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

Ms Louise Malady
Senior Research Fellow
UNSW Australia

Professor Ross Buckley
Scientia Professor
UNSW Australia

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BUILDING CONSUMER DEMAND FOR DIGITAL FINANCIAL SERVICES – THE NEW REGULATORY FRONTIER

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 paper 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. In this paper 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.

* Ross Buckley is Scientia Professor of Law and CIFR King & Wood Mallesons Chair of International Finance Law, UNSW Australia.

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I INTRODUCTION

Financial inclusion is considered an important means for alleviating poverty and promoting a country's broader economic development; it is therefore now receiving greater attention from international financial regulators. This heightened importance of financial inclusion for economic development is seeing 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 minimise 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 mind-set on their part. To assist in navigating this new regulatory frontier this paper recommends that, in promoting financial inclusion, financial regulators must sharpen their focus on understanding and building consumer demand for Digital Financial Services (DFS).¹ Regulators are already focused on designing enabling regulatory frameworks to accommodate the 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 critically important 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 with little DFS to regulate.

¹ A note on terminology: Digital Financial Services (DFS) is a term which is increasingly used in place of more specific terms such as mobile money. DFS recognises there are a range of players and technology platforms involved in providing access to financial services. In this paper, DFS is used to refer to a range of financial services accessible 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. For more terminology definitions see Mobile Financial Services: Basic Terminology Alliance for Financial Inclusion (March 2013) http://www.afi-global.org/sites/default/files/publications/mfswg_gl_1_basic_terminology_finalnewnew.pdf.

Of course, the focus on consumer demand is merely one aspect of a successful DFS ecosystem. Providers will also need to, for example, design highly efficient DFS systems with such low transaction costs that the business can be done profitably.² However, to explore all factors which drive the success of DFS ecosystems is beyond the scope of this paper and we focus on one relatively new concept for financial regulators: their role in building and understanding consumer demand for these promising and innovative financial products.

In this paper, we explain the importance of financial regulators *understanding* and *building* consumer demand so as to encourage sustainable DFS ecosystems which can improve financial inclusion. In understanding and building consumer demand, financial regulators will be able to intelligently direct or channel industry efforts towards encouraging sustainable DFS ecosystems which improve financial inclusion. In particular, we recommend regulators turn their attention to *partnerships* in the DFS space as one way to build consumer demand. We are referring to 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 towards successful sustainable DFS ecosystems.

Financial regulators must be ready to identify and assess the risks from prospective partnerships and adjust regulatory frameworks so 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 towards the identification, assessment and mitigation of risks arising from partnerships in DFS:

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

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.

² Rodger Voorhies, Jason Lamb and Megan Oxman, Fighting Poverty Profitably – Transforming the Economics of Payments to Build Sustainable, Inclusive Financial Systems Bill and Melinda Gates Foundation (September 2013).

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

II BACKGROUND

A. *The Regulation of Digital Financial Services – 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 the world of financial regulation). Regular announcements cite the latest moves by countries in establishing enabling regulatory environments for mobile money. These new regulatory environments respond to the entry of new players in the payments space; players previously not captured by financial regulation.³

Internationally accepted standards for the regulation of mobile money are also emerging; the Alliance for Financial Inclusion (AFI), and in particular 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. AFI and MFSWG develop and publish guidance papers outlining common approaches for the oversight and supervision of mobile money and mobile financial services more broadly.⁴

However, regulatory approaches for dealing with the wider category of products becoming available through partnerships in the DFS (products such as loans, insurance and savings) are still very much in the nascent stage. The same could be said of our understanding of the regulatory challenges presented by partnerships themselves in DFS. This paper presents these

