulus package and to coordinate with relevant organizations, departments and officials to contain the impact on the economy. In the CERP, the action plans assigned to the Task Force to implement in coordination with the MoPFI and CBM are as follows:

- Action Plan 2.1.1 (a): to provide MMK 100 billion for one-year working capital loans to improve working capital of affected MSMEs, with a focus on MSMEs in the CMP and hotel and tourism sectors at 1 percent interest rate per annum;
- Action Plan 2.1.1 (c): to increase the fund size to MMK 200-500 billion depending on market response; and
- Action Plan 2.4.1 (a): to establish an MMK 100 billion fund to designated commercial banks to promote trade financing of any products.





Covid-19 Fund

A COVID-19 Fund has been created out of the government budget with an initial capital of MMK 100 billion to provide one-year working capital loans at an interest rate of 1.0% per annum to severely affected businesses owned by Myanmar citizens. The Task Force commenced its main task with its announcement on 29 March 2020, inviting loan applications from enterprises owned by Myanmar citizens hit by the COVID-19 crisis.

CMP enterprises, hotel and tourism services and SMEs were designated as priority sectors to receive cheap loans in the first batch. Apart from ownership, other loan eligibility criteria include (1) a running enterprise temporarily halted due to the pandemic; which (2) must have a work permit received before 31 March 2018; (3) must have an annual income during the previous two years; (4) must be able to repay the loan; (5) must use the loan money in paying salaries; and (6) if it is an enterprise, it must have paid due taxes. Failure to pay back the loan shall be met with legal procedures in accordance with the existing laws ⁹⁰.

Loan applications were made available at the offices of the Chamber of Commerce and Industry (CCI), the

Directorate of Investment and Company Administration (DICA), the Directorate of Industrial Supervision and Inspection (DISI), and the Directorate of Hotels and Tourism (DHT) in states and regions as well as from respective internet websites. The applications were assessed and evaluated in coordination with the mentioned organizations and departments together with the Myanmar Institute of Certified Public Accountants (MICPA). The disbursement of the first tranche was made in April 2020 through the Myanmar Economic Bank (MEB). The following table shows how the first tranche of the COVID-19 Fund was disbursed to the enterprises badly affected by the pandemic ⁹¹.

Type of business	No. of businesses	Loan Amount (MMK million)	Percent of Total
CMP (Garment enterprise)	45	6,312.00	6.24%
CMP (Other)	2	75.00	0.07%
Hotel	340	15,720.74	15.55%
Travel Companies	236	3,757.46	3.72%
Restaurants	220	5,182.00	5.12%
MSMEs including production and services enterprises	2550	70,081.10	69.30%
Total	3393	101,128.30	100.00%

Source: MIFER, 2020

Table 2 Loan disbursement of the first tranche of the Covid-19 Fund



In continuation of the program, a second tranche of another MMK 100 billion was disbursed to affected businesses engaged in agriculture, livestock breeding, marine products business, export items production, import-substituted items production, supply chain

business, food producers, overseas job agencies, and vocational training schools. The following table shows the disbursement of loans to the businesses as of 14 October 2020 ⁹².

Type of Business	No. of borrowers	Loan Amount (MMK Million)
Agriculture product	41	1,010
Livestock Breeding	182	2,957
Marine Product	93	2,218
Export	42	1,770
Import Substitution	153	3,432
Supply chain	49	1,257
Food producing	1,570	27,560
Overseas Job Agency	70	870
Vocational Trainings	41	825
Total	2,241	41,899

Source: MIFER, 2020

Table 3 Loan disbursement of the second tranche of the Covid-19 Fund (as of 14 October 2020)



YES
Language
Education Centre

BELL
Mobile & Tablets

လမ်း
လမ်း
Make Up Artist

STARS BAR NINE
Floral Services

MO
LOTTERY ENTERPRISE

မိုး
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Monetary Management

While the CERP sets the national guidelines for combating the impact of the COVID-19 pandemic all the government ministries and departments involved are responsible to implement their parts of the CERP Action Plans. According to the CERP, the Central Bank of Myanmar was assigned to take relevant monetary measures to achieve the set goals.

As for implementing Goal 1 of the CERP, i.e. to improve the macroeconomic environment through monetary stimulus, the CBM has taken various kinds of liberalization measures in its monetary management – a kind of quantitative easing to quickly increase the domestic money supply and spur the economic activities. Significant measures that have an immediate effect on the banking sector are: (1) lowering interest rates ⁹³, (2) lowering maximum reserve requirement ⁹⁴, (3) relaxing the calculation of the liquidity ratio ⁹⁵ and (4) postponement of meeting the requirements of the four prudential regulations until 31 August 2023 ⁹⁶. Other monetary stimulus measures included in the CERP are:

- Credit auctions to be conducted to inject more liquidity into the banking and financial sector (Action Plan 1.1.3)
- Central Bank's financing of fiscal deficit to be allowed as a one-off measure (Action Plan 1.1.4)
- Treasury Bonds and Bills auctions to be reduced temporarily (Action Plan 1.1.5)
- Credit Guarantee Schemes for working capital to be established (Action Plan 2.1.2)
- An Asset Management Company (AMC) to be established as soon as practicable; through AMC potential NPLs held by banks could be set aside for 5-7 years allowing banks some breathing space and contributing towards credit growth (Action Plan 2.2.2)

