Notes on Regulation of Branchless Banking in Russia May 2008

Since November 2006, when President Putin advocated greater financial access for the Russian people in a widely publicized address, a number of government initiatives have begun to take shape indicating the strong interest among Russian policy makers and regulators in taking up this challenge. Branchless banking, or "distance banking", as it is often called in Russian translation, is seen as a cost-efficient way of achieving the goal of improved financial access – particularly for lower income Russians living in the country's many vast and sparsely populated areas.

Since the fall of the Soviet Union, banks have been the main formal providers of financial services in Russia. The past few years, however, have witnessed new developments, including the burgeoning business of payment terminals, operated both by banks and nonbanks. Banks have also been partnering with mobile phone operators to provide payment and other banking services. In addition, a handful of web-based e-money issuers are signing up large numbers of customers and claim huge (and fast-growing) transaction volumes. These e-money issuers and other nonbanks offer the public the opportunity for easy and cheap electronic payments without requiring a bank account or, in most instances, identification.

The regulatory framework for branchless banking has been slow to catch up with industry practice. The further development of branchless banking in Russia is being threatened both by the risks posed by unregulated entities and their significant growth and size, as well as by the legal ambiguity regarding whether nonbanks may provide payment services. The future course will also depend significantly on (i) adopting a legal definition of e-money (and resolving the legal issues regarding whether nonbanks may issue e-money), (ii) permitting a broader use of retail banking agents, and (iii) revising the anti-money laundering/combating the financing of terrorism (AML/CFT) requirements to provide a truly risk-based approach.

BACKGROUND: CGAP, BRANCHLESS BANKING AND THIS SERIES OF POLICY DIAGNOSTICS

CGAP is a global resource center for microfinance standards, operational tools, training, and advisory services. Its members – bilateral, multilateral, and private donors – are committed to building more inclusive financial systems for the poor. The CGAP Technology Program is a multi-year learning initiative co-funded by the Bill and Melinda Gates Foundation to find and test promising technology solutions to improve access to finance.

CGAP defines branchless banking as the delivery of financial services outside conventional bank branches using information and communications technologies and retail agents. Because of their potential to radically reduce the cost of delivery and

increase convenience for customers, branchless banking approaches can expand coverage to new, previously unserved segments of the population. Technology can help a range of market actors push the boundaries of access to finance, including not only banks but also microfinance institutions, mobile phone operators and technology companies.

Two models of branchless banking – bank-based and nonbank-based – can be distinguished. Both make use of retail agents such as merchants, supermarkets or post offices to deliver financial services outside traditional bank branches. In the **bank-based model**, every customer has a direct contractual relationship with a prudentially licensed and supervised financial institution - whether account-based or involving a one-off transaction - even though the customer may deal exclusively with a retail agent who is equipped to communicate directly with the bank (typically using either a mobile phone or a point-of-sale (POS) terminal).

In the **nonbank-based model**, customers have no direct contractual relationship with a fully prudentially licensed and supervised financial institution. Instead, the customer exchanges cash at a retail agent (or otherwise transfers, or arranges for the transfer of, funds) in return for an electronic record of value. This virtual account is stored on the server of a nonbank, such as a mobile operator or an issuer of stored-value cards.[1] The balance in the account can be used for making payments, storing funds for future use, transferring funds or converting back to cash at agents. If the system relies on a POS network and plastic cards, customers must visit a participating retail agent to conduct a transaction. If the system is mobile phone-based, customers need to visit a retail agent only to add value or to convert stored value back into cash. A more limited version of the nonbank-based model can be found in payment networks, which involve a technology provider or other nonbank institution offering a network of "payment points" (for example, payment terminals, ATMs or retail agents equipped with POS devices) where a customer can make payments due to third parties or a governmental entity can make payments to beneficiaries.

Russia - Highlights

- A number of government initiatives are aimed at improving financial access, although none has yet produced notable changes to the regulatory framework.
- Thus far, a generally cautious “wait and see” approach by government has resulted in branchless banking models outpacing regulation, particularly with respect to payment services and web-based e-money issuers.
- Existing regulatory restrictions on the use of bank agents and disproportionate AML/CFT regulation limit the growth of branchless banking in Russia.