³ See for example comments of Alliance for Financial Inclusion’s Senior Policy Advisor, John Owens, on Tanzania’s approach to the regulation of mobile money: John Owens, [Highlights on the Mobile Financial Services Landscape in Tanzania and Lessons for Regulators](http://www.afi-global.org/blog/2014/02/24/highlights-mobile-financial-services-landscape-tanzania-and-lessons-regulators) Alliance for Financial Inclusion (24 February 2014) <http://www.afi-global.org/blog/2014/02/24/highlights-mobile-financial-services-landscape-tanzania-and-lessons-regulators>; see also GSMA’s article published in December 2013 on the regulatory development for mobile money in Brazil and Peru - this provides a good overview of the benefits of levelling the playing field for non-banks through regulation: Mireya Almazan, [Mobile Money for the Unbanked](http://www.gsma.com/mobilefordevelopment/mobile-money-regulation-in-latin-america-leveling-the-playing-field-in-brazil-peru), GSMA (19 December 2013) <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: Eva Gutierrez and Sandeep Singh, [What Regulatory Frameworks are More Conducive to Mobile Banking? Empirical Evidence from Findex Data](http://ssrn.com/abstract=2338858) (World Bank Policy Research, Working Paper No 6652, 1 October 2013) <http://ssrn.com/abstract=2338858>.

⁴ See, [Mobile Financial Services: Consumer Protection in Mobile Financial Services](http://asbaweb.org/E-News/enews-37/incfin/06incfin.pdf) Alliance for Financial Inclusion (March 2014) <<http://asbaweb.org/E-News/enews-37/incfin/06incfin.pdf>>; [Mobile Financial Services: Supervision and Oversight of Financial Services](http://www.afi-global.org/sites/default/files/publications/mfswg_guidelinenote12_oversight_and_supervision_of_mfs_2.pdf) Alliance for Financial Inclusion (February 2014) http://www.afi-global.org/sites/default/files/publications/mfswg_guidelinenote12_oversight_and_supervision_of_mfs_2.pdf.

issues as a new regulatory frontier. We provide initial guidance for regulators to respond to partnerships in DFS. As partnerships in DFS 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.

B. 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 a principal path towards greater financial inclusion and economic development.⁵ Policy-makers must now look beyond their traditional policy objectives of promoting safe and efficient financial systems to also focus on promoting financial inclusion.⁶ This dual regulatory focus of ensuring safe and sound financial systems while developing financially inclusive systems 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.⁷

With financial inclusion the regulatory focus should be not only on financial sector regulation and supervision but also on realising 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

⁵ DFS can drive greater financial inclusion because they offer more than merely a viable alternative to the hawala systems or basic remittance networks which 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 compared to cash remittance receipts held under the mattress. Financial products and services can also be wrapped into the mobile money service including credit and insurance creating greater demand for the DFS. The DFS ecosystem is still in its nascent form, as deployments are still to crack just how to create the ecosystem necessary for mass adoption and usage in many markets, i.e. how to extend mobile money beyond a simple ‘cash-in’/‘cash-out’ service to be where ‘cash-in’ stays ‘in’. This ideal DFS ecosystem is to be strived for because financial inclusion will take hold, financial systems will be strengthened and economic development will benefit.

⁶ Financial inclusion efforts are being aligned, and pursued in tandem, with efforts directed towards financial stability, integrity and consumer protection because they are seen as complementary and because financial inclusion is considered an important means for alleviating poverty and promoting a country’s broader economic development. The focus on financial inclusion is seen in many international forums: G20 Summits, the G20’s Global Partnership for Financial Inclusion (GPMI), 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).

⁷ Timothy Lyman, [Building an Enabling and Protective Policy Environment](http://www.cgap.org/blog/building-enabling-and-protective-policy-environment) CGAP (24 May 2013) <http://www.cgap.org/blog/building-enabling-and-protective-policy-environment>.