These unconventional measures of monetary management were urgently launched during this unprecedented period of COVID-19 to arrest the impact of the pandemic on the economy at the expense of banking sector transformation. Responding to the emergency policy guidelines of adopting flexible prudential controls on banks, the moratorium on the transformation process was extended until September 2023; essential international banking standards such as capital adequacy requirements, maintenance of adequate provisions and reserves, dealing with

concentration of risks and keeping large exposures under acceptable limits as well as the maintenance of liquidity requirements are put on hold. This relaxation on the application of prudential regulations could slow down the transformation process towards modernization of the banking sector and the underlying problems associated with non-performing loans and related party lending could continue to threaten the stability of the banking sector in the post-COVID-19 period.

Realizing the danger of ignoring the regulatory framework, the MERRP puts forward Strategy 14 of strengthening the banking and financial system to promote financial system stability. The CBM shall develop specific and realistic timelines for each bank based on its special conditions to comply with key regulatory requirements. In this regard, some phasing and sequencing should be considered in upgrading local banks to be in line with international standards and requirements. To check the looming danger of NPLs, action plan 14.4 of the MERRP assigns CBM to make sure that the banks continue reporting their exact NPL positions calculated as per the CBM's Asset Classification and Provisioning Regulation 17/2017.

In the MERRP the authorities consider problems of both low and high inflation in maintaining monetary stability. A central bank usually uses its tools of monetary policy in managing inflation and maintaining stability. These tools include discount rate, reserve requirement, selective credit control and open market operation (OMO). However, CBM has its limitations in using its tools of monetary policy. As rightly mentioned in the MSDP, the country lacks a well-functioning OMO, an active secondary bond market and REPO market. Once the open market operation and its necessary institutions are in place, other mechanism for controlling inflation such as interest rate and reserve money targeting can be deployed (MSDP Strategy 2.2). In its Strategy 1 of managing inflation and maintaining monetary stability, the functions of OMO were mentioned and CBM and MOPFI were assigned as responsible agencies for establishing secondary and REPO markets.



It is encouraging to learn that under Strategy 14 (Strengthening the Banking and Financial System) for achieving Goal 4 (Promote Financial System Stability), deposit and lending rates shall be gradually liberalized. Myanmar is among a few countries in the world left with regulated interest rates. The mandatory interest rates usually do not reflect the actual market condition and tend to create investment distortions. The fixed interest rate environment does not allow banks to price their risks and hence reduces their ability to choose viable businesses for effective financing. Offering the same price to every customer would weaken a bank's ability of risk assessment and heighten the risk of loan default.

As part of the strategy of easing strains in the banking sector the CBM and the MoPFI have been assigned under the CERP Action Plan 2.2.2 to coordinate in establishing an Asset Management Company (AMC). The state-owned AMC is to be established with the purpose of making temporary investment in bank collaterals (mostly land and landed property) of potentially non-performing loans (NPLs) in banks, thus giving a breathing space to the banks and allowing them to maintain the momentum of credit growth.

The establishment of the AMC was again mentioned in Strategy 14 of MERRP. However, as it is a new initiative and given the current lengthy law-making procedures one cannot expect a public AMC in place soon. It may be possible to allow establishment of private AMCs by issuing directives and instructions by such monetary authority as CBM, MoPFI or MIFER. Nevertheless, local bankers expect any AMC to lift their burden of collateralized defaulted loans under litigation, at least temporarily while waiting for the final court decision. In the event of loan default, the current judicial foreclosure proceedings on a property usually take a long time – generally five to seven years. Moreover, the lackluster performance of the property market since 2015 together with the lack of proper credit risk assessment and weak loan monitoring increase the risk loan defaults and undermine the banks' capacity of loan extension, while AMC appears to be a good option.





Impacts on the Economy

In its latest issue of the MERRP, the Myanmar government acknowledges that the COVID-19 pandemic has delivered a setback to Myanmar's economy, bringing about a sharp reduction in the country's GDP growth, a surge in unemployment, and significant disruption to almost every aspect of the economy ⁹⁷. The World Bank estimates the country's economic growth to drop from 6.8% in FY 2018/19 to 0.5% in FY 2019/20. It foresees economic disruptions in all components of the country's GDP: the growth rate of the service sector to fall by 1%, industrial sector by 0.2% and agriculture sector by 0.7% ⁹⁸.

