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THE NEW REGULATORY FRONTIER: BUILDING CONSUMER DEMAND FOR DIGITAL FINANCIAL SERVICES—PART II

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The New Regulatory Frontier: Building Consumer Demand for Digital Financial Services—Part II

Ross P. Buckley and Louise Malady*

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 which match end-users' means, needs or wants. As a result DFS in emerging markets may suffer from limited uptake and usage, with consequently 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 two-part 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 mind-set for financial regulators who are more familiar with promoting financial stability, safety and efficiency. The authors explore this changing role for financial regulators and recommend that regulators particularly focus on building consumer demand through promoting partnerships in DFS as a means of promoting financial inclusion. In addition, the authors highlight that partnerships introduce collaboration risks and heighten consumer risks; requiring regulators to adjust regulatory frameworks to ensure such risks are identified and mitigated. The first part of this article, which appeared in the November/December 2014 issue of The Banking Law Journal*, provided an introduction to the topic, regulatory background, and a section on understanding consumer demand. Part two of this article discusses building consumer demand and the authors' conclusions.*

BUILDING CONSUMER DEMAND

Regulators can encourage the development of successful and sustainable

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digital financial services ("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 government-to-person ("G2P") and person-to-government ("P2G");
- To facilitate financial literacy efforts which focus on incorporating end-users' needs;
- To develop open/interoperable/interconnected systems; and
- To enable partnerships between the various market players leveraging on the "sum is greater than the parts."

Further details on these examples are provided below, with a particular focus on the last one: *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.

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.[1] In an interview with the Consultative Group to Assist the Poor ("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.[2] 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 (with the latter a

[1] For a brief description of an enabling regulatory environment for mobile money, *see* Gutierrez and Singh, *supra,* Part I. These authors cite David Porteous, *The Enabling Environment for Mobile Banking in Africa* Department for International Development (Report, May 2006) http://bankablefrontier.com/wp-content/uploads/documents/ee.mobil_.banking.report.v3.1.pdf; David Porteous, *Mobilizing Money through Enabling Regulation*, 4 Innovations 75 (2009).

[2] Jeanette Thomas, *Regulation Spurs Innovation in the Philippines* CGAP (November 5, 2012) http://www.cgap.org/blog/regulation-spurs-innovation-philippines.

particularly important outcome for the Philippines where external remittances comprise 10 percent 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 towards mobile money ecosystems has, until very recently, sat in stark contrast to that of the Philippines. The Reserve Bank of India ("RBI") has required mobile network operators ("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. The RBI has, however, become much more proactive on the financial inclusion front, especially in relation to payments.[3] The RBI recently announced it would create a new class of regulated institutions, "payment banks" which will accept demand deposits and provide remittance services.[4] 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").[5] In announcing this change, the RBI is acknowledging the importance of payments services

[3] PTI, *Reserve Bank of India to soon come out with payment bank*, The Economic Times (June 12, 2014) http://economictimes.indiatimes.com/news/economy/policy/reserve-bank-of-india-to-soon-come-out-with-payment-bank/articleshow/36445449.cms.

[4] RBI Web site, *RBI releases Draft Guidelines for Licensing of Payments Banks and Small Banks* (July 17, 2014) http://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=31646. For further details on the regulatory change see Dinesh Unnikrishnan, *RBI lets NBFCs work as banking correspondents*, Livemint (June 2014) http://www.livemint.com/Industry/PuwOHdv8crJQ28dIWY7TGK/RBI-allows-NBFCs-work-as-banking-correspondents.htmland; Leo Mirani, *A new kind of no-frills bank could kickstart India's long awaited mobile money revolution*, Quartz (July 2014) http://qz.com/237847/a-new-kind-of-no-frills-bank-could-kickstart-indias-long-awaited-mobile-money-revolution/.

[5] Reserve Bank of India, *The Report of the Committee on Comprehensive Financial Services for Small Business and Low Income Households* (January 7, 2014) http://rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=30353.

products which facilitate domestic remittances for greater financial inclusion.[6] 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 non-bank Pre-paid Instrument Issuers ("PPIs"), Non-Banking Finance Companies ("NBFCs"), corporate Business Correspondents, mobile telephone companies, super-market 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 not yet clear whether this means MNOs can provide cash-out services to their mobile money customers.[7] The RBI may maintain its cautious approach in this area.[8]

Shifting Government Payments to Electronic Funds Transfer Channels

Regulators may also assist by working with governments to channel government funds and subsidies through more safe and efficient payments systems.[9] Such efforts are not without challenges.[10] However, the incentive behind shifting government payments across to electronic channels is to provide a more efficient and safe means of making and receiving government payments. Financial regulators supporting such initiatives (either through regulation of the entities channelling 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 towards more

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[6] For further commentary on "payments banks" and the Mor Committee's Report, *see* Graham Wright, *The Mor Committee Report—the Demand Side Conundrum*, MicroSave (February 2014) http://blog.microsave.net/the-mor-committee-report-the-demand-side-conundrum/.