Pilipinas (BSP), the Philippines' central bank; Roman noted that the result of making mobile financial services available for a remote island in the Philippines, Rapu Rapu, was increased economic activity on the island.⁸

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 is progressing to the extent that these emerging countries are 'reshaping the approach of central banking'.⁹ This trend continues and global standard-setting bodies are now actively engaging with regulators seeking to promote financial inclusion.¹⁰

C. 'Build It and They Will Come' – Avoid the Trap

While this international cooperation and alignment of goals bodes well for financial inclusion, it is important that the refinement and implementation of 'best practice' regulatory frameworks does not become the sole focus of financial regulators. Financial regulators, 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 which ultimately suffer from low uptake and limited success because the products and services do not match what the end-users need and want. This outcome is of little use in improving financial inclusion and is a questionable use of regulatory resources.¹¹ By focusing on the need to understand and build consumer demand, regulators will assist in avoiding these situations.

⁸ Id.

⁹ Alfred Hannig, Developing Countries Focused on Financial Inclusion are Reshaping Central Banking Alliance for Financial Inclusion (25 November 2013) <http://www.afi-global.org/blog/2013/11/25/developing-countries-focused-financial-inclusion-are-reshaping-central-banking>.

¹⁰ Alfred Hannig, Financial Inclusion a New Common Ground for Central Banks Alliance for Financial Inclusion (14 May 2014) <http://www.afi-global.org/blog/2014/05/14/financial-inclusion-new-common-ground-central-banks>.

¹¹ Graham Wright (head of Microsave) recently commented on this point in his reflections on the Mor Committee Report in India. Wright notes 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 Graham Wright, The Mor Committee Report – the

Low uptake and inactive users are already common in the roll-out 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 or need to switch to the new products or services. As a consequence, development partners are now encouraging greater focus on the demand side. To develop successful DFS ecosystems, it is now recognised that it is necessary to go beyond ensuring these products are simply available, accessible and affordable. Development partners must ensure the products meet consumer demand, are being used and will become sustainable.

D. 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 which match the unbanked and under-banked's needs and wants and ultimately improve financial inclusion. This is because the target markets in this case are traditionally from a low-income socioeconomic group which is likely to translate into 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 paper posits consumer demand as a key driving force behind determining whether the requisite scale for profitability will be achieved.¹²

E. 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 towards increasing financial inclusion. As part of these efforts, 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:

Demand Side Conundrum MicroSave (February 2014) <<http://blog.microsave.net/the-mor-committee-report-the-demand-side-conundrum/>>.

¹² For a discussion on other factors which come into play in developing profitable innovative products and services see Voorhies et al, supra.

- understanding the financial desires of the unbanked and under-banked (including understanding the existing demand for formal financial mechanisms); and
- 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).

III 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 the *customer value proposition*. Emphasising these two aspects in DFS initiatives will ensure players are being encouraged to deliver solutions and products which are useful and relevant for the under-banked and unbanked. Considerable research has emphasised the importance of these two aspects for DFS. A summary follows of some of this research highlighting what regulators can consider when assessing if *local context* and *customer value proposition* have been adequately considered.

A. *Local Context*

What does it mean when we say consumer demand is an issue requiring an understanding of local context? Davis and Owens (2009) contrast different countries to illustrate the importance of local context in understanding demand.¹³ 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.¹⁴ 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.¹⁵ There is little incentive for consumers in this market to replace their existing methods of accessing funds with a mobile phone payments channel.¹⁶ Attention to the local context is therefore paramount. In order to determine whether a product will be

¹³ John Owens and Ben Davis, POS vs. Mobile Phone as a Channel for M-Banking MicroSave (19 September 2008).

¹⁴ Id. at 2.

¹⁵ Id.

¹⁶ Id.

successful, insight into the local customer base will be essential.¹⁷ In particular, any new service must be evaluated in the context of existing services that customers are accessing.¹⁸ 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.¹⁹

B. Customer Value Proposition

Similarly, what does it mean to understand the customer value proposition in order to assess consumer demand? MicroSave has written extensively on the importance of the customer value proposition and keeping the client's needs at centre focus when designing new products.²⁰ Manoj Sharma, Managing Director - Asia at MicroSave, has noted what might seem obvious, but what 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".²¹ 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?²²

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 emphasises 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".²³ For example,

¹⁷ Debbie Watkins, [Context and Culture: Designing Relevant Financial Services](http://www.cgap.org/blog/context-and-culture-designing-relevant-financial-services) CGAP (13 August 2013) <http://www.cgap.org/blog/context-and-culture-designing-relevant-financial-services>.

