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APPROACHES TO RESOLVE E-MONEY CRISIS

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This briefing note proposes three ways in which appropriate authorities in developing countries could be granted resolution powers over non-bank e-money issuers ('Providers') in the event that a Provider experiences financial distress, as the authors explored in a recent paper.

E-money has shown substantial growth in a number of countries in recent years, often driven by Providers, including telecommunications companies, mobile network operators and transportation companies. These Providers frequently have competitive advantages in the form of substantial existing networks, related expertise and economies of scope.

Many countries have passed regulations to address risks inherent in the issuance of e-money. However, there is a discrepancy in the treatment of banks and Providers. When a bank or financial institution experiences financial distress, legislation often grants an authority resolution powers to ensure the orderly winding up of the institution while limiting systemic disruption and losses to deposit holders. These resolution powers do not generally extend to Providers, notwithstanding the economy-wide disruption that the collapse of a large Provider could cause.

Defining e-money regulations

E-money regulations in developing countries often provide a regulator—usually the central bank—with powers aimed at protecting e-money customers from the insolvency, illiquidity and operational risks inherent in the provision of e-money. In jurisdictions with a common law tradition in particular, policymakers sometimes have addressed these risks by requiring the Provider to isolate the e-money 'float' in a trust account (the 'float' being the aggregate of funds an e-money issuer receives from customers in exchange for the issuance of e-money).

Other powers granted to regulators under e-money regulations include powers to license appropriately qualified Providers; to set minimum liquidity requirements; to suspend, or to revoke, the licence of a Provider that breaches the law; and to apply for the winding up of a Provider in the event of insolvency. However, e-money regulations generally do not provide regulators with power to supervise, or to take over, the business of a Provider that experiences financial distress. These kinds of powers are often referred to as resolution powers.

What are resolution powers?

Resolution powers are powers that enable a resolution authority to intervene to address the liquidity and solvency problems of financial institutions through early intervention, while protecting the savings of deposit holders, minimizing systemic disruptions and promoting market efficiency. They include powers to sell assets and liabilities to a viable third party; to transfer systemically significant functions or viable operations to a temporary bridge entity that can continue these operations; and to terminate burdensome contracts of the institution, subject to conditions and compensation. A typical situation involves relevant regulators meeting over the course of a weekend to develop an emergency plan to determine how the institution's operations, assets and liabilities should be held and managed, and presenting that solution, as a done deal, to the market the following Monday morning.

In developed countries, there has been a substantial push for reform of statutory resolution powers since the global financial crisis of 2008, which includes requiring major banks to draft 'living wills' that provide for how a bank is to be administered and restructured in the event of severe financial distress, and providing a more comprehensive range of powers and mechanisms for cross-border coordination between relevant authorities where an institution operates in a number of jurisdictions.

The same reform effort generally has not been seen in developing countries. However, legislation in these countries frequently incorporates fundamental resolution powers, including the power to direct an institution to take, or to refrain from taking, certain actions; to appoint an adviser to advise on the proper operation of the institution's business; to appoint the regulator itself to act as controller or statutory manager of the institution with power to operate its business; and to apply to the court for the winding up of the institution.

These resolution powers are generally triggered when an institution becomes insolvent or is likely to become insolvent, or when it is unable or likely to become unable to meet its obligations. Importantly, this legislation generally applies only to banks and financial institutions and does not extend to Providers.

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Could non-bank Providers pose a threat to financial stability?

There is a reasonable argument that Providers do not present the same systemic risks as banks and financial institutions, since e-money transactions tend to account for a very small percentage of the total value of deposits and electronic payments in a country. However, while the value of transactions may be low, in some countries the use of e-money is sufficiently pervasive that the failure of a large Provider could cause a major disruption to the economy, including disturbances to government payments if its services are also used for government-to-person payments. Further, losses from such a failure could represent a very significant financial shock for many low-income households. These events may undermine consumer confidence in e-money services and electronic payment instruments more generally, working against objectives of financial inclusion.

In the remainder of this note, the authors present three approaches, legislative and non-legislative, to grant resolution powers in respect to Providers to appropriate regulators in developing countries in order to avert such threats and losses before Providers actually fail.

Resolution powers under e-money regulations

One solution is for e-money regulations to be amended in order to provide the regulator with power to intervene at an earlier stage when a Provider begins to experience financial distress. Kenya offers a relatively rare example of e-money regulations that provide resolution-style powers over Providers. The National Payment System Regulations (2014) grant powers to the Central Bank of Kenya in respect to payment service providers, which cover e-money providers, including the power to 'take over control of the business of the payment service provider to safeguard and facilitate distribution of the money in the Trust Fund' and 'appoint any person, including another payment service provider, to distribute the balances held in the Trust Fund of the revoked payment service provider at the time of revocation.'** This example demonstrates the manner in which resolution powers can be adapted to the specific context of the e-money sector under e-money regulations.

To avoid overlap with other regulators—such as telecommunications regulators—and to assist in ring-fencing the e-money business, the authors recommend that such regulations also require an e-money business to be conducted by a separate entity that was incorporated solely for the purpose of providing e-money and that engages only in the business of e-money.

** Kenya, The National Payment System Regulations, 2014, p. 697.

Resolution powers as a condition of the Provider's licence

E-money regulations frequently provide the regulator with the power to impose conditions on the grant of an e-money licence. In the absence of legislative provision for resolution powers over Providers, it may be possible for the resolution authority, or its nominee, to be given similar powers by making the grant of an e-money licence or approval conditional on the grant of resolution powers in respect to the Provider and its e-money business. This solution may be particularly useful where legislative change is likely to be a lengthy process.

Resolution powers granted to a protector under an e-money trust deed

As noted, one means by which policymakers have addressed insolvency, illiquidity and operational risks inherent in the provision of e-money is to require the Provider to isolate the e-money float in a trust account, to be held on trust for the benefit of e-money holders. While this measure is most often found in countries with a common law tradition, there are civil law equivalents.

Where a Provider is required to transfer the e-money funds to a trustee, it may be possible to appoint a 'protector' under the trust deed and to grant that protector powers over the e-money float in the event of the Provider's financial distress. A protector is sometimes appointed by the entity that transfers property to the trustee (the 'settlor') to exercise ongoing powers over the trustee and the trust property. A regulator or other appropriate entity could be appointed to the role of protector under the e-money trust instrument, with powers to take control of the e-money float and to appoint another trustee if a Provider begins to experience financial difficulties.

This approach may be particularly appropriate in jurisdictions where there are no e-money regulations but where Providers are required to place the e-money float in a trust. Fiji, for example, has done so.

One limitation on this solution is that it would only provide the regulator with power over the trust property—that is, the e-money float—and not over the e-money business more generally, since this business would not be part of the trust property. Further, regulators may be reluctant to expose themselves to potential fiduciary liabilities as protectors. However, depending on the law of the relevant jurisdiction, these liabilities might be limited by legislation or by the trust instrument itself.

Conclusion

E-money providers from non-banking backgrounds introduce beneficial competition and innovation in financial services as well as new opportunities for financial inclusion. However, there is rarely provision for a regulator to exercise resolution powers when such Providers experience financial distress, which could lead to major economic disruption in some markets. The authors propose that an appropriate regulator could be provided with resolution powers by legislative amendment or, where there are obstacles to such amendment, by non-legislative means, either by the imposition of conditions on the grant of an e-money licence or (to more limited effect) by the appointment of the regulator or its nominee as 'protector' under the e-money trust.

FOR MORE INFORMATION

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