In the worst-case scenario, the onslaught of the pandemic and associated stringent measures taken to arrest the impact on the economy could produce:

- Declining / low GDP growth rate due mainly to paralysis of many business entities
- Rising rural and urban unemployment due to closure of businesses and returnees from abroad
- High inflation – may be double digit inflation due to cheap loans, lax restriction on loans, possible central bank’s financing of budget deficits
- Volatile exchange rates with over-valuation of national currency due to low domestic demand and low business activities
- Widespread defaults on bank loans due to lax credit risk management and weak loan monitoring

In its recent Myanmar Economic Monitor (MEM) report released in June 2020, the World Bank points out that stringent preventive measures taken by the Myanmar government have suppressed economic activity, undermining aggregate demand, disrupting value chains, and reducing household incomes. Reflecting the onslaught of the pandemic crisis since March 2020 in the country and subsequent measures taken by the authorities together with lowering energy prices have resulted in weak domestic demand: the country’s year-on-year inflation rate has sharply declined from 8.36% in February 2020 to 1.84% in August. At the same time, the local currency has been appreciating against its trading currencies. The following figure shows while the inflation rate was declining the real effective exchange rate (REER), the weighted average of the Myanmar Kyat relative to an index of its major trading currencies adjusted for the effects of inflation was increasing – a tendency towards losing competitiveness in the country’s export markets.

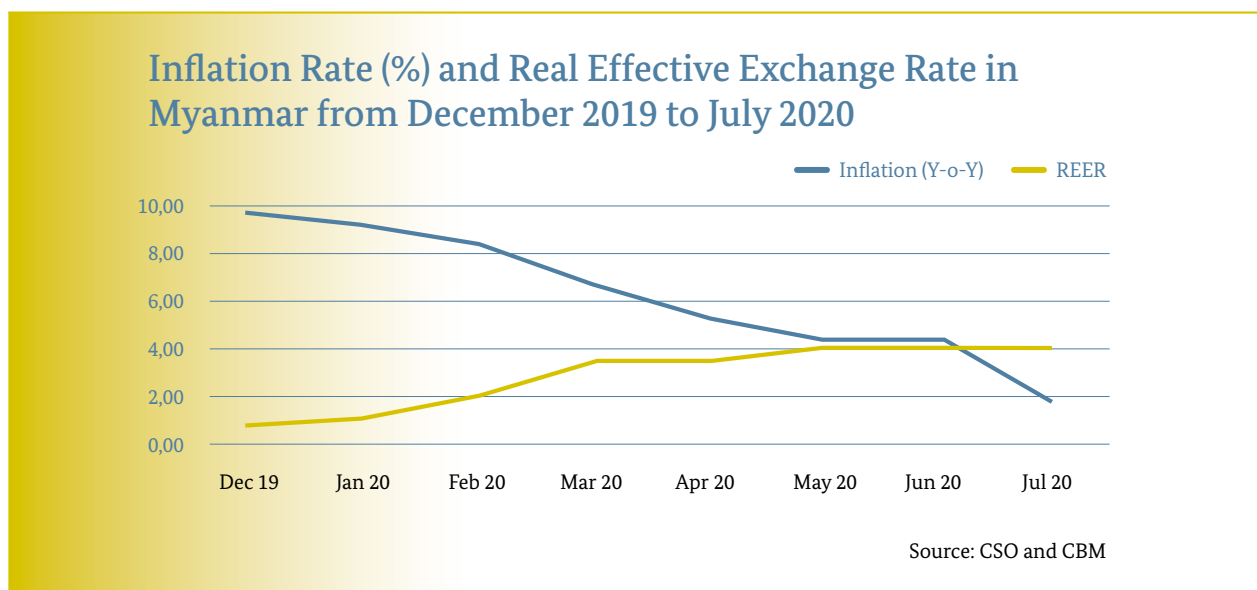


Figure 30 Inflation Rate (%) and Real Effective Exchange Rate (Index: July 2012 = 100) in Myanmar from December 2019 to July 2020

The trend of both inflation and REER indicates over-valuation of the local currency against major trading currencies, which would have an adverse effect on exports’ competitiveness in the long run. The following

figure shows appreciation of MMK against both US Dollar and the EURO. During the last two years, the Myanmar Kyat appreciated by 17% against the EURO and 22% against the US Dollar.

The impact of the corona crisis on the private sector of Myanmar is rather shocking. A survey conducted by the Myanmar Business Coalition for Gender Equality (BCGE) reveals that initial challenges facing private businesses were overwhelmingly due to a decline in customer demand on account of the crisis. Other immediate challenges were constrained cash flows, absent workers and business partners having been badly affected and not operating normally. Businesses also have problems of procuring raw materials. In the

hotel and tourism sector, firms were heavily impacted by the closure of international borders with no plan for how they might respond. Companies experiencing a decline in consumer or client demand for their goods and services reported a range of plans for diversifying their markets, introducing E-commerce and digital delivery platforms such as tele-health or online education services. Banks are concerned about the impact of the economic crisis on SMEs and their loan repayments ⁹⁹.