[1] The stored-value card, like other stored-value instruments, is often referred to as "e-money." There are various definitions of e-money, including the following from the European Union's Electronic Money Institutions Directive (2000): “monetary value as represented by a claim on the issuer which is: (i) stored on an electronic device; (ii) issued on receipt of funds of an amount not less in value than the monetary value issued; (iii) accepted as a means of payment by undertakings other than the issuer.”

1. Introduction

From May 21 to 30, 2007, CGAP conducted a mission in Russia[2] to analyze the policy, legal, and regulatory environment for branchless banking. This document summarizes CGAP's findings.[3] It is based on an analysis of existing and upcoming legislation relevant to branchless banking models and on the CGAP team's insights from 34 interviews with more than 60 representatives of a wide range of stakeholders. Interviews were conducted with representatives of the Central Bank of the Russian Federation (CBR), the Ministry of Information Technologies and Communication (MoITC), the Ministry of Finance (MinFin), the Ministry of Economic Development and Trade (MoEDT), the Russian Parliament (the State Duma), the Federation Council, the Russian Post, the Federal Anti-Monopoly Service, commercial banks, non-bank credit organizations, microfinance institutions (MFIs), mobile network operators, payment terminal providers, technology firms, donor agencies, and other knowledgeable parties. (A list of persons interviewed is appended to this document.)

In light of its rapidly evolving branchless banking market and the regulatory challenges the country is facing, CGAP selected Russia as one in a series of seven country diagnostics.[4]

2. State of Play: Government Authorities

In November 2006, at a meeting of the Presidium of the State Council concerning the Russian banking system, President Putin highlighted that 60 million Russians do not have access to banking services and only one quarter of Russians have a bank account. He advocated for fundamentally new approaches to providing access to financial services. In response, there have been a number of government initiatives indicating an interest in improving access to financial services and, in particular, supporting branchless banking, which is seen as a cost-efficient way to achieve the goal.

- In March 2007, the State Duma's Credit Organizations and Financial Markets Committee organized a round table on the legal aspects of increasing access to retail financial services. Branchless banking was one of the main discussion

[2] CGAP Policy Advisory Consultant Stefan Staschen, CGAP Senior Policy Advisor Timothy Lyman, CGAP Microfinance Analyst Mark Pickens and CGAP Consultants Olga Tomilova and Timothy Frost conducted the field portion of the mission, with support from Mikhail Mamuta of the Russian Microfinance Center (RMC). RMC's legal consultants Oleg Ivanov and Andrei Emelin participated in some of the meetings and they, together with Victoria Tagirova, provided advice on the interpretation of various laws, regulations, and bills mentioned. Messrs. Staschen and Pickens and CGAP Policy Advisory Consultant Kate Lauer authored the Notes with assistance from Mr. Lyman, Mr. Mamuta, Ms. Tomilova, and CGAP Consultant Michael Tarazi.

[3] This document summarizes results from an analysis of the regulatory environment for branchless banking in Russia conducted in May 2007 with follow-up through December 2007, and is subject to the limitations of such an approach.

[4] The other countries are Brazil, India, Kenya, Pakistan, the Philippines and South Africa.

topics of the round table, resulting in the establishment of a Working Group for Branchless Banking Development.[5] Members of the Working Group include representatives of the State Duma, the CBR, MoITC, the Russian Post, Russian Microfinance Center as well as various nongovernmental organizations and other private sector actors.

- MoITC established an inter-ministerial task force that includes MinFin, MoEDT, CBR and the Ministry of Justice. The task force, co-chaired by CBR, is focusing on m-payments (payments by mobile phone), e-payment (payments by other electronic communication) and the mobile phone-based "Universal Payment Platform" (UPP). The UPP is a pilot program that will use mobile phones for payments at public conveyances, parking, kiosks, terminals and banks. The first UPP pilots are planned for Moscow, St, Petersburg and Sochi.[6] The Minister of the MoITC has predicted that draft legislation will be prepared in the second half 2008.
- In the second half of 2007, in response to letters from the Kremlin to CBR and the government regarding national security threats due to the absence of a clear legal framework for the national payments system, CBR and MinFin began discussions on regulation of the national payments system.
- In 2007, the Russian Post proposed a plan to use post offices for financial services access.

