

Article:

Building consumer demand for digital financial services - the new regulatory frontier

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Building consumer demand for digital financial services - the new regulatory frontier



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Abstract

Digital financial services (DFS) are held out as key financial solutions for improving financial inclusion. However, targeted end users often offer little in the way of obvious profitable opportunities and so market forces alone are not enough to ensure the supply of services and products that match end users' means, needs or wants. As a result, DFS in emerging markets may suffer from limited uptake and usage, with little effect on financial inclusion. In emerging markets, financial regulators have been focusing on supporting the success of DFS largely through institutional and regulatory framework efforts. This article argues that financial regulators must first work to understand and build consumer demand for DFS rather than purely focusing on developing enabling regulatory frameworks. This requires a change in mindset for financial regulators, who are more familiar with promoting financial stability, safety and efficiency. In this article, we explore this changing role for financial regulators. We recommend that regulators particularly focus on building consumer demand through promoting partnerships in DFS as a means of promoting financial inclusion. We highlight that partnerships introduce collaboration risks and heighten consumer risks; requiring regulators to adjust regulatory frameworks to ensure such risks are identified and mitigated.

1. Introduction

Financial inclusion is considered an important means for alleviating poverty and promoting a country's broader economic development; hence, it is now receiving greater attention from international financial regulators. This heightened importance of financial inclusion for economic development is resulting in a change in the role of financial regulators. Historically, banks have innovated in pursuit of higher profits and the role of a financial regulator has been to maintain the safety and soundness of the financial system. However, promoting financial inclusion requires promoting the provision of financial services by banks and new players to customers who may offer little in the way of profitable opportunities. In this environment, market forces alone cannot be expected to deliver the products to match end users' needs and wants. In promoting financial inclusion, financial regulators must work to minimize the gap between what market forces provide and what end users need, can afford and want.

This responsibility to promote financial inclusion is a relatively new and different role for financial regulators and requires a change of their mindset. To assist in navigating through this new regulatory frontier this article recommends that, in promoting financial inclusion, financial regulators must sharpen their focus on understanding and building consumer demand for DFS.² Regulators are already focused on designing enabling regulatory frameworks to accommodate new players and innovative DFS; largely because DFS have been held out as key innovative solutions to improve financial inclusion. However, building consumer demand is also critical to the success and sustainability of DFS ecosystems; end users' needs and desires must be a key focus. Without focusing on consumer demand, DFS will suffer from limited uptake and we may be left with sophisticated frameworks for overseeing and regulating DFS but little DFS to regulate.

² Digital financial services (DFS) is a term increasingly used in place of more specific terms such as mobile money. DFS is used here to refer to a range of financial services accessible via digital remote access, including e-money or mobile money. For more terminology definitions, see Alliance for Financial Inclusion, 2013, "Mobile financial services: basic terminology," March http://www.afi-global.org/sites/default/files/publications/mfswg_gl_1_basic_terminology_finalnewnew_pdf.pdf.

Of course, the focus on consumer demand is merely one aspect of a successful DFS ecosystem. Providers will also need to design highly efficient DFS systems with such low transaction costs that business can be done profitably.³ However, exploring all the factors that drive the success of DFS ecosystems is beyond the scope of this article.

Instead, we explain the importance of financial regulators understanding and building consumer demand, so as to encourage sustainable DFS ecosystems that can improve financial inclusion. In understanding and building consumer demand, financial regulators will be able to intelligently direct industry efforts toward encouraging sustainable DFS ecosystems that improve financial inclusion. In particular, we recommend regulators turn their attention to partnerships in the DFS space as a way to build consumer demand; that is, partnerships between payments providers, banks, microfinance institutions (MFIs) and mobile network operators (MNOs). Such partnerships are fast emerging as a principal way to build consumer demand in the DFS space and a path toward successful sustainable DFS ecosystems.

Financial regulators must be ready to identify and assess the risks from prospective partnerships and adjust regulatory frameworks, so that they are open to the benefits of partnerships and responsive to the risks. It will be critical to ensure financial safety and stability is maintained alongside greater financial inclusion. We highlight two areas for regulators to focus on in their approach toward the identification, assessment and mitigation of risks arising from partnerships in DFS:

1. Collaboration risks
2. Consumer risks that arise due to a greater range of product offerings available via a mobile phone

³ Voorhies, R., J. Lamb, and M. Oxman, 2013, "Fighting poverty profitably – transforming the economics of payments to build sustainable, inclusive financial systems," Bill and Melinda Gates Foundation, September.

Our analysis of these risks arising from partnerships is at an elementary stage. We will conduct further analysis and research in this area with the objective of improving existing knowledge and awareness of the regulatory challenges arising from partnerships in DFS.⁴

2. Background

2.1 The regulation of DFS - international developments

The regulation of DFS, and mobile money in particular, is currently the focus of considerable discussion and debate among development partners, policy “think tanks,” industry researchers and academics. Financial regulatory frameworks for mobile money are evolving at a fast pace in emerging markets (fast for financial regulation), and regular announcements cite countries’ latest enabling regulatory moves. These new regulatory environments respond to the entry of new players in the payments space; players previously not captured by financial regulation.⁵

Internationally accepted standards for the regulation of mobile money are also emerging; the Alliance for Financial Inclusion (AFI), and particularly its Mobile Financial Services Working Group (MFSWG), is proactive in this area, providing a platform for regulators to share, discuss and develop consistent understandings of the regulatory issues. The AFI and MFSWG develop and publish guidance papers outlining common approaches for the oversight and supervision of mobile money and mobile financial services (MFS) more broadly.⁶

⁴ There are two appendices at the end of this article. The first provides a list of acronyms used throughout this article and the second provides a glossary of terms.

⁵ See for example Owens, J., 2014, “Highlights on the mobile financial services landscape in Tanzania and lessons for regulators,” Alliance for Financial Inclusion, 24 February. <http://www.afi-global.org/blog/2014/02/24/highlights-mobile-financial-services-landscape-tanzania-and-lessons-regulators>; and Almazan, M. 2013, “Mobile money for the unbanked,” GSMA, 19 December. <http://www.gsma.com/mobilefordevelopment/mobile-money-regulation-in-latin-america-leveling-the-playing-field-in-brazil-peru>. For a recapitulation on what is meant by an ‘enabling’ regulatory environment, see: Gutierrez, E., and S. Singh, 2013, “What regulatory frameworks are more conducive to mobile banking? Empirical evidence from Findex data,” World Bank Policy Research, working paper no. 6652, <http://ssrn.com/abstract=2338858>.

⁶ See, Alliance for Financial Inclusion, 2014, “Mobile financial services: consumer protection in mobile financial services,” March, <<http://asbaweb.org/E-News/enews-37/incfin/06incfin.pdf>>; Alliance for Financial Inclusion, 2014, “Mobile financial services: supervision and oversight of financial services,” February, http://www.afi-global.org/sites/default/files/publications/mfswg_guidelinenote12_oversight_and_supervision_of_mfs_2.pdf.

However, regulatory approaches for dealing with the wider category of products becoming available through partnerships in the DFS (such as loans, insurance and savings) are still very much in the nascent stage, as is our understanding of the regulatory challenges presented by partnerships themselves in DFS. This article presents these issues as a new regulatory frontier. We provide initial guidance for regulators to respond to partnerships in DFS. As they assist in building sustainable DFS products, we consider it critical for regulators to be ready to respond. We will develop and extend on this guidance in future research papers.