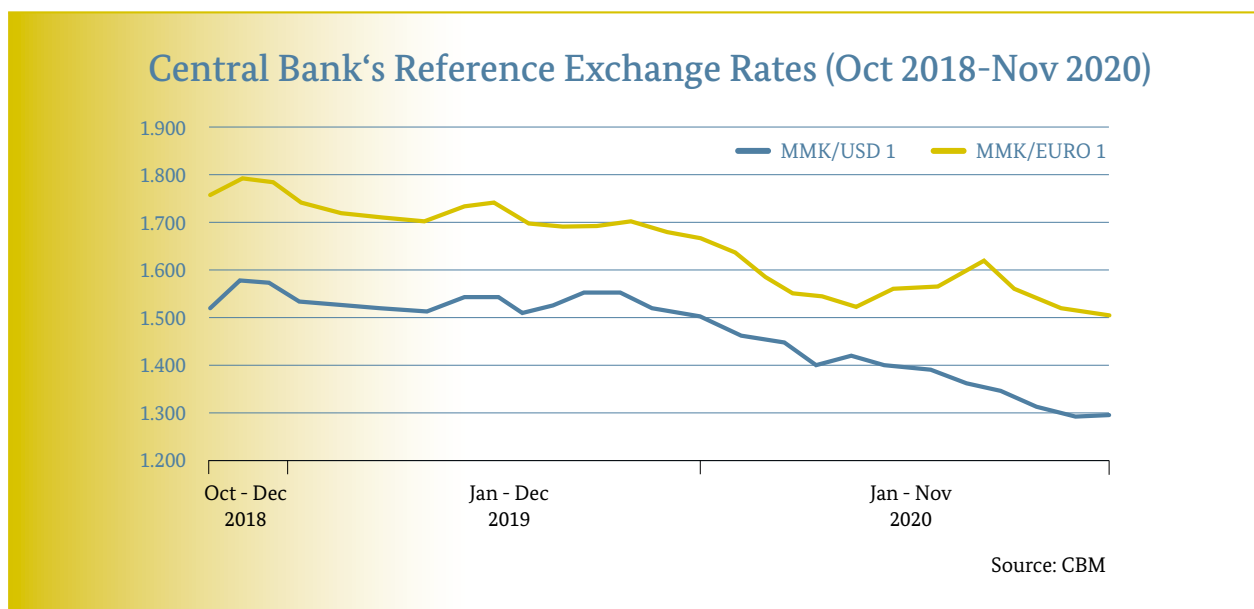


Figure 31 Exchange Rates (October 2018 – November 2020)

The pandemic has wreaked havoc on the Myanmar economy and successful implementation of the coherent strategies of CERP is vitally important to take place in time to prevent the occurrence of a full-blown economic crisis in the country. The measures

taken in both CERP and MERRP should be complementary – they are not substituting each other. In this regard, a coherent and consistent monitoring and evaluation (M&E) of these economic plans is vitally important to achieve the desired goals.





Outlook

7

By Dr. Klaus Maurer

This 5th edition of the Banking Report by GIZ has presented a comprehensive view of the development and current status of the banking sector in Myanmar. Much has been achieved in recent years and the report has furnished ample evidence and data in this regard. Myanmar is on a good path of catching up with its ASEAN peers in financial systems development.



Despite the recent achievements, the development of Myanmar's banking sector remains work in progress for some time to come. The outbreak of the COVID-19 pandemic has interrupted – or at best slowed down – the development efforts. Major challenges remain in the short term and in the medium and long term, and the future outlook depends very much on whether these challenges are tackled and addressed in an appropriate and timely manner.

Short-term challenge: Overcoming the COVID-19 crisis and mitigating its adverse effects on the society, economy and financial system

In the short term, Myanmar – like most countries in the world – will face the challenge of controlling the pandemic and of mitigating the severe effects on the economy. The outbreak of COVID-19 in early 2020 has prompted the Myanmar authorities to take early action, by launching the COVID-19 Economic Relief Plan (CERP) in April 2020 to mitigate the inevitable economic impact posed by the corona crisis, and recently, the Myanmar Economic Recovery and Relief Plan (MERRP) for the post-COVID-19 period.

As vaccinations are being rolled out from early next year, there is well-founded optimism that the pandemic itself can be brought under control in the course of 2021. However, the impact on the economy has been dramatic and as it continues to unfold there is a real danger of transmission to the financial system, in particular by widespread defaults on bank loans. The government has realized this danger and – in hindsight – has adopted a strategy of strengthening the stability of the banking and financial system as integral part of the MERRP. While the strategy aims at preventing increase of loan defaults in the short run, it contains strong elements for fostering financial system stability in the medium and long term.

Medium and long term challenge: Catching up with ASEAN counterparts in building an inclusive and stable financial system

Chapter 5 of this report has amply illustrated that Myanmar still falls behind its neighboring countries in terms of financial systems development. In fact, Myanmar's financial sector is still the least developed in the ASEAN region. Financial sector integration under the ASEAN Banking Integration Framework (ABIF) has commenced with the implementation of various measures to accelerate Myanmar's integration into the ASEAN banking environment. The country needs to catch up in both dimensions of a successful financial system, namely access to finance as well as financial sector stability.

Expanding access to finance and financial inclusion

Elevate the general level of financial inclusion. Myanmar needs to raise the general level of financial inclusion from its current low of only 26% of the population having an account with a financial institution to a range of 50% to 70% ¹⁰⁰. The Myanmar National Financial Inclusion Roadmap 2019 –2023 is targeting a financial inclusion ratio of 50% by 2023. This will require a major effort on the side of financial service providers, by expanding outreach to unbanked populations, but also on the side of users, for example through financial education campaigns. Other directional indicators of financial inclusion comprise the following:

- Domestic bank credit to the private sector will need to rise significantly from its current level of 25% of GDP to a range of 60% to 80% in the medium term.