¹⁸ [Id.](#)

¹⁹ Lesley Deyners, [How Do Smallholder Farmers Access Information](http://www.cgap.org/blog/how-do-smallholder-farmers-access-information) GCAP (31 January 2014) <http://www.cgap.org/blog/how-do-smallholder-farmers-access-information>.

²⁰ Manoj Sharma, [Sustainable Non-Banking Financial Institutions](http://www.microsave.net/resource/sustainable_non_banking_financial_institutions#.U5royViSw00) MicroSave (Presentation, 18 November 2013) http://www.microsave.net/resource/sustainable_non_banking_financial_institutions#.U5royViSw00.

²¹ Manoj Sharma, [DFS for the Under-Banked](http://www.microsave.net/files/pdf/MicroSave_DFS_for_the_Under_Banked.pdf) MicroSave (Presentation, Pacific Microfinance Week, October 2013) http://www.microsave.net/files/pdf/MicroSave_DFS_for_the_Under_Banked.pdf.

²² [Id.](#)

²³ [Id.](#)

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. Therefore 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.²⁴

C. 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.²⁵

D. 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.²⁶ 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”.²⁷ Mas describes how the various needs underpinning financial inclusion can be thought of as layers of a cake which combine to offer a texture, flavour and colour which can only be fully experienced when slicing through the various layers.²⁸ Mas emphasises 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.²⁹ Mas gives the example of M-Pesa referring to the formal mechanisms as being the MNO

²⁴ Ishita Gosh, Remittances vs. Savings on the Mobile Money Platform (Part 2) Institute for Money, Technology and Financial Inclusion (23 July 2013) <http://blog.imtfti.uci.edu/2013/07/remittances-vs-savings-on-mobile-money.html>.

²⁵ Watkins, supra.; Deyners, supra.

²⁶ See Ignacio Mas, Digitizing the Kaleidoscope of Informal Financial Practices 3 Journal of Business Management and Social Science Research 50 (2014).

²⁷ Id. at 57.

²⁸ Id.

²⁹ Id.

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 culture³⁰ (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.³¹ 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”.³²

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.³³ Mas emphasises that the needs of end-users should be viewed in a different light to that taken by many deploying new products to date. New products should not simply be built and rolled out with consumer education on how to use the new products 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 which could displace informal savings options.

³⁰ 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 Agents in Await Huge Commissions after Christmas Boom Mobile Money Africa (6 January 2014) <http://mobilemoneyafrica.com/details.php?post_id=1544> .

³¹ Today, greater 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 but 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 (see Kyla Yeoman, Interview: How M-Pesa Innovates New Business Models for its Base of the Pyramid Customers Global Envision (13 December 2013) <http://www.globalenvision.org/2013/12/13/interview-how-m-pesa-innovates-new-business-models-its-base-pyramid-customers>).

³² Mas, supra, at 57.

³³ Id. At 58.

IV 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 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'.

We provide further detail on these examples 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.

A. 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.³⁴ 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.³⁵ 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

³⁴ For a brief description of an enabling regulatory environment for mobile money, see Gutierrez and Singh, *supra*. These authors cite David Porteous, [The Enabling Environment for Mobile Banking in Africa](http://bankablefrontier.com/wp-content/uploads/documents/ee.mobil_banking.report.v3.1.pdf) 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).

³⁵ Jeanette Thomas, [Regulation Spurs Innovation in the Philippines](http://www.cgap.org/blog/regulation-spurs-innovation-philippines) CGAP (5 November 2012) <http://www.cgap.org/blog/regulation-spurs-innovation-philippines>.