2.2 Financial inclusion - international developments

The increased international focus on financial inclusion is also contributing to the fast pace of regulatory developments for DFS; as such products are seen as key to greater financial inclusion and economic development.⁷ Policymakers must now look beyond their traditional policy objectives of promoting safe and efficient financial systems to also focus on promoting financial inclusion.⁸ This dual regulatory focus has been referred to as “the two sides to the financial inclusion coin;” enabling innovation to reach the financially excluded while at the same time providing protection for those newly included to ensure they have confidence in the system and use it regularly.⁹

⁷ DFS can drive greater financial inclusion because they offer more than merely a viable alternative to the hawala systems or basic remittance networks that simply transfer cash from A to B. As mobile money also involves storing values electronically it provides the end user with a potentially improved budgeting and payments mechanism. Financial products and services can also be offered including credit and insurance creating greater demand for DFS. The DFS ecosystem is still nascent, as deployments are still to crack how to create mass adoption and usage so that mobile money moves beyond a simple “cash-in”/“cash-out” to where “cash-in” stays “in.” This will mean financial inclusion will flourish, financial systems will be strengthened and economic development will benefit.

⁸ The focus on financial inclusion is seen in many international forums: G20 Summits, the G20’s Global Partnership for Financial Inclusion (GPII), the Global Policy Forum (GPF) of AFI, the Better Than Cash Alliance (BTCA), the Financial Action Task Force (FATF), and the Bank for International Settlements’ Basel Committee on Banking Supervision (BCBS).

⁹ Lyman, T., 2013, “Building an enabling and protective policy environment,” CGAP, 24 May. <http://www.cgap.org/blog/building-enabling-and-protective-policy-environment>.

With financial inclusion, the regulatory focus should also include realizing the broader economic and social policy objectives and the potential for inclusive growth. In this context, the Consultative Group to Assist the Poor (CGAP) highlights comments from Pia Roman, Head of Financial Inclusion at Bangko Sentral ng Pilipinas (BSP), the Philippines' central bank; Roman noted that the result of making MFS available for a remote island in the Philippines, Rapu Rapu, was increased economic activity on the island.¹⁰

Alfred Hannig, Executive Director of AFI, has noted that the phenomenon of financial regulators increasingly focusing on financial inclusion is mostly being seen in emerging countries and they are "reshaping the approach of central banking."¹¹ This trend continues and global standard-setting bodies are now actively engaging with regulators seeking to promote financial inclusion.¹²

2.3 "Build it and they will come" – avoid the trap

While this international cooperation and alignment of goals bode well for financial inclusion, it is important that the refinement and implementation of "best practice" regulatory frameworks do not become the sole focus of financial regulators, who, operating with the goal of financial inclusion in mind, also need to ensure end users are provided with safe, affordable and practical payment options. If payment providers assume the position of "build it and they will come" and regulators respond only by determining how to devise risk-based regulations for the new entities or new payments products and services, the result may be sound and supportive regulatory frameworks for new products and services with low uptake and limited success as they do not match what the end users need and want.

¹⁰ Ibid.

¹¹ Hannig, A., 2013, "Developing countries focused on financial inclusion are reshaping central banking," Alliance for Financial Inclusion, 25 November. <http://www.afi-global.org/blog/2013/11/25/developing-countries-focused-financial-inclusion-are-reshaping-central-banking>.

¹² Hannig, A., 2014, "Financial inclusion a new common ground for central banks," Alliance for Financial Inclusion 14 May <http://www.afi-global.org/blog/2014/05/14/financial-inclusion-new-common-ground-central-banks>.

This outcome is of little use in improving financial inclusion and is a questionable use of regulatory resources.¹³ By focusing on the need to understand and build consumer demand, regulators will assist in avoiding these situations.

Low uptake and inactive users are already common in the rollout of mobile money in emerging markets. The success stories of Kenya and the Philippines have been difficult to replicate. This situation may have occurred due to a focus on broadening accessibility (i.e., through developing agent networks and mass sign-ups of end users) without understanding the real desires of end users. Consumers may have no strong incentive to switch to the new products or services. To develop successful DFS ecosystems, it is now recognized that it is necessary to go beyond ensuring these products are simply available, accessible and affordable. Development partners are now encouraging greater focus on the demand side, to ensure the products meet consumer demand, are being used and will become sustainable.

2.4 Market forces not enough to deliver products for unbanked and under-banked

Experience to date suggests that financial inclusion regulators and advocates cannot expect market forces alone to deliver products that match the unbanked and under-banked's needs and wants and ultimately improve financial inclusion. This is because their target markets are traditionally from low-income socioeconomic groups, which likely means low returns for providers of products and services if insufficient scale is achieved. While a number of driving forces will be needed to achieve the scale required for profitable products and services for the unbanked and under-banked, this article posits consumer demand as a key driving force behind determining whether the requisite scale for profitability will be achieved.¹⁴

¹³ Graham Wright (head of MicroSave) recently commented on this point in his reflections on the Mor Committee Report in India. Wright notes that the Report offers a "sophisticated vision of the financial architecture" and a road map for providing financial access to all. However, he questions whether due consideration was given to the demand side, noting that "the report seems to imply that low income people's demand for formal financial services was a given." See Wright, G., 2014, "The Mor Committee report - the demand side conundrum," MicroSave, February. <<http://blog.microsave.net/the-mor-committee-report-the-demand-side-conundrum/>>.

¹⁴ For a discussion on other factors that come into play in developing profitable innovative products and services see Voorhies et al., supra.

2.5 A financial regulator's role in understanding and building consumer demand

There is a general trend for regulators to now extend themselves beyond the traditional oversight role of encouraging the safety and stability of the financial system to also focus on actively directing efforts toward increasing financial inclusion. In particular, financial regulators are focusing on how to encourage the building of sustainable DFS ecosystems. We consider that financial regulators can improve their efforts by sharpening their focus on understanding and building consumer demand for DFS, specifically by:

- ▶ Understanding the financial desires of the unbanked and under-banked, including understanding the existing demand for formal financial mechanisms
- ▶ Facilitating the processes that can build demand for financially inclusive products and services (Regulators who first understand consumer demand can better appreciate which market developments need to be encouraged or facilitated through policy and regulatory changes).

3. Understanding consumer demand

Regulators can assess a DFS product's potential for promoting financial inclusion by considering how well the initiative focuses on local context and customer value proposition. Emphasizing these two aspects in DFS initiatives will ensure players are being encouraged to deliver solutions and products that are useful and relevant for the under-banked and unbanked. Considerable research has emphasized the importance of these two aspects for DFS, a summary of which follows, highlighting how regulators can assess if local context and customer value proposition have been adequately considered.

3.1 Local context

Davis and Owens contrast different countries to illustrate the importance of local context in understanding demand.¹⁵ In the Philippines, the demand is to move money between urban and rural areas and from overseas. The MNOs have, therefore, enjoyed a distributional advantage over point-of-sale (POS) networks and their mobile money products, Smartmoney and GCash, have been very successful.¹⁶

¹⁵ Owens, J., and B. Davis, 2008, "POS vs. mobile phone as a channel for mbanking MicroSave," 19 September.

¹⁶ Ibid. at 2.