- The number of borrowers from commercial banks needs to increase – as a first step – from a very low level of only 4 per 1,000 adults to at least 70 borrowers which constitutes the average for lower middle income countries. Another major effort will be required to catch up with the majority of ASEAN countries with a range of 300 to 400 borrowers per 1,000 adults.
- Major investments will be required to install automated teller machines (ATM), with the number of ATM per 100,000 adults expanding from currently 5 to over 40 like in most ASEAN countries.

Expand bank lending to SMEs. SMEs are regarded the backbone of the economy but they are highly underserved by commercial banks. SME loans account for only 4% of the total loan portfolio of the Myanmar banking sector. Banks are generally reluctant to lend to SMEs and frequently need technical assistance and incentives, e.g. credit guarantees, to get acquainted with SME customers, and sometimes a “push”. The regulatory authorities in Indonesia, for example, imposed a portfolio target of 20% for SME lending in its early stage of financial systems development. Furthermore, a secured transaction framework with a movable collateral registry constitutes another important component in support of SME lending.

Expand bank services to semi-urban and rural areas. Bank outlets and services are highly concentrated in Yangon and Mandalay where most (formal and larger) businesses are located. Rural areas where 70% of the country’s population lives are effectively not served by the banking sector. However, expanding the traditional banking network and brick and mortar infrastructure into rural areas is costly, hence, the development of mobile and digital financial services is crucial for financial deepening into remote rural areas.

Develop inroads to agricultural finance through and innovations and incentives. Financing agriculture and agribusiness is another area that urgently needs to be developed in Myanmar. Commercial banks – especially private ones – are traditionally reluctant to venture into agricultural finance due to inherent production

and price risks but also heavy government interventions. Innovations such as a weather index-based crop insurance can help to manage the (often only perceived) high risks associated with agriculture. Furthermore, value chain finance offers a number of innovative instruments to make lending to agriculture and agribusiness a relatively secure proposition. It is encouraging that some private banks have ventured into the agri-business sector experimenting with contract finance, post-harvest loans for processors, agricultural inventory discounting and other innovative approaches. Incentives can potentially propel these initiatives, e.g. through risk-sharing arrangements. Despite these inroads by private banks, however, the role of state-owned banks like MADB – today the largest agricultural lender – and MEB will remain the crucial source of short and longer term finance for millions of farmers. The recently announced merger of the two state-owned banks will likely strengthen the financial service offer to the agricultural sector.

Promote mobile banking and digital financial services. Myanmar has experienced a remarkable development of mobile banking and digital finance. Chapter 4 of this report provides a comprehensive overview of mobile service providers and e-banking platforms which have emerged in recent years. Already now but even more so in the future, these providers will play a crucial role in reaching out to remote customers in rural areas at low cost, thereby fostering financial inclusion. The widespread use of smartphones and the digital affinity of the young population in Myanmar, coupled with a conducive regulatory framework, provide a ready basis for digital finance and for the emergence of fintech companies and digital financial service providers. If prudently regulated and managed, this will enable Myanmar to leapfrog in many areas and will accelerate financial deepening at a pace unthinkable a few years ago.



Fostering the stability of the financial system

Implement prudential regulations in line with international standards (“four regulations”). The CBM had issued a prudential regime – the so-called “four regulations” on capital adequacy, NPL and large exposure limits – to bring the regulatory framework to a minimum international standard by August 2020. Due to COVID-19, the CBM has waived the date for meeting the requirements of the four key regulations and extended the deadline for full compliance by three years to August 2023. As this relaxation poses a considerable danger to the stability of the banking sector, the stakeholders should not wait until the 2023 deadline. The CBM should foster a gradual “shadow implementation” with selected system-relevant banks in priority areas, e.g. NPL clean-up, and thus work towards full compliance by the final deadline.

Enhance transparency and disclosure by adopting IFRS. International Financial Reporting Standards (IFRS) are widely recognized as the common global financial reporting standards. Myanmar has decided to adopt IFRS standards by the fiscal year 2022–23 to promote modernization and transparency in its banking sector. Much support under the leadership of the CBM has been provided to commercial banks in their preparation for this challenging transition. The transition entails high cost, and it requires sophisticated IT systems in place as well as qualified human resources. Several banks have realized that they can tangibly benefit from this transition, for example in discussions and negotiations with international investors. Ultimately, the full adoption of IFRS will be an important building block for a modern, transparent and stable financial system.