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 particularly important outcome for 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 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 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 cash-out of 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.³⁶ The RBI recently announced it would create a new class of regulated institutions, "payment banks" which will accept demand deposits and provide remittance services.³⁷ 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

³⁶ PTI, Reserve Bank of India to soon come out with payment bank The Economic Times (12 June 2014) <http://economictimes.indiatimes.com/news/economy/policy/reserve-bank-of-india-to-soon-come-out-with-payment-bank/articleshow/36445449.cms>.

³⁷ RBI Website, RBI releases Draft Guidelines for Licensing of Payments Banks and Small Banks (17 July 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.html>; 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/>.

Committee Report”).³⁸ In announcing this change, the RBI is acknowledging the importance of payments services products which facilitate domestic remittances for greater financial inclusion.³⁹ 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.⁴⁰ The RBI may maintain its cautious approach in this area.⁴¹

B. 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.⁴² Such efforts are not without challenges.⁴³ 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

³⁸ Reserve Bank of India, The Report of the Committee on Comprehensive Financial Services for Small Business and Low Income Households (7 January 2014) http://rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=30353.

³⁹ 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/>.

⁴⁰ Kalyan Parbat, Telecom companies expect spurt in revenues with ‘payments banks’ Economic Times (19 July 2014) http://articles.economictimes.indiatimes.com/2014-07-19/news/51744670_1_vodafone-india-mobile-payments-safaricom?_ga=1.89423515.1014043529.1405995841.

⁴¹ 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).

⁴² Better Than Cash Alliance (2014) <http://betterthancash.org/>.

⁴³ 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 (12 March 2014) <http://www.cgap.org/blog/e-payments-low-income-settings-cutting-edge-or-high-risk>.

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 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.⁴⁴ This program may contribute towards the success of moving from cash-based payments to electronic-based methods.

C. 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".⁴⁵

D. 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.

⁴⁴ Andrews, Ed, [Think ID Theft Is a Problem Here? Try Protecting One Billion People](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), Stanford Graduate School of Business (1 May 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.

⁴⁵ 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](http://www.huffingtonpost.com/tilman-ehrbeck/the-financial-literacy-debate_b_4459311.html) Huffington Post (19 December 2013) http://www.huffingtonpost.com/tilman-ehrbeck/the-financial-literacy-debate_b_4459311.html.

Mobile money in the Philippines consists of two MNOs offering e-money but they are not interoperable. The central bank, Bangko Sentral ng Pilipinas (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’– 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 emphasises 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.⁴⁶

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”.⁴⁷ 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

⁴⁶ [Building Consensus Towards Enabling an Efficient and Inclusive National Payments System in the Philippines: A Significant Step](http://www.simmphil.org/misc/building-consensus-towards-enabling-an-efficient-and-inclusive-national-payments-system-in-the-philippines-a-significant-first-step) USAID (24 April 2013) <http://www.simmphil.org/misc/building-consensus-towards-enabling-an-efficient-and-inclusive-national-payments-system-in-the-philippines-a-significant-first-step>.

⁴⁷ Ralph Jooma, [Inclusive Growth in Malawi and Digital Financial Inclusion](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/) (Speech, UNGA Week, 24 September 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/>.

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, 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 a great potential for these three MNVO's services to be made interoperable as they will all operate over the same MNO's network.⁴⁸

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.⁴⁹

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.

⁴⁸ 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 26 June 2014. Susan Mwenesi, [COFEK wants Kenyan MVNO licenses revoked](http://www.humanipo.com/news/45013/cofek-wants-kenyan-mvno-licenses-revoked/) Humanipo (11 June 2014) <http://www.humanipo.com/news/45013/cofek-wants-kenyan-mvno-licenses-revoked/>.

⁴⁹ [Airtel wins case to open up M-Pesa](http://www.biztechafrika.com/article/airtel-wins-case-open-m-pesa/8514/#.U9nGzYCSw00) BizTech Afrika (28 July 2014) <http://www.biztechafrika.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](http://www.humanipo.com/news/43623/safaricom-airtel-seek-extension-in-talks-over-m-pesa-fees/) Humanipo (8 May 2014) <http://www.humanipo.com/news/43623/safaricom-airtel-seek-extension-in-talks-over-m-pesa-fees/>.