In contrast, in South Africa, consumers either have a bank account in which to receive their salary or access to a cash-out facility provided by the Government.¹⁷ There is little incentive for consumers in this market to replace their existing methods of accessing funds with a mobile phone payments channel.¹⁸ In order to determine whether a product will be successful, attention to the local context, and insight into the local customer base will be essential.¹⁹ In particular, any new service must be evaluated in the context of existing services that customers are accessing.²⁰ Only with that information can a reasonable assessment be made of what might or might not be successful. A good illustration of this point is recent research into smallholder farmers, whose demand for mobile services, including finance and information, is far below the potential it has to benefit their businesses.²¹

3.2 Customer value proposition

MicroSave has written extensively on the importance of the customer value proposition and keeping the clients' needs at center focus when designing new products.²² Manoj Sharma, Managing Director at MicroSave Asia, has noted what might seem obvious, but seems to have been missed by many product developers: "Your good intentions are not necessarily good for the client – talk to them and find out."²³ Sharma lists certain questions to address when assessing how compelling the value proposition is for end users:

- ▶ What pain points does the new system address?
- ▶ Is it more convenient and easier to use?
- ▶ Does it provide value for money (if not less expensive)?
- ▶ Is it more secure than alternatives?²⁴

¹⁷ Ibid.

¹⁸ Ibid.

¹⁹ Watkins, D., 2013, "Context and culture: designing relevant financial services," CGAP, 13 August <http://www.cgap.org/blog/context-and-culture-designing-relevant-financial-services>.

²⁰ Ibid.

²¹ Deyners, L., 2014, "How do smallholder farmers access information," GCAP, 31 January. <http://www.cgap.org/blog/how-do-smallholder-farmers-access-information>.

²² Sharma, M., 2013, "Sustainable non-banking financial institutions," MicroSave (Presentation), 18 November. http://www.microsave.net/resource/sustainable_non_banking_financial_institutions#.U5royViSw00.

²³ Sharma, M., 2013, "DFS for the under-banked," MicroSave (Presentation, Pacific Microfinance Week), October. http://www.microsave.net/files/pdf/MicroSave_DFS_for_the_Under_Banked.pdf.

²⁴ Ibid.

Sharma refers to “consumer pull” as being the key consideration. He notes the “natural pull” of particular products such as “money transfers/remittances and welfare receipts” but emphasizes that “[a] deeper understanding of consumer aspirations and preferences is essential for the success of other products that do not have the benefit of a natural pull.”²⁵ For example, consumers may want a savings account product, but simply be prevented from actively using the account due to expenditure shocks and having very little income to keep as savings. Consequently, financial literacy and aggressive marketing may have little effect on long-term usage. In contrast, the demand for other products, such as remittances, is naturally strong and explicit and requires little in the way of marketing and consumer education.²⁶

3.3 Customer demand surveys

Customer demand surveys are also useful for drawing background information. However, care should be taken in interpreting the results of demand studies as survey results depend heavily on the precise questions asked. Surveys are also done at a single point in time when what is needed is an understanding of the longer-run perspective – what the customer may need in three months’ or a year’s time. Capturing customer perceptions in these surveys is also important: perceptions on existing access to financial services (formal and informal) and what customers may perceive as valuable in a new service or product.²⁷

3.4 Understanding consumer demand – not so straightforward

Ignacio Mas has looked at why moving consumers from informal financial mechanisms to formal financial mechanisms, such as DFS, is not as straightforward as some might believe or want.²⁸ Mas posits an interesting thesis on how to marry the “richness of informal financial practices” with the “structure of formal finance” to create a financial experience analogous to eating a “richly layered cake.”²⁹

²⁵ Ibid.

²⁶ Gosh, I., 2013, “Remittances vs. savings on the mobile money platform (part 2),” Institute for Money, Technology and Financial Inclusion, 23 July. <http://blog.imtfti.uci.edu/2013/07/remittances-vs-savings-on-mobile-money.html>.

²⁷ Watkins, *supra.*; Deyners, *supra.*

²⁸ See Mas, I., 2014, “Digitizing the kaleidoscope of informal financial practices,” *Journal of Business Management and Social Science Research* 3:5.

²⁹ Ibid. at 57.

Mas describes how the various needs underpinning financial inclusion can be thought of as layers of a cake that combine to offer a texture, flavor and color that can only be fully experienced when slicing through the various layers.³⁰ Mas emphasizes that it is only through combining formal and informal financial mechanisms, akin to combining the various layers of a cake, that the benefits of financial inclusion come to the fore.³¹ Mas gives the example of M-Pesa, referring to the formal mechanisms as the MNO offering the product, and the Central Bank and competition regulator overseeing the process, while the informal mechanisms are the existing domestic remittance methods embedded in Kenyan culture³² (which quickly shifted across to being remitted via mobile money upon commencement of M-Pesa). These formal and informal mechanisms combined to create the DFS ecosystem that is today spurring on financial inclusion in Kenya.³³ Mas cites Susan Johnson as appropriately revealing this “source of the magic that has lit up Kenya with electronic money” which Johnson has termed “The Rift.”³⁴

³⁰ Ibid.

³¹ Ibid.

³² Mobile Money Africa recently reported on M-Pesa agents observing a tripling of transactions over the Christmas and New Year period as people sent money to relatives and friends as gifts, see Mobile Money Africa, 2014, “Mobile money agents await huge commissions after Christmas Boom,” 6 January <http://mobilemoneyafrica.com/details.php?post_id=1544> .

³³ Today, more than than 40% of GDP flows through M-Pesa, more than two-thirds of the adult population use it and the Head of Strategy for Financial Services, Sitoyo Lopokoiyit, at Safaricom (the operator of M-Pesa), recently interpreted this usage figure to mean that 80% of the population in Kenya is now considered financially included. Without M-Pesa this figure drops to 23%. Lopokoiyit noted that now with M-Shwari, M-Pesa users are provided with further formal financial services; M-Shwari is a partnership between Safaricom and the Commercial Bank of Africa. Users can move savings into M-Shwari using their mobile phone and M-Pesa account, it is an opt-in service, the savings earn interest and M-Shwari users can also borrow funds. Users are learning about savings and credit ratings through education provided by Safaricom. Lopokoiyit noted there were now four million M-Shwari customers. Kyla Yeoman, K., 2013, Interview: How M-Pesa innovates new business models for its base of the pyramid customers, Global Envision, 13 December. <http://www.globalenvision.org/2013/12/13/interview-how-m-pesa-innovates-new-business-models-its-base-pyramid-customers>.

³⁴ Mas, supra. at 57.

Mas explains that by combining informal and formal mechanisms, end users will feel as though they own the financial services relationship and have control over their money.³⁵ Mas emphasizes that new products should not simply be built and rolled out with consumer education on their use with the expectation that this will create consumer demand. Instead, Mas advocates pursuing a more detailed understanding of what is important to the end users operating in an informal economy and then working out how to combine those important informal disciplines and mechanisms with formal payments, disciplines and mechanisms. This would give rise to digital savings solutions that could displace informal savings options.

4. Building consumer demand

Regulators can encourage the development of successful and sustainable DFS ecosystems by encouraging, and being a part of, efforts to build consumer demand. Examples of what these efforts might include are:

- ▶ To be an enabling regulator
- ▶ To encourage the movement of cash payments to be done electronically using mobile money, particularly government payments (such as G2P and person-to-government (P2G))
- ▶ To facilitate financial literacy efforts that focus on incorporating end users' needs
- ▶ To develop open/interoperable/interconnected systems
- ▶ To enable partnerships between the various market players leveraging on the "sum is greater than the parts."

We provide further detail on these examples below, with particular focus on the importance of enabling partnerships in building consumer demand. Financial regulators' roles for the other examples above are well-canvassed in the literature on DFS and mobile money regulation; examples of this literature are provided in the footnote references below.

³⁵ Ibid. At 58.

