



THE FOUNDATION FOR
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Policy and Regulatory Framework for Remittance – Timor Leste

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Preface

This report provides a brief overview of the policy and regulatory framework for remittances in the Timor Leste. In particular, the report provides an overview of the foreign exchange licencing rules and regulations; rules relating to mobilisation of deposits by non-bank institutions; prudential regulations affecting non-bank sector growth; tax treatment; and incentives relating to migration and remittances.

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1.0 THE POLICY AND REGULATORY ENVIRONMENT

The Government of Timor Leste has no overarching policy which applies to inward remittances from Timor Leste migrant workers. However, a number of policies and regulations do affect this issue indirectly.

Forex licensing rules and restrictions

Banks are licensed to exchange foreign currency as part of their bank license. Westpac was issued with a foreign exchange licence in 2000 but soon thereafter closed its operations in Timor Leste. Western Union is the only non-bank holder of a currency exchange license and reports at least monthly on its transactions to the Banking and Payments Authority.

Rules on mobilisation of remittance deposits by non-bank Institutions

There remains no non-bank financial institution regulation in effect. Presently, the five principal microfinance institutions self-regulate according to a code of conduct that was struck by the Association of Microfinance Institutions of Timor Leste. The continuing lack of NBFi regulation is a constraint on growth and expansion of microfinance institutions. The publicly held Microfinance Institution of Timor Leste has a limited bank license which caps its deposits at US\$1m and IMFTL has, therefore, been unable to mobilise deposits above this level for the last four years, thus limiting its lending program. *Moris Rasik* has recently reached break even after seven years of operations. Grameen of Bangladesh has been invited to set up an operation in Timor Leste.

Tax treatment of remittances

There is no particular regulation applying to remittances. Although technically income, in the absence of any operable double-taxation agreements inward migrant worker, remittances are not known to be assessed for income tax purposes.

Other policies relating to migration and remittances

- Incentives Related to Migration

The Government has a draft regulation relating to formal programs promoting the migration of labour, with a strong focus on worker safety nets and social protections. Whilst this regulation has not yet been enacted, an overseas worker unit has been established within the Ministry of Labour and Community Reinsertion which is coordinating the first batch of migrant workers sent to South Korea. There are no incentives offered other than salaries more than 15 times the local average.

- Incentives Related to Remittances

At present, there are no incentives related to remittances in Timor Leste.

2.0 THE FINANCIAL SECTOR

The formal financial system of Indonesian Timor Leste was destroyed in 1999. At present, Timor Leste's financial sector is limited in its operational activities including outreach. There are no local banks in Timor Leste. There are currently ONLY three foreign owned commercial banks: the Portuguese Caixa Geral de Depositos (CDG, which owns BNU Timor), the Indonesian Bank Mandiri and the ANZ Bank. There is also one local institution with limited banking licence (IMFTL), Microfinance Institutions (MFIs), credit unions and NGOs. The regulatory and supervisory functions are undertaken by the Banking and Payment Authority (BPA).

2.1 Banks

At present, there are three commercial banks in Timor Leste, all of which are branches of foreign-owned banks. They are:

- ANZ - The ANZ branch was established in 1999-2000. According to the IFC (2007), ANZ is effectively a non-lending institution. Key constraints faced by ANZ in extending its lending services include: difficulties with collateral documentation; absence of notary services and credible financial statements; and other uncertainties in the current legal environment. ANZ has introduced ATMs and EFTPOS (electronic funds transfer services) with participating organisations in Dili. ANZ has a number of plans to extend its banking services to rural areas (such as the mobile banking model), though these have not been implemented yet.
- CGD (Caixa Geral do Depositos) – is the branch of a state-owned Portuguese bank and was established in 1999-2000. CGD acquired the Banco Nacional Ultramarino (BNU) and operates in Timor Leste under the trading name BNU-Timor. CGD is the industry leader in terms of assets, customer numbers and branches. CGD central office is in Dili, with additional six branches located in the districts of: Baucau, Gleno, Maliana, Oecusse, Viqueque and Suai. CGD is the only bank to offer savings deposits to those engaged in informal sector employment and in rural areas (IFC, 2007). The IFC also notes that CGD has a substantial backlog of loan applications. CGD is also acts as a service provider to MFIs (through the provision of banks transfer and deposits) operating in the rural areas of Timor Leste.
- Bank Mandiri – is the branch of a state-owned Indonesian bank and was established in 2003 with a single office in Dili. Bank Mandiri main banking service is related to the provision of financing trade with Indonesia and servicing Indonesian businesses in Timor Leste. The bank rarely provides any credit to micro- and smaller businesses, with almost entirely focused on commercial enterprises. Bank Mandiri has extended a line of credit to the MFI (Moris Rasik) in return for collateral at 100% of the loan value.

The IFC (2007) notes that there is a general growth trend in the banking sector in Timor Leste, particularly the rapid growth of deposits with savings account contributing

almost a third of the total deposits. With savings account being the product of choice for lower-income people, there is projected demand for this financial product in Timor Leste.

Apart from the three commercial banks, Western Union has a 'currency exchange licence'. It has to send monthly reports on its transactions to the Banking and Payment Authority. The Western Union is located in the capital Dili. Clients have to travel to the city office to receive funds when these are remitted from overseas.

2.2 The microfinance sector

The microfinance sector (MFI) is small, but one of its key features has been its resilience to shocks and crisis, and its progress when compared to other donor investments and economic development initiatives (IFC, 2007). The Timor Lesteese microfinance sector consists of the Instituicao de Microfinancas de Timor-Leste (IMFTL), three specialised NGOs, several Credit Unions which were initiated by the Asian Development Bank (ADB) and a number of microfinance programs. Most of these organisations are members of the Association for Microfinance in Timor-Leste (AMFITIL) – the only professional association in the sector. With the exception of IMFTL, MFIs are registered as NGOs. The BPA (Banking and Payment Authority) does not regulate the activities of NGO or MFIs, though it issued a 'limited' license to IMFTL in 2002 to operate as a registered MFI.

Most microfinance activities are concentrated in Dili, Bobonaro and the Cova Lima districts. While IMFTL and Credit Unions provide a wide range of services, including individual and group credit products, as well as saving deposits services. NGO programs focus mainly on micro credit, using group lending methodologies, with some adapting the Grameen Bank model, and others developing self-help groups.

Instituicao de Microfinancas de Timor-Leste (IMFTL): IMFTL was initiated and developed by the ADB under the Microfinance Development Project, with funding from the Trust Fund for Timor Leste. Established in December 2001, it operates through branches in Dili (head quarters), Aileu, Gleno, Maliana and Oecusse. In 2002, BPA issued a license for IMFTL to operate as a registered MFI, but its license is limited to caps on microcredit loan portfolio, amount of deposit maintained and liquidity ratio. According to its performance report to the Association of Microfinance Institutions of Timor Leste (AMFITIL), IMFTL is making profits on its operations, though these are reported to be based on its payroll loan product.

Credit Unions

Credit Unions provide individual loans to members while accepting savings deposits. They operate throughout the country. However, they are small, their systems are weak and accountability is questionable. Despite an attempt by the ADB to rehabilitate credit unions, most are now reported to have collapsed, with only four out of 27 operational.

According to the ADB, some of the constraints noted included: low membership, inadequate capital and limited savings mobilisation, shortage of trainers and technical staff, governance and transparency problems (Conroy, 2006).

