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MOBILE MONEY FOR THE POOR

Regulation and Digital Financial Services

# Using Trusts
## to Protect Customers' Mobile Money Funds

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Mobile money is a payment and storage service that uses 'e-money'—a form of stored value that is not a bank deposit. This note focuses on mobile money services provided by non-banks, such as a mobile network operator (the provider).

In this non-bank model, customers exchange cash for e-money at an agent. The e-money, once acquired, is stored on the server of the phone company. These funds are not protected by the sort of prudential regulation that applies to banks (because they are stored on the server of a phone company, not a bank). This note explores how a regulator can protect customers' funds like these from loss.

## There are three risks to customers' funds

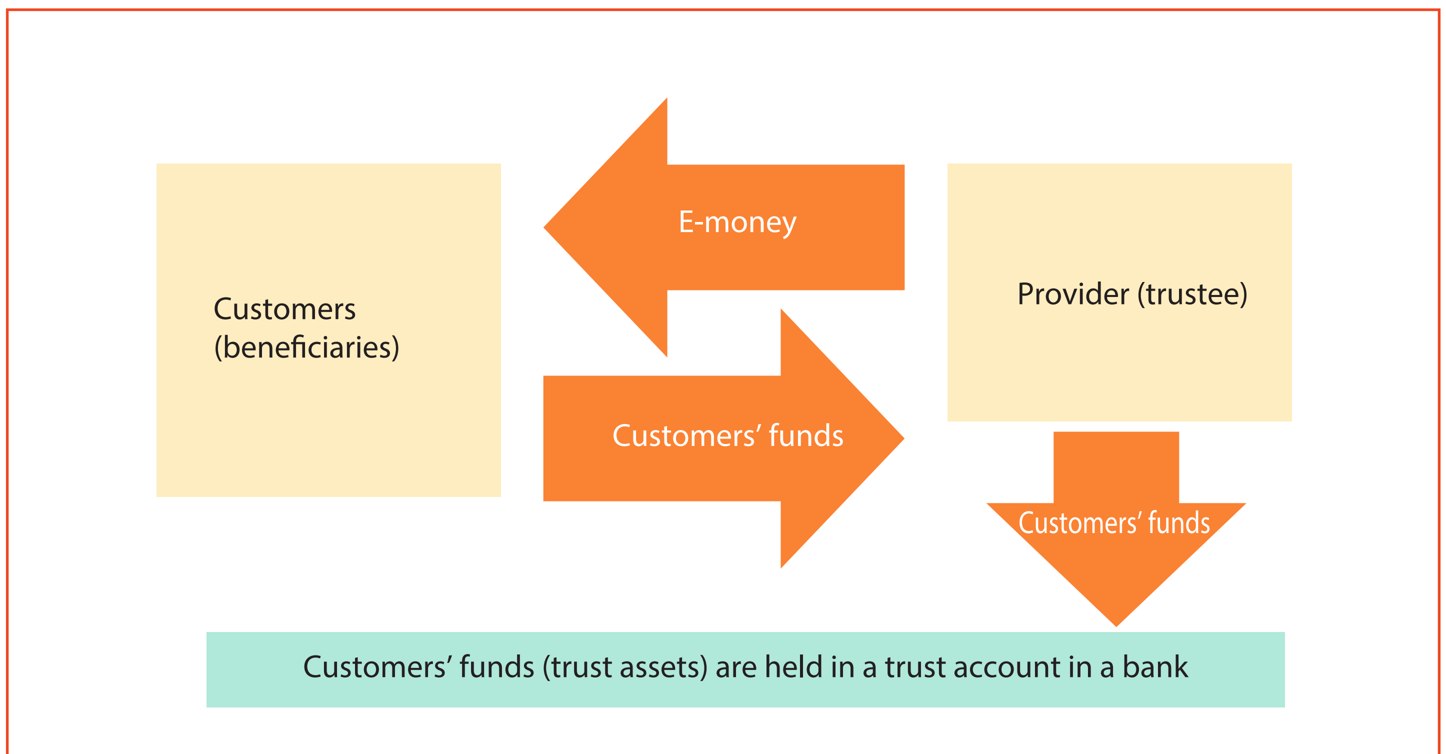
- **Insolvency risk:** The provider becomes insolvent or otherwise fails, and customers' funds are used to repay debts of the provider;
- **Liquidity risk:** The provider uses customers' funds for its own purposes (such as to build a new phone tower) and cannot repay customers when asked to do so; and
- **Operational risk:** Loss of customers' funds due to fraud, misuse or poor administration by the provider or its employees.

A **'trust'** is a legal instrument used in common law countries (that follow the English legal tradition). It is a relationship whereby one person (trustee) holds property (trust assets) for the benefit of another (beneficiary).

The trustee can use the asset but must comply with prescribed duties when doing so. These duties are express (set out in the 'trust deed' that establishes the trust) or implied (the law imposes the duty to fill a gap in the trust deed).

In many common law countries, such as Fiji, Kenya and Papua New Guinea, providers put customers' funds in a trust account in a prudentially regulated bank. In this situation, the provider (or a designated company) will be the trustee, the customers' funds are the trust assets, and the customers are the beneficiaries (see **figure I**).

Figure I
**How a trust applies to customers' funds**



# Trusts can protect customers' funds in three ways

**1. Establishing a trust** over customers' funds protects the funds from *insolvency risk* because a trust isolates the funds. Without a trust, customers' funds are assets of the provider. If the provider becomes insolvent, the funds can be used to pay off the provider's debts. With a trust, the provider holds the funds on behalf of customers, and legally, ownership of the funds remains with the customers so that the funds cannot be used to meet the provider's debts.