4.1 An enabling regulator

The Philippines' central bank, Bangko Sentral ng Pilipinas (BSP), is renowned for being an enabling regulator when it comes to innovations in financial services.³⁶ In an interview with CGAP in November 2012, Deputy Governor Nestor Espinilla Jr. explained how the BSP created space for private sector innovation in the area of DFS by adopting a regulatory approach of allowing the private sector to test and learn.³⁷ The BSP developed regulations for mobile money which enabled the telecommunications companies to compete with banks to deliver mobile money services through a subsidiary which is required by BSP regulations to focus solely on mobile money services. Espinilla noted two main benefits from BSP's "test and learn" approach: increased competition leading to a greater range of available services and decreased remittance costs (the latter particularly important in the Philippines where external remittances comprise 10% of GDP and internal remittances are an important part of the domestic economy as families working in urban areas regularly send money to family members living in remote rural areas). BSP supported this enabling regulatory approach for the new financial services by strengthening its regulatory capacity to oversee e-money issuers. BSP established a new supervisory unit bringing together the skills of regulators from its information technology area as well as the banking supervisory area.

India's regulatory approach toward mobile money ecosystems has, until very recently, sat in stark contrast to that of the Philippines. The Reserve Bank of India (RBI) has required MNOs to use bank agents for the "cash-out" service associated with MNOs' mobile money products. The MNOs would prefer to use their own agents to provide this service. The MNOs have argued that the infrastructure is already in place, through their extensive network of agents which mobile phone customers use to "top-up" airtime on prepaid cards. The RBI has prohibited MNOs from using these agents for cashing out mobile money. The banks themselves have been reluctant to move into this space as there were limited prospects for profitability. Banks tend to seek profitability from cross-selling, whereas MNOs focus on profits from large volumes.

³⁶ For a brief description of an enabling regulatory environment for mobile money, see Gutierrez and Singh, *supra*.

³⁷ Thomas, J., 2012, "Regulation spurs innovation in the Philippines," CGAP, 5 November. <http://www.cgap.org/blog/regulation-spurs-innovation-philippines>.

The RBI has, however, become much more proactive on the financial inclusion front, especially in relation to payments.³⁸ The RBI recently announced it would create a new class of regulated institutions, “payment banks” that will accept demand deposits and provide remittance services.³⁹ This was a key recommendation in the RBI’s Report of the Committee on Comprehensive Financial Services for Small Business and Low Income Households (the “Mor Committee Report”).⁴⁰ In announcing this change, the RBI is acknowledging the importance of payments services products that facilitate domestic remittances for greater financial inclusion.⁴¹ The payment banks will be allowed to act as agents for banks. Entities eligible to apply to undertake this new bank agent activity include existing nonbank prepaid instrument issuers (PPIs), non-banking finance companies (NBFCs), corporate business correspondents, mobile telephone companies, supermarket chains, companies, real sector cooperatives and public sector entities. It is expected that this regulatory change will see a more effective and efficient use of the MNOs’ extensive agent networks. However, it is not yet clear whether this means MNOs can provide cash-out services to their mobile money customers.⁴² The RBI may maintain its cautious approach in this area.⁴³

³⁸ PTI, 2014, “Reserve Bank of India to soon come out with payment bank,” The Economic Times, 12 June, <http://economictimes.indiatimes.com/news/economy/policy/reserve-bank-of-india-to-soon-come-out-with-payment-bank/articleshow/36445449.cms>.

³⁹ RBI, 2014, “RBI releases draft guidelines for licensing of payments banks and small banks,” Reserve Bank of India, 17 July. http://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=31646; Unnikrishnan, D., 2014, “RBI lets NBFCs work as banking correspondents,” Livemint, June. <http://www.livemint.com/Industry/PuwOHdv8crJQ28dIWY7TGK/RBI-allows-NBFCs-work-as-banking-correspondents.html>; and Mirani, L., 2014, “A new kind of no-frills bank could kickstart India’s long awaited mobile money revolution,” Quartz, July. <http://qz.com/237847/a-new-kind-of-no-frills-bank-could-kickstart-indias-long-awaited-mobile-money-revolution/>.

⁴⁰ RBI, 2014, “The report of the Committee on Comprehensive Financial Services for Small Business and Low Income Households,” Reserve Bank of India, 7 January http://rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=30353.

⁴¹ For further commentary on “payments banks” and the Mor Committee’s Report, see Wright G., 2014, “The Mor Committee Report - the demand side conundrum,” MicroSave, February. <http://blog.microsave.net/the-mor-committee-report-the-demand-side-conundrum/>.

⁴² Parbat, K., 2014, “Telecom companies expect spurt in revenues with ‘payments banks’,” Economic Times, 19 July. http://articles.economictimes.indiatimes.com/2014-07-19/news/51744670_1_vodafone-india-mobile-payments-safaricom?_ga=1.89423515.1014043529.1405995841.

⁴³ As agents to a bank, MNOs can appoint their own agent and cash-in/cash-out is allowed through these agents as long as the client has a bank account. MNOs can provide a “wallet” to customers that may or may not be linked to a bank account. However, in this instance, customers can perform cash-in activities (purchase goods and services) but not do cash-out from the wallet. (Thank you to Manoj Sharma, MicroSave, for this explanation).

4.2 Shifting government payments to electronic funds transfer channels

Regulators may also assist by working with governments to channel government funds and subsidies through safer and more efficient digital payments systems.⁴⁴ Such efforts are not without challenges.⁴⁵ However, financial regulators supporting such initiatives (either through regulation of the entities channeling the payments or through policy changes to support the required payments infrastructure developments) will contribute to building consumer demand for the new payment methods.

An example of a government initiative to support the move toward more efficient and safer payments systems is India's Aadhaar program. This involves biometric identification processes to capture fingerprints and eye scans to confirm a person's identity. Early findings suggest this program can reduce fraud, which prevents government aid from reaching the intended recipients.⁴⁶ This program may contribute toward the success of moving from cash-based payments to electronic methods.

4.3 Financial literacy efforts focused on end users' needs

Improved financial literacy can help build more trust with the end users of the new payment methods. Tilman Ehrbeck, CEO of CGAP, has commented that what is really needed is not necessarily financial literacy but new thinking on how products are designed and how their usage and functionality is communicated to an audience that is linguistically illiterate and consequently have different lenses through which they view the world. Ehrbeck argues that the onus is on the designers of the products to translate the formal financial concepts "into language consistent with the everyday realities of poor people."⁴⁷

⁴⁴ Better Than Cash Alliance (2014) <http://betterthancash.org/>.

⁴⁵ CGAP has also recently released four case studies (from Haiti, the Philippines, Kenya and Uganda) examining the challenges of establishing mobile money based G2P payment systems; see Zimmerman, J., and K. Bohling, 2014, "E-payments in low-income settings: cutting-edge or high risk?" CGAP, 12 March. <http://www.cgap.org/blog/e-payments-low-income-settings-cutting-edge-or-high-risk>.

⁴⁶ Andrews, E., 2014, "Think ID theft is a problem here? Try protecting one billion people," Stanford Graduate School of Business, 1 May. http://www.gsb.stanford.edu/news/headlines/think-id-theft-is-problem-here-try-protecting-one-billion-people?utm_source=twitter&utm_medium=social-media&utm_campaign=wein-india-id.

⁴⁷ Ehrbeck, T., 2013, "Avoid blaming the victim in the financial literacy debate," Huffington Post, 19 December. http://www.huffingtonpost.com/tilman-ehrbeck/the-financial-literacy-debate_b_4459311.html.