Specialised NGOs

Moris Rasik: means 'independent life' in the local language of Tetum. It was established in 2000 with the support of CASHPOR, the network of Grameen Bank replications in Asia, to provide micro credit to poor women in western districts. The financial resources of *Moris Rasik* come from international organisations, including \$70,000 from Touch Community Services and \$100,000 from the Lee Foundation. HIVOS has been the largest provider of funds to *Moris Rasik* over the last six years. *Moris Rasik* is the largest rural microfinance organisation in Timor Leste (with 10,170 loan clients through 13 branches and US\$1.9million loans outstanding) and probably the most successful with a 98% repayment rate. Operational self-sufficiency was achieved in August 2007.

Tuba Rai Metin (in Tetum, 'Feet Firmly on the Ground') is supported by Catholic Relief Services that receive funding from USAID. It runs microfinance programs for women in Dili and in the eastern districts of Baucau and Viqueque through solidarity groups of three to ten members. *Tuba Rai Metin* reached approximately 1,500 clients at the end of 2004. In 2005 *Tuba Rai Metin* signed accord with the Ministry for Labour and Community Reinsertion regarding credit assistance for Timor Leste women's groups.

Other NGO-led microfinance programs include the Christian Children's Fund (CCF), which provides training and technical assistance to groups managing their own credit and savings operations, and Tiimor Aid, which receives funding from the Nobel peace prize of Jose Ramos Horta.

Overall, at present, financial institutions in Timor Leste have only achieved limited coverage. In rural areas of Timor Leste, the majority of households face financial exclusion and lack access to basic financials service such as low-cost deposits, loans and remittances (Conroy, 2006).

In recent times, the level of domestic credit and bank deposits has grown as a proportion of non-oil GDP (Conroy, 2006). This is attributed to the growth of the banking industry. According to Conroy (2006) this suggests the excess demand for bank credit and the need to expand savings mobilisation.

Major donor agencies for microfinance activities in Timor Leste have included over time AusAID, the ADB and USAID. Of these, the ADB has played a very significant part with the Microfinance Development Project. In addition to rehabilitating credit unions, the project sought to assist development of a policy and legal framework within which the intended microfinance institution could be developed, particularly in matters influencing the ability to lend to the poor. It also established the IMFTL and provided

technical assistance aimed to improving corporate governance and management operational and financial performance and building a pro-poor client orientation.

Despite efforts from major donors, the microfinance sector in Timor Leste still faces a number of problems:

- lack of financial resources to sustain and develop their operations, particularly the growth of their loan portfolio;
- scarcity of skilled human resources as a consequence of decades of conflict and colonisation;
- weak and nascent financial infrastructure causing higher costs and risks;
- poor physical and legal infrastructure resulting in high operating costs, low self-sufficiency ratios and dependence on donor subsidies; and
- lack of trust which might discourage entrepreneurs to start and expand income-generating activities.

Given the various challenges faced by MFIs in Timor Leste, Conroy (2006) suggests a number of recommendations to help support the sector. These include:

- Institutionalising their presence in the country with attention to sustainability and scale of the organization.
- Self-regulation of MFIs has been identified as an opportunity for the sector. However, the need to strengthen the capacity of AMFITIL to act as a supervisor has been noted.
- Capacity building of individual MFIs has also been suggested. In particular, in the areas of training and management of staff, technical assistance, transport and office equipment.
- Capacity building assistance for MFIs clients, particularly in the area of financial literacy.

Around 11 per cent of the labour force in Timor Leste is 'self-employed' (Ministry of Labour and Reinsertion 2006). Conroy (2006) notes that the potential for microenterprise sector development in Timor Leste is restricted due to limited access to the financial system in general and microfinance in particular; and the deficiencies that exist in the legal and regulatory environment. A World Bank survey also noted that access to finance was a constraint to 81% of the informal enterprises (World Bank, 2005). The World Bank (2006) identified a number of challenges facing Timor Leste, which have implications for the microenterprise sector. These include: critical gaps in land law, land and property registration, leasing and collateral, bankruptcy, business licensing, accounting and auditing, competition policy, intellectual property rights, social security, and key sectoral legislation in areas of important potential in the economy such as tourism, manufacturing and trade.