To establish a trust, a provider should enter into a trust deed that states the provider (or a designated third party) holds customers' funds 'on trust' for the customers.

**2. Fund safeguarding** can be achieved by the terms of the trust deed serving as a 'rule book' that requires the provider (as trustee) to always keep a strict 1:1 ratio between e-money and customers' funds.

The 1:1 ratio protects customers' funds against *liquidity risk* because the 1:1 ratio ensures the provider will always have enough funds to repay customers who want to convert their e-money into cash.

To achieve fund safeguarding, the trust deed should provide for the following:

- Liquidity: The provider must hold an amount of liquid assets such as bank deposits and government securities that can quickly be converted to cash and equals the amount of issued e-money;
- Restrictions on use: The provider can only store customers' funds, not use them for other purposes; and
- Diversification: The provider must hold a range of liquid assets.

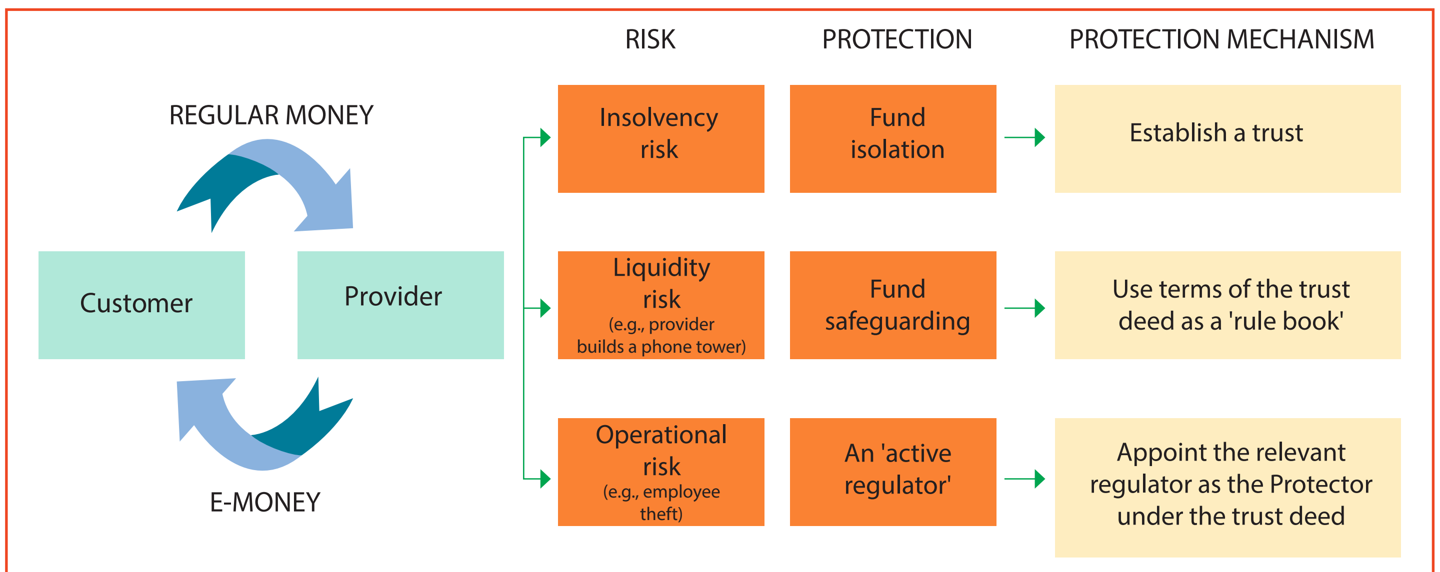
**3. Appointing an active regulator as the Protector** under the trust deed protects customers' funds. Under a trust, it is generally the responsibility of the beneficiaries to enforce the rules of the trust. However, most mobile money customers will lack the financial experience to enforce their rights as beneficiaries under the trust, so the regulator or a delegate should be appointed as the Protector under the trust to audit the trustee and enforce the terms of the trust.

The deed should expressly empower the Protector to do the following:

- Monitor the trustee's compliance with the terms of the deed, particularly in relation to the trust account (through, for example, auditing the trust account); and
- Take enforcement action against the provider (which may include revoking its licence) if it fails to comply with the terms of the trust deed.

**Figure II** summarises this framework.

Figure II
**Summary of using trusts to protect customers' funds**



## Benefits of using a trust to protect customers' funds

The use of a trust to protect customers' funds usually results in earnings, which raises the question, Who is the beneficiary? Many regulators have hesitated to require or allow proceeds from a trust to be paid to clients because it mimics the benefits of a savings-type account.

In February 2014, the Tanzanian central bank issued a circular, which directed that interest accrued on the trust account held at a bank should directly benefit mobile money customers and agents. It specified that this could be done in several ways:

- To fund customer education campaigns;
- For customer care;
- To subsidize operations in rural areas;
- To provide other benefits to customers such as insurance; or
- To be paid out directly to customers.

In September 2014, Tigo Tanzania announced that it would distribute US$8.7 million of returns generated by its Tigo Pesa Trust to its 3.5 million Tigo Pesa mobile money customers and agents, and that it would continue to make payouts of accrued interest every quarter. Other countries such as Ghana, Kenya and Liberia have recently introduced regulations that also permit interest to be paid to customers. This recent innovation further supports the value of using a trust to protect and benefit the customer by providing further value to mobile money customers as a means for increasing financial inclusion.

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