4.4 Open/interoperable/interconnected systems

The development of system infrastructure that enables interoperability and interconnectivity will assist in building consumer demand for DFS systems. As explained below through the examples of the Philippines, Malawi, Papua New Guinea and Kenya, the path toward interoperable DFS systems is a challenging one for regulators. However, regulatory involvement is likely to be necessary to provide the drive that market forces alone will not create.

Mobile money in the Philippines consists of two MNOs offering e-money which are not interoperable. The central bank, Bangko Sentral ng Pilipinas (BSP), is working with the MNOs to speed the journey to interoperability. BSP is working with Bankable Frontiers Associates and began the process by defining the ideal of interoperability. A vision was developed for “any to any” – sending e-money to bank accounts or to other e-money accounts irrespective of with whom the end users banked or held mobile money accounts. BSP is now working with the industry to develop the rules of the game and has aimed for interoperability between electronic payments by 2018.⁴⁸ BSP emphasizes the role of consultation and has conducted a conference on the topic with industry players. Feedback from industry participants at the conference indicated they wanted BSP to play a key role in the journey toward interoperability. BSP is now working on options, such as a common switch, that will operate as a utility to which payments participants can connect.⁴⁹

BSP is also considering a payments system law alongside these market developments because the legal framework will determine what it can do, including a regulation mandating the interoperability of all POS and cash-in/cash-out outlets.⁵⁰

⁴⁸ Philippine News Agency, 2015, “BSP eyes national payments system by 2018,” June 15. <http://www.interaksyon.com/business/112425/bsp-eyes-national-payment-system-by-2018>.

⁴⁹ USAID, 2013, “Building consensus towards enabling an efficient and inclusive national payments system in the Philippines: a significant step,” 24 April. <http://www.simmphil.org/misc/building-consensus-towards-enabling-an-efficient-and-inclusive-national-payments-system-in-the-philippines-a-significant-first-step>.

⁵⁰ USAID, 2014, “Internal assessment report for the scaling innovations in mobile money (SIMM) activity: Philippines,” November. http://pdf.usaid.gov/pdf_docs/PA00KB2M.pdf.

Malawi's central bank, the Reserve Bank of Malawi (RBM), has also identified interoperability as a goal. The RBM has launched a national switch for retail payment systems to improve interoperability between existing digital payment systems, and to further accelerate digital payment uptake.⁵¹ In a speech delivered by Ralph Jooma, the Minister of Economic Planning and Development, he noted that the national switch "will provide a switching platform for internet banking, remittances, and mobile money transactions."⁵² Jooma said, "we have decided to develop this as a shared payment services arrangement with the Bankers Association of Malawi so as to facilitate interoperability and help ensure the volumes to make the investment viable."

In Papua New Guinea, the challenges of interoperability possibly still lie ahead for the regulator, as there are six mobile money providers with no fully interoperable systems as yet. Its central bank, the Bank of Papua New Guinea (BPNG), encourages interoperability but does not mandate it. Nationwide Microbank's (NMB) mobile money wallet, MiCash, has entered into an agreement with Digicell and Post to move toward interoperability. However, this agreement will still be outside of the main payments system. PNG recently launched a new real-time payments system, CATS, but it does not include players outside of the traditional payments systems such as mobile money providers.

In Kenya, the National Payment Service Regulations provide a framework for market-led interoperability, and permit the Central Bank to recognize a payment service provider management body whose intent is to facilitate interoperability among payment service providers.⁵³ In early 2014 in Kenya, the Communications Authority of Kenya (CAK) licensed three Mobile Virtual Network Operators (MVNOs) (Finserve Africa, Mobile Pay and Zioncell Kenya), which will all have their wallets hosted by Airtel.

⁵¹ Better than Cash Alliance, 2015, "The opportunities for Malawi's transition away from cash, April. <http://betterthancash.org/wp-content/uploads/2015/04/BTCA-Highlights-Malawi-Diagnostic.pdf>.

⁵² Jooma, R., 2013, "Inclusive growth in Malawi and digital financial inclusion, speech, UNGA Week, 24 September. <http://betterthancash.org/speech-delivered-by-hon-ralph-jooma-mp-minister-of-economic-planning-and-development-at-partnership-for-digital-financial-inclusion-a-driver-of-inclusive-growth/>.

⁵³ GSMA, 2015, "Enabling mobile money policies in Kenya: fostering a digital financial revolution," GSMA Mobile Money for the Unbanked, January. http://www.gsma.com/mobilefordevelopment/wp-content/uploads/2015/02/2015_MMU_Enabling-Mobile-Money-Policies-in-Kenya.pdf.

Aside from the serious competitive threat this brings to Safaricom's M-Pesa (Airtel is Kenya's second-largest MNO behind Safaricom), there is a great potential for these three MNVOs' services to be made interoperable as they will all operate over the same MNO's network.⁵⁴

Safaricom, Airtel and CAK have also had extended negotiations seeking an out-of-court settlement of a case in which Airtel accused Safaricom of abuse of its market-leader position. CAK declined to investigate unfair pricing of M-Pesa transfers between Safaricom users and users of other MNOs' networks and so Airtel launched a court case. Safaricom was subsequently ordered by CAK to open up its network and CAK indicated in its ruling that further discussions with the Central Bank of Kenya on interoperability and costs of transactions will take place.⁵⁵

Central banks, in endeavoring to improve financial inclusion through interoperable networks, need to think and act strategically. Acknowledging the presence and importance of new payments players in the payments space and navigating the path toward open and interoperable systems will be challenging but is important and potentially productive of major improvements in financial inclusion.

4.5 Role of partnerships in building consumer demand

The importance of partnerships in the DFS space is of increasing interest to development partners and policy think tanks, such as CGAP and AFI. In this article, we are referring to partnerships between payments providers, banks, MFIs and MNOs. Such collaborative efforts assist to strengthen the products and services available, as outlined below, and can consequently strengthen financial systems more broadly.

⁵⁴ The Consumers Federation of Kenya (COFEK) has launched a court case against the awarding of these licenses, seeking for them to be revoked as it says there was no stakeholder and public consultation on the matter. The court case was to be on 26 June 2014. Mwenesi, S., 2014, "COFEK wants Kenyan MVNO licenses revoked," Humanipo, 11 June. <http://www.humanipo.com/news/45013/cofek-wants-kenyan-mvno-licences-revoked/>.

⁵⁵ BizTech Afrika, 2014, "Airtel wins case to open up M-Pesa," 28 July. <http://www.biztechafrika.com/article/airtel-wins-case-open-m-pesa/8514/#.U9nGzYCSw00>; and for background see Nduku, A., 2014, "Safaricom, Airtel seeks extension in talks over M-Pesa fees," Humanipo, 8 May. <http://www.humanipo.com/news/43623/safaricom-airtel-see-extension-in-talks-over-m-pesa-fees/>.

Partnerships between nonbanks and banks within the DFS space are beneficial on a number of fronts. Partnerships can address some regulatory concerns; the pool of funds held by a nonbank may be reduced as end users transfer funds into prudentially regulated deposit accounts at a bank that has a partnership with a mobile money provider. Partnerships can also allow for deeper product offerings: beyond bill payments and remittance activities to providing customers with a greater range of services, including savings, credit and insurance. From a bank's perspective, partnering with nontraditional competitors also provides an opportunity to tap into expert innovative digital solutions that may otherwise be beyond their capability.⁵⁶ From a nonbank's perspective, partnerships provide an opportunity to take advantage of a bank's governance arrangements and operating models.⁵⁷ From a regulator's perspective, where there is an emphasis on financial inclusion in particular, the regulator may need to reassess which institutions are allowed to take deposits. In many markets, there are restrictions on MFIs taking deposits. Such restrictions may need to be reassessed in order to enable partnerships in DFS ecosystems to be successful.⁵⁸

We provide examples below of how partnerships deepen the product offerings in DFS and the risks and challenges that arise as a result.