E. 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 paper 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 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 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.⁵⁰ From a non-bank’s perspective, partnerships provide an opportunity to take advantage of a bank’s governance arrangements and operating models.⁵¹ 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.⁵²

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

⁵⁰ Andrew Starke, [The Payments Revolution](http://www.australianbankingfinance.com/banking/the-payments-revolution/) AB+F Online (1 June, 2014)

<http://www.australianbankingfinance.com/banking/the-payments-revolution/>.

⁵¹ Manoj Nambiar and Shraddhar Srimal, [From Vision to Reality: RBI ruling brings India one step closer to true financial inclusion](http://www.nextbillion.net/blogpost.aspx?blogid=3965) (July 2014) <http://www.nextbillion.net/blogpost.aspx?blogid=3965>.

⁵² [Product Development](http://www.cgap.org/topics/product-development) CGAP, <http://www.cgap.org/topics/product-development>.

(i) Partnerships Deepening Product Offerings

The potential for deeper product offerings is driving a number of the partnerships now being established in the DFS space.⁵³ 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 the other involving Safaricom in Kenya (of M-Pesa fame).⁵⁴

(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).⁵⁵ 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.⁵⁶ Users do not need an EcoCash account, they can do an over-the-counter transfer in the same way people do with

⁵³ 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 (19 June 2014) qz.com/222964/why-mobile-money-has-failed-to-take-off-in-india/.) The Reserve Bank of India has since revised its requirements.

⁵⁴ For an extended overview of partnerships in mobile money deepening the product offerings see Leo Mirani, [How to manage all your financial affairs from a \\$20 mobile phone](#) Quartz (18 June 2014) qz.com/218988/how-to-manage-all-your-financial-affairs-from-a-20-mobile-phone/.

⁵⁵ Tendai Mupaso, [EcoCashLoans Now Available to EcoCashSave Customers with Zero Interest](#) Techzim (2 April 2014) <http://www.techzim.co.zw/2014/04/ecocashloans-now-available-ecocashsave-customers-zero-interest/>.

⁵⁶ [Steward bank launches product suite for Zimbabweans livings in the Diaspora](#) Steward Bank (Press Release, February 2014) www.stewardbank.co.zw.

MoneyGram or Western Union.⁵⁷ 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.⁵⁸ Steward Bank customers open an EcoCash Account if they have an Econet mobile line activated in Zimbabwe with roaming capabilities.⁵⁹

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.⁶⁰

(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).⁶¹ 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.⁶² The loans are for small amounts between KES100 and KES 50,000 (approx. USD1.5 and USD550).⁶³

In late 2013, there were around 4 million M-Shwari customers according to Safaricom.⁶⁴ The service has been recognised in Computerworld Honors Program in Washington DC with the 21st Century Achievement Award in emerging technology.⁶⁵

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.⁶⁶ At the launch of the

⁵⁷ Tendai Mupaso, [EcoCash to launch EcoCash Diaspora in the UK in the coming days](http://www.techzim.co.zw/2014/03/ecocash-to-launch-ecocash-diaspora-in-the-uk-in-the-coming-days/) Techzim (19 March 2014) <http://www.techzim.co.zw/2014/03/ecocash-to-launch-ecocash-diaspora-in-the-uk-in-the-coming-days/>.

⁵⁸ Tendai Mupaso, [Steward Bank's EcoCash enabled Diaspora banking not so clear](http://www.techzim.co.zw/2014/02/steward-banks-ecocash-enabled-diaspora-banking/) Techzim (21 February 2014) <http://www.techzim.co.zw/2014/02/steward-banks-ecocash-enabled-diaspora-banking/>.

⁵⁹ Tendai Mupaso, [EcoCash to launch EcoCash Diaspora in the UK in the coming days](#), *supra*.