[7] Kalyan Parbat, *Telecom companies expect spurt in revenues with 'payments banks'*, Economic Times (July 19, 2014) http://articles.economictimes.indiatimes.com/2014-07-19/news/51744670_1_vodafone-india-mobile-payments-safaricom?_ga=1.89423515.1014043529.1405995841.

[8] 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 which 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).

[9] *Better Than Cash Alliance* (2014) http://betterthancash.org/.

[10] CGAP has also recently release four case studies (from Haiti, the Philippines, Kenya and Uganda) examining the challenges in establishing mobile money based G2P payment systems,*see* Jamie Zimmerman and Kristy Bohling, *E-Payments in Low-Income Settings: Cutting-Edge or High Risk*, CGAP (March 12, 2014) http://www.cgap.org/blog/e-payments-low-income-settings-cutting-edge-or-high-risk.

efficient and safe 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.[11] This program may contribute towards the success of moving from cash-based payments to electronic-based methods.

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 who are 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."[12]

Open/Interoperable/Interconnected Systems

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

Mobile money in the Philippines consists of two MNOs offering e-money but they are not interoperable. The central bank, BSP, is working with the MNOs in an effort to speed the journey to interoperability. In the Philippines, ATMs were introduced in the 1980s but only made interoperable in 2006. 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"–

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[11] Andrews, Ed, *Think ID Theft Is a Problem Here? Try Protecting One Billion People*, Stanford Graduate School of Business (May 1, 2014) 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.

[12] Ehrbeck's comments followed "recent human-centered research and product design efforts in Pakistan . . . by Rachel Lehrer from the Boston-based design firm Continuum on behalf of CGAP;" Ms Lehrer spent six weeks in Pakistan studying how "poor women in rural area use (or don't use) the accounts linked to the transfer benefits that they are paid by a large-scale Pakistani social protection program." *See* Tilman Ehrbeck, *Avoid Blaming the Victim in the Financial Literacy Debate*, Huffington Post (December 19, 2013) http://www.huffingtonpost.com/tilman-ehrbeck/the-financial-literacy-debate_b_4459311.html.

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. 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 towards interoperability. BSP is now working on options such as a common switch which will operate as a utility to which payments participants can connect.[13]

BSP is also considering a payments system law alongside these market developments because the legal framework will determine what it can do.

Malawi's central bank, the Reserve Bank of Malawi ("RBM"), has also identified interoperability as a goal. RBM is also considering a national switch for retail payment systems. 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."[14] Jooma said "we have decided to develop this as a shared payment services arrangement with the Bankers Association of Malawi so as to facilitate inter-operability 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. Papua New Guinea's 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 towards 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 early 2014 in Kenya, the Communications Authority of Kenya ("CAK") licensed three Mobile Virtual Network Operators ("MVNOs") (Finserve Africa,

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[13] *Building Consensus Towards Enabling an Efficient and Inclusive National Payments System in the Philippines: A Significant Step*, USAID (April 24, 2013) http://www.simmphil.org/misc/building-consensus-towards-enabling-an-efficient-and-inclusive-national-payments-system-in-the-philippines-a-significant-first-step.

[14] Ralph Jooma, *Inclusive Growth in Malawi and Digital Financial Inclusion* (Speech, UNGA Week, September 24, 2013) 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/.

Mobile Pay, and Zioncell Kenya) which will all have their wallets hosted by Airtel. Aside from the serious competitive threat this brings to Safaricom's M-Pesa (Airtel is Kenya's second largest MNO behind Safaricom) there is great potential for these three MNVOs' services to be made interoperable as they will all operate over the same MNO's network.[15]

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.[16]

Central banks, in endeavouring 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 towards open and interoperable systems will be challenging but is important and potentially productive of major improvements in financial inclusion.