4.5.1 Partnerships deepening product offerings

The potential for deeper product offerings is driving a number of partnerships being established in the DFS space and is expected to contribute to the sustainability of DFS.⁵⁹ Such expectations are seen in the increased references to MFS or DFS, as opposed to simply mobile money, which connotes a more basic product offer.

⁵⁶ Starke, A., 2014, "The payments revolution," AB+F Online, 1 June. <http://www.australianbankingfinance.com/banking/the-payments-revolution/>.

⁵⁷ Nambiar, M., and S. Srimal, 2014, "From vision to reality: RBI ruling brings India one step closer to true financial inclusion," July. <http://www.nextbillion.net/blogpost.aspx?blogid=3965>.

⁵⁸ CGAP, Product development. <http://www.cgap.org/topics/product-development>.

⁵⁹ Mirani, L., 2014, "Why mobile money has failed to take off in India," Quartz, 19 June. qz.com/222964/why-mobile-money-has-failed-to-take-off-in-india/.

Below is an overview of two successful partnerships, one involving Econet, a Zimbabwean mobile money provider (EcoCash) and the other involving Safaricom in Kenya (of M-Pesa fame).⁶⁰

4.5.1.1 Econet and EcoCash

Econet, a mobile telecommunications operator in Zimbabwe, provides a good example of how partnerships enable deeper product offerings. Econet's mobile money service is called EcoCash. Since early 2014, EcoCash's mobile money customers have been able to access both savings and loans: EcoCashSave and EcoCashLoans (customers must first establish a savings history in order to qualify for a loan).⁶¹ Steward Bank provides the savings and loans facilities. Steward Bank was acquired by Econet Wireless in early 2013 reportedly for the purpose of supporting the adoption of EcoCash.

Econet has also moved into mobile money remittance services. EcoCash Diaspora enables Zimbabweans in the U.K. to transfer cash to Zimbabwe via EcoCash.⁶² Users do not need an EcoCash account, they can do an over-the-counter transfer in the same way as with MoneyGram or Western Union.⁶³ Earlier in 2014, Steward Bank announced a suite of diaspora banking products that included EcoCash Diaspora. It appeared to operate in a similar way to EcoCash diaspora but relied on Steward Bank customers having Econet roaming and so may be more suitable for people traveling in and out of Zimbabwe.⁶⁴

⁶⁰ Mirani, L., 2014, "How to manage all your financial affairs from a \$20 mobile phone," Quartz, 18 June. qz.com/218988/how-to-manage-all-your-financial-affairs-from-a-20-mobile-phone/.

⁶¹ Mupaso, T., 2014, "EcoCashLoans now available to EcoCashSave customers with zero interest," Techzim, 2 April. <http://www.techzim.co.zw/2014/04/ecocashloans-now-available-ecocashsave-customers-zero-interest/>.

⁶² Steward bank launches product suite for Zimbabweans living in the Diaspora Steward Bank (Press Release, February 2014) www.stewardbank.co.zw.

⁶³ Mupaso, T., 2014, "EcoCash to launch EcoCash Diaspora in the U.K. in the coming days," Techzim, 19 March. <http://www.techzim.co.zw/2014/03/ecocash-to-launch-ecocash-diaspora-in-the-uk-in-the-coming-days/>.

⁶⁴ Mupaso, T., 2014, "Steward Bank's EcoCash enabled diaspora banking not so clear," Techzim, 21 February. <http://www.techzim.co.zw/2014/02/steward-banks-ecocash-enabled-diaspora-banking/>.

Steward Bank customers open an EcoCash account if they have an Econet mobile line activated in Zimbabwe with roaming capabilities.⁶⁵

Most recently, Econet has partnered with WorldRemit and now WorldRemit's payout networks incorporate EcoCash and Steward Bank – people can receive money to their EcoCash Mobile Wallets or to their Steward Bank account.⁶⁶

4.5.1.2 Safaricom and M-Pesa

M-Shwari, launched in November 2012, is a partnership between Safaricom (the operator of M-Pesa) and the Commercial Bank of Africa (CBA).⁶⁷ Users can move savings into M-Shwari using their mobile phone and M-Pesa account. It is an opt-in service, the savings earn interest and M-Shwari users can also borrow funds.⁶⁸ The loans are for small amounts between KES100 and KES50,000 (approximately U.S.\$1.5 to U.S.\$550).⁶⁹

In late 2013, there were about 4 million M-Shwari customers according to Safaricom.⁷⁰ The service has been recognized in Computerworld Honors Program in Washington DC with the 21st Century Achievement Award in emerging technology.⁷¹

In mid-2014, CBA and Safaricom launch a fixed deposit savings account – “Lock Savings Account” – claimed to be the first of its kind in the mobile money space.⁷² At the launch of the product, CBA was reported to have said that the product was developed in response to customer demand for a facility that would encourage them to save in the medium term for a specific goal.⁷³

⁶⁵ Mupaso, T., 2014, “EcoCash to launch EcoCash Diaspora in the U.K. in the coming days,” supra.

⁶⁶ Techzim, 2014, “Econet's partnership with WorldRemit a smart way to stay in money remittance?” 24 April. <http://www.techzim.co.zw/2014/04/econets-partnership-worldremit-smart-way-stay-money-remittance/>.

⁶⁷ Wakoba, S., 2014, “M-Shwari launches a fixed deposit account dubbed lock,” TechMoran, 16 June. <http://techmoran.com/m-shwari-launches-a-fixed-deposit-account-dubbed-lock/>.

⁶⁸ Yeoman, supra.

⁶⁹ Wakoba, supra.

⁷⁰ Yeoman, supra.

⁷¹ Wakoba, supra.

⁷² Ibid.

⁷³ Ibid.

4.5.2 Risks from partnerships in DFS and regulatory responses

Regulators will need to assess and approve partnerships that regulated entities wish to enter. Partnerships between nonbanks and banks give rise to potential risks that regulators need to consider before giving their approval. In this article, we highlight two areas for regulators to include in their approach toward identification, assessment and mitigation of risks arising from partnerships in DFS:

- ▶ Collaboration risks
- ▶ Consumer risks that arise as a result of a greater range of product offers available via a mobile phone

4.5.2.1 Collaboration risks

Collaboration risks are the risks arising from the chosen legal nature of the partnership. Partnerships between MNOs and banks or MFIs can be structured in a number of ways. The two entities can enter into a legal partnership, but are unlikely to want to do so, and we would recommend against it, because, at law, partners are liable for each other's obligations.

The more likely structure to be adopted is some form of joint venture, which can be incorporated so that a new corporate legal entity is created in which the MNO and bank or MFI would each hold shares; or unincorporated which means the two entities simply do business together but no new legal entity is created. There can be tax or other advantages to either form of joint venture.

An incorporated joint venture will only have whatever assets the shareholders inject into it, which may cause a concern for regulators, as it probably will not be a substantial organization in financial terms. For this reason, regulators may prefer an unincorporated joint venture or may ask that the shareholders give guarantees of the liability of an incorporated joint venture.