Develop and implement a comprehensive NPL resolution strategy. Non-performing loans pose perhaps the major threat to the stability of the Myanmar financial sector. An estimated one third of the banking sector's overdraft facilities is considered as bad loans, exposing some banks to the risk of capital insufficiency and insolvency. As proposed also by the IMF, a comprehensive

NPL resolution strategy is needed to safeguard the stability of the banking sector at large. This has been acknowledged by the government. As a first step, the CBM instructed private banks to convert overdrafts to term loans with clear repayment schedules and to reduce the share of overdrafts in their portfolios from 70% (2018) to 20% by July 2020 ¹⁰¹. Together with improved disclosure standards, it is clear that for some banks this process will be painful. Furthermore, and most important, both the CERP and the MERRP foresee the establishment of a state-owned Asset Management Company (AMC) with the purpose of making temporary investment in bank collaterals (mostly land and landed property) of NPLs in banks, thus giving a breathing space to the banks and allowing them to maintain the momentum of credit growth. However, strict and prudent regulations must guide the building of a new loan portfolio with better quality, and prevent banks from reverting to unsound lending practices of the past.

Commercial banks must become more efficient and profitable. Profitability is crucial for the soundness and the stability of the banking sector. The commercial banks in Myanmar have a long way to go for achieving the levels of efficiency and profitability that will safeguard this objective. In the short term, increased provisions for non-performing loans will make this task a difficult one. It is likely to get significantly worse before it is getting better. Some banks might not survive the cleaning of their balance sheets. Other directional indicators on the path towards improved profitability include the following:

- The cost-income ratio of Myanmar banks must come down from over 80% to a range of 50% to 60% ¹⁰².
- Bank profitability – measured by Return on Assets (RoA) – must increase beyond the 1% threshold from the current level of only 0.4%.
- The loan-to-deposit ratio needs to be raised from below 60% to some 90% which constitutes the lower band of the other ASEAN countries.

Competition is a driving force for increase in efficiency. The entry of foreign banks is exerting considerable pressure on domestic banks to improve performance.

Gradually liberalize interest rates. The fixed interest rate environment and a narrow spread between lending and deposit rates are often cited as major obstacles for banks' profitability. Moreover, regulated interest rates often do not reflect true market conditions, thus leading to distortions in the allocation of capital. It is encouraging to note that the deposit and lending rates shall be gradually liberalized as a strategic component under the MERRP. This will allow banks to introduce risk-based pricing and differentiate interest rates across different client segments. The pricing-in of higher transaction costs for certain clients, e.g. in remote rural areas, will enable commercial banks to push the outreach frontier in a profitable way.

Reduce concentration risk in the banking sector. The concentration in Myanmar's banking sector is not healthy and bears considerable risks. The three largest banks hold almost two thirds of total private banks' assets. Needless to say that a failure of one these banks would have severe repercussions on stability of the entire financial system. The notion of being "too big to fail" may foster an attitude of complacency and resistance towards reform among these large banks. A greater diversification of the banking landscape is warranted, and a level-playing field with a good dozen of sound and solid private banks, some with foreign partnership.

Delicate balancing act: Access to finance and stability must go hand in hand

Financial systems development must pursue a dual objective at the same time, namely financial inclusion and stability. The choice is not a trade-off, rather must both objectives go hand in hand and be carefully calibrated. An over-emphasis of stability concerns may choke off access to finance, and vice versa, pushing the financial inclusion frontier too hard may lead to instability of single banks and the sector as a whole. Policy makers and regulators are confronted with a delicate balancing act of finding the right equilibrium, and this is perhaps more an art than a science.



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Annex 1: Prudential requirements for banks in Myanmar

Capital adequacy (percentage of risk-weighted assets)

Item	Requirement	Reference
Regulatory capital adequacy ratio	≥ 8%	Notification No. (16/2017)
Tier 1 capital adequacy ratio	≥ 4%	Notification No. (16/2017)

Paid-up capital (MMK)

Item	Requirement	Reference
Paid-up capital (MMK)	≥ 20 billion	Financial Institutions Law (FIL) – 34(a)

Credit risk concentration

Item	Requirement	Reference
Individual or group financial exposure	≤ 20% of core capital	Notification No. (18/2017), FIL 59(a)
Aggregate of large exposure limit	Not exceed 8 times of core capital	Notification No. (18/2017)
Unsecured exposure to another bank	≤ 100% of core capital	Notification No. (18/2017)
Staff loans	≤ 5.0% of paid-up capital	FIL 63(c)

Market risk

Item	Requirement	Reference
Net open position (% of tier 1 capital)	Short Position/ Long Position – not more than 20% of core capital	Directive No. (6/2019)
Restriction on Investment	≤ 10% of capital of bank	FIL 60 (b)
Total ownership stake in another bank or Non-Bank Financial Institution	≤ 5% of that institution's equity	FIL 61 (a)
NPL	< 5%	Directive No. (5/2017)

Liquidity

Item	Requirement	Reference
Minimum reserve requirement	≥ 3.5% of total deposit (temporarily changed)	Directive No. (6/2020)
Liquidity ratio (net liquid assets, % of volatile liabilities)	≥ 20%	Notification No. (19/2017)
Statutory reserve	25% of net profit, up to equal to 100% of the paid-up capital	FIL 35(a) and Directive No. (1/2008)
General provision	2% of outstanding loans and advances	Notification No. (17/2017)
Specific provision	Standard (30 days past due) 0% Watch (31 to 60 days past due) 5% Substandard (61 to 90 days past due) 25% Doubtful (91 to 180 days past due) 50% Loss (over 180 days past due) 100%	Notification No. (17/2017)
Overdraft ratio (% of total loan portfolio)	Not more than 50% (6-7-2018) Not more than 30% (6-7-2019) Not more than 20% (6-7-2020)	Directive No. (7/2017)