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 Alliance for Financial Inclusion ("AFI"). In this article we are referring to partnerships between payments providers, banks, microfinance institutions ("MFIs") and MNOs. Such collaborative efforts assist to strengthen the products and services available, as outlined below, and so in turn can strengthen financial systems more broadly.

Partnerships between non-banks and banks within the DFS space are beneficial on a number of fronts. Partnerships can address some regulatory

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

[16] *Airtel wins case to open up M-Pesa*, BizTech Afrika (July 28, 2014) http://www.biztechafrica.com/article/airtel-wins-case-open-m-pesa/8514/#.U9nGzYCSw00; and for background *see* Agatha Nduku, Safaricom, *Airtel seeks extension in talks over M-Pesa fees*, Humanipo (May 8, 2014) http://www.humanipo.com/news/43623/safaricom-airtel-seek-extension-in-talks-over-m-pesa-fees/.

concerns; the pool of funds held by a non-bank may be reduced as end-users transfer funds into prudentially regulated deposit accounts at a bank as a result of a partnership between the bank and 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 non-traditional competitors also provides an opportunity to tap into expert innovative digital solutions which may otherwise be beyond their capability.[17] From a non-bank's perspective, partnerships provide an opportunity to take advantage of a bank's governance arrangements and operating models.[18] 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 be deposit-taking institutions. In many markets there are restrictions on MFIs taking deposits. Such restrictions may need reassessment in order to enable partnerships in DFS ecosystems to be successful.[19]

Examples of how partnerships deepen the product offerings in DFS and the risks and challenges which arise as a result are provided below.

Partnerships Deepening Product Offerings

The potential for deeper product offerings is driving a number of the partnerships now being established in the DFS space.[20] These deeper product offerings are expected to contribute to the sustainability of DFS. Such expectations and trends are seen in the increased references to mobile financial services ("MFS") or DFS, as opposed to simply mobile money which connotes a more basic product offer. Below is an overview of two successful partnerships, one involving Econet, a Zimbabwean mobile money provider (EcoCash) and

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[17] Andrew Starke, *The Payments Revolution*, AB+F Online (June 1, 2014) http://www.australianbankingfinance.com/banking/the-payments-revolution/.

[18] Manoj Nambiar and Shraddhar Srimal, *From Vision to Reality: RBI ruling brings India one step closer to true financial inclusion*, (July 2014) http://www.nextbillion.net/blogpost.aspx?blogid=3965.

[19] *Product Development*, CGAP, http://www.cgap.org/topics/product-development.

[20] However, it could be said that regulatory requirements mandating partnerships in order to both deepen product offerings and address regulatory concerns is best avoided when looking at the effect of such requirements on market developments in India, one of the world's biggest markets for mobile money. The Reserve Bank of India required mobile money providers to use bank agents for cash-out services which resulted in limited uptake for mobile money. (Leo Mirani, *Why mobile money has failed to take off in India*, Quartz (June 19, 2014) qz.com/222964/why-mobile-money-has-failed-to-take-off-in-india/.) The Reserve Bank of India has since revised its requirements.

the other involving Safaricom in Kenya (of M-Pesa fame).[21]

(a) Econet & 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).[22] 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 Econet's mobile money service, EcoCash.

Econet has also moved into mobile money remittance services. EcoCash Diaspora enables Zimbabweans in the UK to transfer cash to Zimbabwe via EcoCash.[23] Users do not need an EcoCash account, they can do an over-the-counter transfer in the same way people do with MoneyGram or Western Union.[24] Earlier in 2014, Steward Bank announced a suite of Diaspora Banking products which included Diaspora EcoCash. 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 travelling in and out of Zimbabwe.[25] Steward Bank customers open an EcoCash Account if they have an Econet mobile line activated in Zimbabwe with roaming capabilities.[26]

Most recently Econet has partnered with WorldRemit and now WorldRemit's payout networks incorporate EcoCash and Steward Bank—people can

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[21] For an extended overview of partnerships in mobile money deepening the product offerings, *see* Leo Mirani, *How to manage all you financial affairs from a $20 mobile phone*, Quartz (June 18, 2014) qz.com/218988/how-to-manage-all-your-financial-affairs-from-a-20-mobile-phone/.

[22] Tendai Mupaso, *EcoCashLoans Now Available to EcoCashSave Customers with Zero Interest*, Techzim (April 2, 2014) http://www.techzim.co.zw/2014/04/ecocashloans-now-available-ecocashsave-customers-zero-interest/.