Davidson has analyzed how banks and operators can structure their agreements most effectively.⁷⁴ Davidson compares straightforward outsourcing contracts versus partnerships that require agreements on sharing of revenue or profits and responsibilities. Davidson found that banks and operators identified a number of best practices in structuring agreements with each other: “clarity about responsibilities,” “an explicit governance structure” and “a win-win proposition, now and in the future.”⁷⁵ We recommend regulators consider whether the parties involved have considered such best practices in their agreements.

4.5.2.2 Consumer risks

Consumer risks that arise as a result of a greater range of product offers available via a mobile phone or other digital device need to be identified, assessed and mitigated by market players and the regulator. This risk management process is necessary before consumer protection problems arise for the end users that could negatively affect trust in the new DFS. Without consumer trust, the uptake and usage of these new DFS will be compromised. This issue is a subset of the broader topic of consumer risks associated with DFS or “responsible digital finance”⁷⁶ and while beyond the scope of this article is noted here to illustrate that it is considered an important emerging issue for market players and in international policy development. There is currently a general awareness among financial inclusion advocates that far too little is known about this broader topic and considerable work is underway to improve all players’ comprehension of how to balance the promotion of DFS with mitigating consumer risks.⁷⁷

⁷⁴ Davidson, N., 2012, “Mapping and effectively structuring operator-bank relationships to offer mobile money for the unbanked,” GSMA. <http://www.gsma.com/mobilefordevelopment/wp-content/uploads/2012/03/mappingandeffectivestructuringfinal2643.pdf>.

⁷⁵ Ibid. at 14.

⁷⁶ Zimmerman, J., 2014, “The emergence of responsible digital finance,” Centre for Financial Inclusion, 21 July. <http://cfi-blog.org/2014/07/21/the-emergence-of-responsible-digital-finance/>.

⁷⁷ Ibid.

The specific consumer risks to be mitigated in relation to DFS have been identified by CGAP and UNCDF's Better Than Cash Alliance to include:

- ▶ **"Fraud** types that have potential negative effects on customers, such as SIM swaps and card skimming
- ▶ Breaches of **data privacy and protection**, as inadequate data handling can trigger other risks, such as identity theft, misuse by government, sale of one's data without knowledge or consent, etc.
- ▶ **Agent misconduct** that causes financial loss, poor service quality or mistrust in the agent network
- ▶ Ineffective or **inadequate consumer recourse** and its effect on consumer trust as well as financial services uptake and usage
- ▶ Customer risk implications of the predicted rapid transition to **smartphones in BOP [base of the pyramid] markets**"⁷⁸

Interestingly, the above list does not specifically consider the consumer risks that arise as a result of partnerships in DFS providing the end users with access to a broader range of financial services. To be fair, international discussions are still at the very early stage of identifying and assessing emerging consumer risks in DFS.⁷⁹ This article represents an important contribution to these preliminary international discussions, given its focus on consumer risks arising as a result of partnerships in DFS. In due course, we expect and urge that consideration is given to separately identifying the need to mitigate consumer risks associated with partnerships in DFS.

⁷⁸ Ibid.

⁷⁹ Ibid.

Examples of how consumer risks arise from partnerships in DFS include:

- ▶ Consumers access **credit via digital interfaces**. Mobile money customers may initially be using basic mobile money products to receive and transfer funds but then as a result of their mobile money provider partnering with a bank or MFI, they are provided with access to a micro-loan. The provider needs to be wary of excessive or nontransparent interest rate charges and/or poor credit risk assessments leading to client indebtedness and potential loan defaults. The challenges involved in managing loan portfolios comprising largely of unsecured microfinance credit have been well documented.⁸⁰ However, regulators responsible for the DFS partnership will need to consider the implications associated with customers accessing loans via a digital interface. Is such credit more readily accessible or automated, are the customers adequately assessed, are the loan portfolios well-managed and, most importantly, are financial inclusion goals truly being served or are the end users at risk of becoming over-indebted?
- ▶ Consumers misunderstand the **legal distinction between stored values in mobile money accounts versus the funds held in the deposit accounts**. When a mobile money provider enters into a partnership with an approved deposit-taking institution, such as a bank, the mobile money customer may be offered access to traditional bank deposit accounts. Such deposit accounts will be attractive as they can earn interest. However, there are likely to be different mechanisms in place for protecting the funds in the deposit accounts versus protecting the stored values.⁸¹ Consumers may not understand the distinction and implications of these different mechanisms.

⁸⁰ The Smart Campaign and its Smart Microfinance and the Client Protection Principles provide a framework for addressing the challenges involved in microfinance Client Protection Principles The Smart Campaign (2014) <http://www.smartcampaign.org/about/smart-microfinance-and-the-client-protection-principles>.

⁸¹ Where there is stored value (also known as "e-money") the regulators will focus on how to safeguard the customers' funds and how to isolate the funds. The funds will not generally be recognized as a deposit of the end user, however the end user may think of the funds as a deposit and therefore appropriate safeguards need to be implemented to ensure consumer confidence can be maintained in these systems. For further background on the distinction and implications of protecting stored value (or "e-money") reference should be made to the "knowledge product" by Jonathan Greenacre and Ross Buckley and supported by the Pacific Financial Inclusion Programme, Trust Law Protections for E-Money Customers: Lessons and a Model Trust Deed Arising from Mobile Money Deployments in the Pacific Islands (October 2013) <http://www.cifr.edu.au/assets/document/E226%20Buckley%20E-Money%20Knowledge%20Product%202014%2009.pdf>.

If at the “end of the day,” the stored values are compromised and are at risk but end users consider there to be no distinction between their stored values and the funds in their deposit accounts, what will be the implications for the reputation risk of the providers and the regulators responsible for the providers? Will regulators be faced with “bail-out” scenarios in order to address considerable reputation risk that could create a crisis of confidence in DFS more broadly?

- ▶ **Partnerships bring new, and previously unregulated, players into the DFS space.** Regulators will need to determine whether consumer protection frameworks that focus on disclosure requirements and consumer recourse mechanisms apply to the new players providing DFS. CGAP’s Financial Access 2010, the state of financial inclusion through the crisis (September 2010) found that for the economies captured in the survey even where regulations for consumer protection did exist, they did not apply to unregulated financial service providers.⁸²
- ▶ Consumer protection frameworks may not be enforceable and relevant if **regulatory mandates or inter-regulatory cooperation arrangements do not keep pace with partnerships.** For example, with the scenario of an MNO offering a mobile money product wanting to enter into a partnership with an MFI in order to provide its end users with access to loans. The microfinance industry in which that particular MFI operates may have been largely unregulated or regulated in a different way from traditional financial institutions involved in taking deposits and extending loans. Regulators may find themselves in a situation where they have a regulatory mandate over one of the participants in a partnership but not over the other (the MFI). Regulators may need to consider implementing memorandums of understanding to clarify areas for regulator cooperation where partnerships involve players with different regulators.

From the above points on consumer risks arising as a result of partnerships in DFS, it will not be surprising if some regulators find themselves in uncharted territory. Regulators are being proactive in deepening their skills and knowledge in these areas with the focus on improving financial inclusion.

⁸² Consultative Group to Assist the Poor and World Bank Group Financial Access 2010, The State of Financial Inclusion Through the Crisis (2010) <http://www.cgap.org/publications/financial-access-2010>.

