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ENCOURAGING INTEREST ON E-MONEY

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In too many countries, mobile money account numbers are high and usage rates low. Most accounts in many countries are used only to receive government payments that are then quickly withdrawn as cash. This pattern does not lead to the development of a vibrant digital financial ecosystem that truly supports financial inclusion. In a recent paper, the authors explore one way to tackle this problem, which is to encourage the payment of interest on e-money.

Backed by cash

Though many are unaware of the back-end processes involved, the e-money sent and received by customers represents actual currency on deposit, often in trust, with a commercial bank. These trust funds guard against customers losing their money in the event of provider insolvency. Many financial regulators find the issue of whether to permit the payment of interest on this e-money troubling: they worry that the payment of interest may mislead customers into thinking e-money accounts are bank accounts when, typically, e-money does not attract deposit insurance protection and e-money providers are not subject to prudential regulation.

Yet paying interest does not make e-money equivalent to a bank deposit because, at least under the law of the United Kingdom and the law of the United States, interest payments are not a defining feature of a bank deposit. The payment of interest may be a custom, but it is not a legal requirement in most countries and is not a feature of all bank accounts. Furthermore, allowing interest payments does not increase risks when, as is common, e-money providers are required to hold funds equal to the amount of e-money issued on trust with a prudentially regulated bank, or they are allowed to invest the funds only in very limited low-risk options such as government bonds—options explored here. Such restrictions on how providers can use the funds underlying e-money are acceptable as providers do not intermediate the funds as banks do, and they certainly do not want to be regulated like banks.

Market conduct regulation can ensure adequate disclosure to e-money customers such that these customers are aware of the risks of e-money. Financial literacy education can be used to further reinforce consumer awareness in this area. Recognizing and correcting for any public misperception will give regulators more policy space when it comes to regulating e-money and encouraging the uptake and usage of it.

Digital financial services need incentives to grow

Providing customers with economic incentives for using digital financial services is becoming a major focus of some governments. These incentives take the form of offering discounts for payments conducted through electronic payment systems or allowing income tax deductions or VAT rebates based on the usage of electronic payments. The Government of India has announced several discounts for customers using electronic payment systems for a range of transactions, as part of its efforts to (i) promote electronic payments so as to reduce what is euphemistically termed 'leakage' in government payments, and (ii) deal with the significant economic challenges resulting from its demonetization policy.

Prohibiting, or failing to encourage, the payment of interest on e-money is at odds with this trend of creating incentives for using digital financial services. However, there are countries where the providers can use, or 'pass through,' the interest earned. These countries include Ghana, Kenya and the United Republic of Tanzania.

This mandate has given rise to arguably the first interest-earning e-money product, Tigo Pesa, which shares revenue generated from the e-money float trust account with customers. The first payment of Tigo Pesa was $8.7 million in September 2014, which represented some 3.5 years of income earned at an average of about 8 percent per annum, at a time when the average deposit interest rate in the United Republic of Tanzania was almost 10 percent. Such returns to customers have the potential to change the usage rates of e-money products.

When customers do not receive interest on their e-money accounts, they have considerably less incentive to save money in their accounts. This effect is compounded when customers are charged fees for cash-in and/or cash-out transactions. Simply put, when usage of non-interest-bearing accounts attracts fees, no matter how minimal, customers will be discouraged from storing funds electronically and often will choose to keep their money as cash. When customers of M-Pesa (mobile money's poster child from Kenya) were asked what additional services they would like, the most frequent response was to earn interest. Interest payments, even on small balances, can act as an effective incentive to enrol and retain users by providing low-income customers with an opportunity to earn a return on the little amount of money they have.

Even if financial regulators remain reluctant to allow customers to be paid the interest earned by mobile money providers on their e-money directly, there are other ways providers can use the interest revenue from e-money to benefit their customers, such as by using the interest income to reduce fees charged for cash-in, cash-out or other transactions. The interest revenue should be freed in these ways to promote the frequent and sustained use of e-money products, as such usage is a critical feature of successful digital financial ecosystems. Channelling the benefits of interest revenue to customers will benefit them economically and promote the entire digital financial ecosystem.

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