[23] *Steward bank launches product suite for Zimbabweans livings in the Diaspora*, Steward Bank (Press Release, February 2014) www.stewardbank.co.zw.

[24] Tendai Mupaso, *EcoCash to launch EcoCash Diaspora in the UK in the coming days*, Techzim (March 19, 2014) http://www.techzim.co.zw/2014/03/ecocash-to-launch-ecocash-diaspora-in-the-uk-in-the-coming-days/.

[25] Tendai Mupaso, *Steward Bank's EcoCash enabled Diaspora banking not so clear*, Techzim (February 21, 2014) http://www.techzim.co.zw/2014/02/steward-banks-ecocash-enabled-diaspora-banking/.

[26] Tendai Mupaso, *EcoCash to launch EcoCash Diaspora in the UK in the coming days*, *supra*.

receive money to their EcoCash Mobile Wallets or to their Steward Bank account.[27]

(b) Safaricom & 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").[28] 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.[29] The loans are for small amounts between KES100 and KES 50,000 (approx. USD1.5 and USD550).[30]

In late 2013, there were around four million M-Shwari customers according to Safaricom.[31] The service has been recognized in Computerworld Honors Program in Washington D.C. with the 21st Century Achievement Award in emerging technology.[32]

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.[33] 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 which would encourage them to save in the medium term for a specific goal.[34]

Risks from Partnerships in Digital Financial Services and Regulatory Responses

Regulators will need to assess and approve partnerships which regulated entities wish to enter. Partnerships between non-banks and banks give rise to potential risks which regulators need to consider as part of their approval of partnerships. In this article, two areas for regulators to include in their approach towards identification, assessment and mitigation of risks arising from partnerships in DFS are highlighted:

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[27] *Econet's partnership with WorldRemit a smart way to stay in money remittance?*, Techzim (April 24, 2014) http://www.techzim.co.zw/2014/04/econets-partnership-worldremit-smart-way-stay-money-remittance/.

[28] Sam Wakoba, *M-Shwari Launches a Fixed Deposit Account Dubber Lock TechMoran*, (June 16, 2014) http://techmoran.com/m-shwari-launches-a-fixed-deposit-account-dubberd-lock/.

[29] Yeoman, *supra.*

[30] Wakoba, *supra.*

[31] Yeoman, *supra.*

[32] Wakoba, *supra.*

[33] *Id.*

[34] *Id.*

- Collaboration risks; and
- Consumer risks which arise as a result of a greater range of product offers available via a mobile phone.

(a) Collaboration Risks

Collaboration risks refer to the risks arising as a result of 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 highly unlikely to want to do so because, at law, partners are liable for each other's obligations and for this reason we would recommend against "partnerships" adopting the structure of legal partnerships.

The more likely structure to be adopted is some form of joint venture. Joint ventures can be incorporated which means a new corporate legal entity is created in which the MNO and bank or MFI would each hold shares; or they can be unincorporated which means the two entities do business together but no new legal entity is created, i.e. the unincorporated joint venture is simply two entities working together. 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 organisation 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.[35] Davidson compares straightforward outsourcing contracts versus partnerships which 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."[36] Regulators should consider whether the parties involved have considered such best practices in their agreements.

(b) Consumer Risks

Consumer risks which arise as a result of a greater range of product offers available via a mobile phone or other digital device need to be identified,

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[35] Neil Davidson, *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.

[36] *Id.* at 14.

assessed and mitigated by market players and the regulator. This risk management process is necessary before consumer protection problems arise for the end-users which 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 sub-set of the broader topic of consumer risks associated with DFS or "responsible digital finance." [37] This broader topic is beyond the scope of this article, however, it 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.[38]

The specific consumer risks to be mitigated in relation to DFS have been identified by CGAP and United Nations Capital Development Fund's ("UNDCF") 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*."[39]

Interestingly, the above list does not specifically consider the consumer risks which 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.[40] This article represents an important contribution to

[37] Jamie Zimmerman, *The Emergence of Responsible Digital Finance*, Centre for Financial Inclusion (July 21, 2014) http://cfi-blog.org/2014/07/21/the-emergence-of-responsible-digital-finance/.

[38] *Id.*

[39] *Id.*

[40] *Id.*

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. 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, the customer, are provided with access to a micro-loan. The provider needs to be wary of excessive or non-transparent interest rate charges and/or poor credit risk assessments leading to client indebtedness and potential loan defaults. The challenges involved in managing loan portfolios comprised of largely unsecured microfinance credit have been well documented.[41] 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.[42]

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[41] 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.