⁶⁰ [Econet's partnership with WorldRemit a smart way to stay in money remittance?](http://www.techzim.co.zw/2014/04/econets-partnership-worldremit-smart-way-stay-money-remittance/) Techzim (24 April 2014) <http://www.techzim.co.zw/2014/04/econets-partnership-worldremit-smart-way-stay-money-remittance/>.

⁶¹ Sam Wakoba, [M-Shwari Launches a Fixed Deposit Account Dubber Lock](http://techmoran.com/m-shwari-launches-a-fixed-deposit-account-dubberd-lock/) TechMoran (16 June 2014) <http://techmoran.com/m-shwari-launches-a-fixed-deposit-account-dubberd-lock/>.

⁶² Yeoman, *supra*.

⁶³ Wakoba, *supra*.

⁶⁴ Yeoman, *supra*.

⁶⁵ Wakoba, *supra*.

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.⁶⁷

(ii) 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 paper, we highlight two areas for regulators to include in their approach towards identification, assessment and mitigation of risks arising from partnerships in DFS:

- 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/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

⁶⁶ Id.

⁶⁷ Id.

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 analysed how banks and operators can structure their agreements most effectively.⁶⁸ 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”.⁶⁹ We recommend regulators 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, 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’.⁷⁰ This broader topic is beyond the scope of this paper, 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.⁷¹

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:

⁶⁸ 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>.

⁶⁹ Id. at 14.

⁷⁰ Jamie Zimmerman, The Emergence of Responsible Digital Finance Centre for Financial Inclusion (21 July 2014) <http://cfi-blog.org/2014/07/21/the-emergence-of-responsible-digital-finance/>.

⁷¹ Id.

- “**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.**”⁷²

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.⁷³ This paper 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. 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

⁷² Id.

⁷³ Id.

documented.⁷⁴ 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 **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.⁷⁵ 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?

⁷⁴ 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>.

⁷⁵ 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 recognised 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 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>.

- **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* (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.⁷⁶
- 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 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. 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

⁷⁶ Consultative Group to Assist the Poor and World Bank Group [Financial Access 2010, The State of Financial Inclusion Through the Crisis](http://www.cgap.org/publications/financial-access-2010) (2010) <http://www.cgap.org/publications/financial-access-2010>.

regulatory requirements for supervised entities and increased information and financial disclosure.⁷⁷

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) recognises that mobile money providers and MFIs are working together to improve the quality and range of financial services available.⁷⁸ 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.⁷⁹

(iii) 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 paper but some examples are noted here to emphasise that partnerships are not straightforward 'win-wins' for MFS and DFS ecosystems.

GSMA has emphasised 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".⁸⁰ 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.⁸¹ 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

⁷⁷ 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 website 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](http://www.afi-global.org/news/2014/4/01/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-supervision>

⁷⁸ [MMU Products – Credit](http://www.gsma.com/mobilefordevelopment/programmes/mobile-money-for-the-unbanked/products/mmu-products-credit) GSMA, <http://www.gsma.com/mobilefordevelopment/programmes/mobile-money-for-the-unbanked/products/mmu-products-credit>.

⁷⁹ [Id.](#)

⁸⁰ Mireya Almazan, [G2P Payments and Mobile Money: Opportunity or Red Herring?](#) GMSA (30 September 2013) <http://www.gsma.com/mobilefordevelopment/g2p-payments-mobile-money-opportunity-or-red-herring>.

⁸¹ Zimmerman and Bohling, [supra](#).

over revenue sharing.⁸² Most recently, one of the first articles analysing 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.⁸³

(iv) 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.

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.

⁸² Erik Heinrich, The apparent M-Pesa monopoly may be set to crumble Fortune Magazine (27 June 2014) <http://fortune.com/2014/06/27/m-pesa-kenya-mobile-payments-competition/>.

⁸³ 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/>.

V 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 recognise this approach is advocating a broader role for financial regulators. We believe, however, it is critical for regulators to assume this role because it now seems clear that market forces alone will not always, or even regularly, deliver sustainable DFS in markets which 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 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 capitalised 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>.