Of note is the recent China-Peru knowledge exchange for the regulation and supervision of nonbank, nondeposit-taking institutions. Peru's regulator (Superintendencia de Banca, Seguros y AFP (SBS)) is addressing the challenges of microfinance lending from a number of angles, including requiring the regulated entity to comply with stricter provisioning and write-off policies and strengthening consumer protection frameworks that involve both regulatory requirements for supervised entities and increased information and financial disclosure.⁸³

Financial inclusion advocates are also being proactive in deepening industry understanding of the benefits of partnerships between MNOs, banks and MFIs. For example, GSMA's mobile money unit (MMU) recognizes that mobile money providers and MFIs are working together to improve the quality and range of financial services available.⁸⁴ GSMA's MMU website brings together articles, blog posts and other resources of use for industry players considering partnerships. GSMA's MMU is also building a deployment tracker on mobile credit and savings services similar to its highly regarded mobile money deployment tracker.⁸⁵

4.5.2.3 Challenges for partnerships in DFS

While partnerships do bring promise in terms of contributing toward the sustainability of MFS and DFS, they also present a number of challenges as stakeholders work out the required commitments and expected returns from the partnerships. These challenges are not explored in this article, but some examples are noted here to emphasize that partnerships are not straightforward "win-wins" for MFS and DFS ecosystems.

⁸³ China-Peru Knowledge Exchange: non-bank non-deposit taking FI regulation and supervision alliance for financial inclusion (1 April 2014) <http://www.afi-global.org/news/2014/4/01/china-peru-knowledge-exchange-non-bank-non-deposit-taking-fi-regulation-and>.

⁸⁴ MMU products – credit GSMA, <http://www.gsma.com/mobilefordevelopment/programmes/mobile-money-for-the-unbanked/products/mmu-products-credit>.

⁸⁵ Ibid.

GSMA has emphasized that government-to-people payments (G2P) may look attractive for providers and those who make payments. However, this business is challenging and “requires fully committed partnerships.”⁸⁶ CGAP has released four case studies (Haiti, the Philippines, Kenya and Uganda) that examine the challenges in the establishment of mobile money based G2P payment systems.⁸⁷ Before the success of M-Shwari, Safaricom had a similar product, MKesho, through a partnership with Equity Bank, which was unsuccessful due to complications over revenue sharing.⁸⁸ Most recently, one of the first articles analyzing the RBI’s regulatory change allowing NBFCs to act as agents providing cash-out services posed the question of whether mutually beneficial agreements on the division of revenues could be reached and whether this challenge would compromise RBI’s efforts to improve financial inclusion.⁸⁹

4.5.2.4 Concluding remarks on partnerships and consumer demand

Partnerships between payments providers, banks, MFIs and MNOs assist the success of DFS. Partnerships can address regulatory concerns and allow for deeper product offerings beyond payments and remittance activities to providing customers with a greater range of services, including savings, credit and insurance products. Regulators need to assess partnerships on a number of grounds, which may include the proposed legal nature of the partnership that gives rise to collaboration risks. Partnerships will also raise consumer protection issues as a result of consumers potentially having access to a much broader range of financial services via a mobile phone than simply mobile money.

Regulators should stay in close contact with industry players regarding developments in partnerships to ensure regulatory oversight supports the benefits from partnerships in the DFS space yet responds quickly and appropriately to any additional risks arising as a consequence of the players’ involvement in partnerships.

⁸⁶ Almazan, M., 2013, “G2P payments and mobile money: opportunity or red herring?” GMSA, 30 September. <http://www.gsma.com/mobilefordevelopment/g2p-payments-mobile-money-opportunity-or-red-herring>.

⁸⁷ Zimmerman and Bohling, *supra*.

⁸⁸ Heinrich, E., 2014, “The apparent M-Pesa monopoly may be set to crumble,” Fortune Magazine, 27 June. <http://fortune.com/2014/06/27/m-pesa-kenya-mobile-payments-competition/>.

⁸⁹ Anand, A., R. Barua and M. Sharma, 2014, “NBFC-MFIs as business correspondents - who benefits?” MicroSave, July. <http://blog.microsave.net/nbfc-mfis-as-business-correspondents-who-benefits-part-i/>.

Our analysis of the risks arising from partnerships is at an elementary stage. We will conduct further analysis and research in this area with the objective of improving existing knowledge and awareness of the regulatory challenges arising from partnerships in DFS.

5. Conclusion

Regulators should develop an understanding of consumer demand, so as to better appreciate which market developments need to be encouraged or facilitated through policy and regulatory changes. We have outlined factors for regulators to consider in developing an understanding of consumer demand, including the importance of local context and the customer value proposition. We have outlined examples of how regulators can build consumer demand, with a particular focus on their role in facilitating successful partnerships in the DFS space.

In summary, by working to understand and build consumer demand, regulators can facilitate the building of sustainable DFS ecosystems and move closer to the goal of providing financial access for all. We urge regulators to consider this approach to consumer demand alongside their traditional responsibilities of ensuring safe and sound financial systems. We recognize this approach is advocating a broader role for financial regulators. We believe, however, it is critical for regulators to assume this role because it is now clear that market forces alone will not always, or even regularly, deliver sustainable DFS in markets that can benefit from improved financial inclusion.

We believe financial inclusion will be significantly strengthened when regulators focus on the importance of consumer demand in DFS and the regulatory challenges that come with building consumer demand. This regulatory focus will strengthen and support the existing efforts of market players, development partners and financial inclusion advocates in emerging markets to use DFS to broaden accessibility to financial services. While this represents a new regulatory frontier for financial regulators, it is a frontier well worth navigating in order to ensure the unbanked and under-banked benefit as much as possible from the abundance of innovative DFS available today.

Appendix 1: List of acronyms*

AFI	Alliance for financial inclusion
BPNG	Bank of Papua New Guinea
BSP	Bangko Sentral ng Pilipinas
CAK	Communications Authority of Kenya
CBA	Commercial Bank of Africa
CGAP	Consultative Group to Assist the Poor
DFS	Digital financial services
G2P	Government to person
MFI	Microfinance institution
MFS	Mobile financial services
MFSWG	Mobile Financial Services Working Group
MMU	Mobile money unit
MNO	Mobile network operator
MVNO	Mobile virtual network operator
NBFC	Non-bank finance company
NMB	Nationwide Merchant Bank
P2G	Person to government
POS	Point of sale
RBI	Reserve Bank of India
RBM	Reserve Bank of Malawi
SBS	Superintendencia de Banca, Seguros y AFP

* Definitions from Alliance for Financial Inclusion, Guideline Note Mobile Financial Services: Basic Terminology (2013) <http://www.afi-global.org/sites/default/files/publications/mfswg_gl_1_basic_terminology_finalnewnew_pdf.pdf>.CGAP>.

Appendix 2: Glossary

E-money	Monetary value electronically recorded with the following attributes: (i) issued upon receipt of funds in an amount no lesser in value than the value of the e-money issued; (ii) stored on an electronic device (e.g. a chip, prepaid card, mobile phone, or computer system); (iii) accepted as a means of payment by parties other than the issuer; and (iv) convertible into cash
Cash-in	Exchanging cash for e-money
Cash-out	Exchanging e-money for cash
Collaboration risk	Risks arising from the legal structure of a joint venture, for example, while the finances of each partner in a joint venture might be robust, the joint venture vehicle itself may be poorly capitalized and carry a real risk of insolvency
Consumer risk	Risks consumers are directly exposed to by their use of a service, for example, fraud, breaches of privacy, or the accumulation of debts that the consumer is unable to service
Customer value proposition	The benefits a product or service holds for a customer, the reasons why a customer might buy that product or service
Digital financial services	Financial services provided via digital remote access, including e-money or mobile money, which is in contrast to traditional financial services accessed through physical means, such as visiting a bank branch
Enabling regulator	An agency that creates a regulatory environment conducive to the safe growth of mobile money

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