Interest rate

Item	Requirement	Reference
CBM reference rate	7% p.a.	Directive No. 8/2020
Minimum deposit rate	5% p.a.	Directive No. 8/2020
Minimum lending rate	10% p.a.	Directive No. 8/2020
Unsecured lending rate	14.5% p.a.	Directive No. 8/2020

Type of collateral

Item*	Requirement	Reference
Treasury bonds	maximum 80% of the assessed value	Directive No. (27/2012)
Saving and Fixed deposits	maximum 80% of outstanding value	Directive No. (24/2011)
Gold	maximum 75% of assessed value for only 1-year term	Directive No. (22/2011)
Machines and Crops	maximum 60% of the assessed value	Directive No. (25/2011)

Source: GIZ -BFSD collection

* Bank Supervisory Committee's Directive No. (1/2008) instructed banks to extend loans by taking strong collaterals in December 2018. In this regard, most of the banks take land and buildings as collateral, which are determined by market price and forced-sale-value (FSV). The banks normally lend out 30% to 50% of the FSV.

The percentage depends on the internal policy of the banks.



Annex 2: Summary of Instructions for Commercial Banks

Year	Instruction	Particular	Commentary
2019	Directive 1/2019, January 15, 2019	Amendment to lending rates	Maximum lending rate for collateralized loans: 13% p.a. Maximum lending rate for loans without collateral: 16% p.a.
	Directive No. 2/2019, January 15, 2019	Housing loans	To expand the loan market and create new opportunities for people to own their homes the CBM permitted banks up to 5% of total loan portfolio for home loans with more than 3-year loan period.
	Directive No. 3/2019, January 24, 2019	Subordinated Debt Directive	A bank may include subordinated debts in the supplementary capital or Tier 2 capital up to a maximum 50% of Tier 1 capital provided the subordinated debt meets the eligibility criteria shown in the directive.
	Ma Bha Ba/ Bank Scrutiny 1(1/2019), January 29, 2019	To submit a notification if domestic private banks wish to accept equity investment from foreign banks or financial institutions	Domestic private banks received permission to accept an equity investment of up to 35% from foreign banks or financial institutions. If they wish to do so, they shall notify the CBM.
	Directive No. 4/2019, January 30, 2019	Permission for Japanese yen and Chinese yuan as settlement options for banks in cross border payments and transfers	The CBM permits banks with Authorized Dealer licenses for foreign exchange to open yen and yuan accounts and settle trades in those currencies.
	Directive No. 6/2019, February 11, 2019	Net Open position	<ul style="list-style-type: none"> The banks with Authorized Dealer License must ensure that long or short positions for any currencies do not occur. To maintain more than 20% of core capital of long or short position of any foreign currency, and if the long/short position exceeds the CBM's limit 2 consecutive days, they need to do the corrective action.
	Directive No. 9/2019, March 25, 2019	Directive on Directors of a Bank.	<ul style="list-style-type: none"> An independent non-executive director of a bank must be a person who has less than 5% of the voting shares of the bank and is not a related party.

2019			<ul style="list-style-type: none"> All directors and candidates for the board of directors need to meet the fit and proper criteria, and the term of a director shall be 3 years and they have no chance to serve more than 3 consecutive times. Both the member of the board of directors and officers must comply with the conflicts-of-interests policy written formally by the board of directors of the bank.
	Directive No. 10/2019, March 25, 2019	Directive on External Auditors of Banks	A suitable external auditor must be appointed during the bank's annual general meeting to audit the annual financial statements of the bank.
	Directive No. 11/2019, March 25, 2019	Directive on Related Parties	<ul style="list-style-type: none"> A bank shall not lend to any related parties and shareholders holding more than 5 % of the voting shares of the bank unless such transaction has been approved by a vote of two thirds or more of the board of directors. The amount of the credit facility granted to a related party must be deducted from its Tier 1 capital if such credit facilities remain outstanding whether the credit facility is on or off balance sheet. Such all credit facilities shall be disclosed in the financial statements for that financial year and each subsequent financial year till full repayments.
	Directive No. 12/2019, March 25, 2019	Directive on Acquisition of Substantial Interest	<ul style="list-style-type: none"> No person, acting alone or in concert, shall acquire a substantial interest in a bank without obtaining the prior approval of the CBM. A person who wants to obtain an approval must apply to the CBM. The CBM can approve or reject within 90 days of receipt of the application.
	Directive No. 14/2019, April 24, 2019	Interest rate on credit card	The maximum interest rate on credit cards is fixed at 20% p.a.