[42] 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 Professor Ross Buckley and supported by the Pacific Financial Inclusion Programme, *Trust Law Protections for E-Money Customers: Lessons and a Model Trust Deed Arising*

Consumers may not understand the distinction and implications of these different mechanisms. 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 the implications be 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 which 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 which 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*,[43] 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.[44]
- 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 a 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 to 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 memoranda of understanding to clarify areas for regu-

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. The "knowledge product" draws on the following papers: Michael Tarazi and Paul Breloff, *Nonbank E-Money Issuers: Regulatory Approaches to Protecting Consumer Funds* CGAP (2010) http://www.cgap.org/gm/document-1.9.45715/FN63_Com.pdf; and Kate Lauer and Michael Tarazi, *Supervising Nonbank Mobile Money Issuers*, CGAP (2012) https://www.cgap.org/sites/default/files/CGAP-Brief-Supervising-Nonbank-Emoney-Issuers-Jul-2012.pdf.

[43] September 2010.

[44] 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.

lator 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. Of note is the recent China-Peru knowledge exchange for the regulation and supervision of non-bank, non-deposit 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 which involve both regulatory requirements for supervised entities and increased information and financial disclosure.[45]

Financial inclusion advocates are also being proactive in deepening industry understanding of the benefits of partnerships between MNOs, banks and MFIs. For example, Groupe Speciale Mobile Association's ("GSMA") mobile money unit ("MMU") recognizes that mobile money providers and MFIs are working together to improve the quality and range of financial services available.[46] GSMA's MMU Web site 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.[47]

Challenges for Partnerships in Digital Financial Services

While partnerships do bring promise in terms of contributing towards 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.

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[45] Representatives from the People's Bank of China and the Legislative Office under the State Council of China visited Peru and the United States. This detail was sourced from AFI's Web site and is part one of a two part series on the knowledge exchange; part two will be issued shortly documenting the United States visit. *China-Peru Knowledge Exchange: Non-bank Non-deposit Taking FI Regulation and Supervision*, Alliance for Financial Inclusion (April 1, 2014) http://www.afi-global.org/news/2014/4/01/china-peru-knowledge-exchange-non-bank-non-deposit-taking-fi-regulation-and.

[46] *MMU Products—Credit*, GSMA, http://www.gsma.com/mobilefordevelopment/programmes/mobile-money-for-the-unbanked/products/mmu-products-credit.

[47] *Id.*

GSMA has emphasized that G2P may look attractive for providers and those who make payments however this business is challenging and "requires fully committed partnerships."[48] CGAP has released four case studies (from Haiti, the Philippines, Kenya, and Uganda) which examine the challenges in the establishment of mobile money based G2P payment systems.[49] Before the success of M-Shwari, Safaricom had a similar product, M-Kesho, through a partnership with Equity Bank which was unsuccessful due to complications over revenue sharing.[50] 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 revenue could be reached and whether this challenge would compromise RBI's efforts to improve financial inclusion.[51]

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 be aware of the implications of regulated entities entering into partnerships and respond accordingly. Regulators need to assess partnerships on a number of grounds; which may include the proposed legal nature of the partnership which 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 engage in dialogue with industry players to stay in close contact on developments in partnerships. This will 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.

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[48] Mireya Almazan, *G2P Payments and Mobile Money: Opportunity or Red Herring?*, GMSA (September 30, 2013) http://www.gsma.com/mobilefordevelopment/g2p-payments-mobile-money-opportunity-or-red-herring.

[49] Zimmerman and Bohling, *supra.*

[50] Erik Heinrich, *The apparent M-Pesa monopoly may be set to crumble*, Fortune Magazine (June 27, 2014) http://fortune.com/2014/06/27/m-pesa-kenya-mobile-payments-competition/.

[51] Abhishek Anand, Rajarshi Barua and Manoj Sharma, *NBFC-MFIs As Business Correspondents—Who Benefits?*, MicroSave (July 2014) http://blog.microsave.net/nbfc-mfis-as-business-correspondents-who-benefits-part-i/.

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. This approach is advocating a broader role for financial regulators. 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 which can benefit from improved financial inclusion.

Financial inclusion will be significantly strengthened when regulators focus on the importance of consumer demand in DFS and the regulatory challenges which 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

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. This 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.

* 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.