2019	Directive No. 18/2019, November 15, 2019	Directive on Customer Due Diligence related to Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT)	<ul style="list-style-type: none"> All Banks and Financial institutions shall adopt, develop and implement internal policies, procedures, systems, and controls to combat money laundering and terrorism financing. They shall conduct risk assessment. They must follow customer identification requirements In addition, other factors like enhanced CDD for high risk customers, politically exposed person etc. that the banks and financial institutions must follow are stated in the directive.
	Directive No. 19/2019, November 15, 2019	Non-Bank Financial Institutions to follow the Directive on Customer Due Diligence related to AML/CFT	<ul style="list-style-type: none"> Non-Bank Financial Institutions, especially licensed money changers and mobile service providers, must follow the Directive on Customer Due Diligence related to AML/CFT.
	Notification No. 21/2019, November 15, 2019	Cross-border remittances regulation	<p>In regulation, the following facts are explained in detail;</p> <ul style="list-style-type: none"> The requirements for license application The amount of security deposit and revolving fund Regulations must be followed by the successful applicants. The maximum amount for a single transaction (\$1,000) and the monthly transaction cap (\$ 5,000 per person) To follow Anti-money Laundering and Counter Financing of Terrorism License fees, validity of license valid, license renewal, revocation of license, license suspension
2020	Directive 1/2020, March 12, 2020	Reducing interest rate by 0.5%	<p>To support economic development during the COVID-19 crisis the interest rates are reduced:</p> <ul style="list-style-type: none"> Bank rate: 9.5% Minimum deposit rate: 7.5% Maximum lending rate: 12.5% Unsecured lending rate: 15.5% <p>Effective date: April 1, 2020</p>
	Directive 2/2020, March 13, 2020	Reducing interest rate by 0.5% – Changing effective date	The effective date for reducing interest rates is changed to March 16, 2020 instead April 1, 2020
	Directive 4/2020, March 24, 2020	Reducing interest rate by 1%	<p>To support economic development during the COVID-19 crisis the interest rates are further reduced:</p> <ul style="list-style-type: none"> Bank rate: 8.5% Minimum deposit rate: 6.5%

2020			<ul style="list-style-type: none"> • Maximum lending rate: 11.5% • Unsecured lending rate: 14.5% <p>Effective date – April 1, 2020</p>
	Directive No. 6/2020, April 9, 2020	Minimum reserve requirement ratio fixed temporarily at 3.5%	To support the liquidity of the banks during the COVID-19 crisis the minimum requirement ratio is cut temporarily from 5% to 3.5% of total deposits. The valid period is until 30 September 2020.
	Directive No.7/2020, April 9, 2020	Temporary change of the calculation formula for liquidity ratio	90% of the value of treasury bonds with a remaining maturity of more than one year shall be included in the liquidity ratio calculation from 20 April to 30 September 2020.
	MaBhaBa/MP/FIR (145/2020), April 22, 2020	Extension of deadlines for certain regulations	To ease the burden on banks during and after the COVID-19 crisis the CBM extends the deadline of certain regulations to 31 August 2023: Notification No. (16/2017) Capital Adequacy Regulation, Notification No. (17/2017) Asset Classification and Provisioning Regulations, Notification No. (18/2017) Large Exposures Regulation, and Notification No. (19/2017) Liquidity Ration Requirement Regulation.
	Directive No. 8/2020, April 27, 2020	Reducing interest rate by 1.5%	To support the economic development during the COVID-19 crisis the interest rates are further reduced: <ul style="list-style-type: none"> • Bank rate: 7% • Minimum deposit rate: 5% • Maximum lending rate: 10% • Unsecured lending rate: 14.5%
	Notification 9/2020, May 15, 2020	To prevent risk resulting from using and trading of digital currency	<ul style="list-style-type: none"> • Cryptocurrencies are not recognized as an official currency • Financial institutions are not allowed to trade digital currencies (BTC, LTC, ETH, PM, etc.) • Buying, selling or exchange of digital currency can lead to losses on the consumer's side
	Directive No.10/2020, September 22, 2020	Extension of the period of the minimum reserve requirement ratio fixed temporarily	To support the liquidity of banks during the COVID-19 crisis the period of the minimum reserve requirement ratio fixed temporarily is extended from 1 October 2020 to 31 March 2021.
	Directive No.11/2020, September 23, 2020	Extension of the period for the temporary change of the calculation formula for the liquidity ratio	To relieve the impact of COVID-19 the period of temporary change of the calculation formula for the liquidity ratio is extended from 1 October 2020 to 31 March 2021.

Source: CBM



Endnotes

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- 12 This issue is presented in more detail in Chapter 3.
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- 14 CBM Directive (3/2019) January 24, 2019
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- 93 CBM Directive No. 8/2020 dated 27 Apr 2020: reduction of interest rate by 3.0% to 7.0%; consequently, maximum lending rate with collateral is set at 10.0% and minimum deposit rate at 5.0% while maintaining maximum lending rate without collateral is maintained at 14.5% pa.
- 94 CBM Directive No. 6/2020 dated 9 Apr 2020: temporary reduction of minimum reserve requirement from 5.0% to 3.5% of total deposits between Apr 9 to end Sep 2020
- 95 CBM Directive No. 7/2020 dated 9 Apr 2020: allowance of total value of government treasury bonds having a remaining maturity of over one year from 50% to 90% in calculating a bank's liquidity ratio between Apr 20 to end Sep 2020
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- 102 The cost-income ratio of banks in lower middle income countries is 57% on average.