Aside from these recent initiatives and indications of interest in branchless banking, both the government and the CBR have been slow in responding to innovative developments in the financial and telecommunication sectors over the past several years. In particular, the government has made clear that it sees very little room for relaxing the strict “know your customer” (KYC) rules of Russia’s AML/CFT legislation. This is particularly problematic for branchless banking (see Section 4.4 below).

The government has opened up some limited space for bank outsourcing of payment services pursuant to a July 2006 amendment to the Law on Banks and Banking Activities (“Banking Law”). There are various reasons given for the amendment, including: (i) the financial crisis in the utilities business caused by widespread customer payment defaults due primarily to the fact that people did not have the time to wait in bank lines to pay their utilities bills and (ii) heavy lobbying by the banking sector in response (and in opposition) to the emergence of unregulated payment service providers (PSPs) working without banks, thus effectively cutting banks out of an important part of their business. (The PSPs were initially working primarily with mobile phone operators.) The Ministry of Finance has signaled that it is prepared to support further amendment to the Banking Law to permit more outsourcing, in particular by allowing post offices to operate as agents for banks.

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[5] At the first meeting of the Working Group on May 28, 2007, the CGAP mission team made a presentation on international experience with business models and regulation of branchless banking.

[6] The MoITC is discussing the use of two possible technologies for the UPP: Near Field Communications (using the chip embedded in phones) and SMS.

In July 2007, the CBR published an instruction[7] that requires any company operating without a banking license that acts as a payment agent to enter into an agreement with an institution licensed under the Banking Law. Although some thought that this Instruction would have the effect of shutting down all PSPs operating without the involvement of a bank or non-bank credit organization,[8] many continue to operate. It is not entirely clear whether the CBR has authority to shut down such nonbank PSPs. And if it does, it is unclear whether the CBR will take action, given the importance of the role now played by such institutions – including companies owning payment terminals - in providing Russians with access to basic financial services. To resolve this issue, the Ministry of Finance formed a special Working Group in November 2007 with CBR, MoEDT, MoITC and market participants. There has been a decision not to restrict nonbank PSP activity while the Working Group is discussing possible solutions.

The CBR has not yet taken any action to shut down web-based e-money issuers either, although their existence and activities are not explicitly provided for under Russian law. (See Section 3.3 for discussion of the importance of these relatively new but important providers of financial services.)

CBR is taking other actions, however, that indicate its interest in providing banks with a low-cost alternative to branches. Over the past three years, CBR has issued instructions enabling banks to establish credit-and-cash offices and operational cash offices that are permitted engage in limited banking operations.[9] For example, a bank may install a teller window (staffed with a bank employee) in the branch of an MFI. This arrangement is not an agency relationship as the teller is still considered to be part of the bank.

3. State of Play: Industry

There are over 1,150 banks in Russia (half of which are registered in Moscow and Moscow Oblast) with 3,400 bank branches and approximately 27,000 bank points of service.[10] The most substantial bank in terms of assets and points of service is Sberbank (60 percent owned by the CBR), with 1,000 branches and 19,000 points of service. Even today, there are districts without a single bank branch.

There is also a wide range of "nonbank institutions,"[11] such as the Russian Post, urban

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[7] 1842-U. The instruction became effective in November 2007.

[8] A nonbank credit organization may, depending on the type of license it has, engage in all banking operations other than the acceptance of deposits from individuals.

[9] The credit-and-cash offices are permitted to perform cash in and cash out services for individuals and small businesses; the operational cash offices are permitted to carry out cash operations with individuals as well as legal persons.

[10] Bank points of service include banks' credit-and-cash offices, operational cash offices and additional bank offices (i.e., any office located within a certain distance from the bank's headquarters or any branch).

[11] In these Notes, the term "nonbank institutions" refers to institutions that are not "credit organizations" as defined in the Banking Law. Credit organizations (banks and nonbank credit organizations) are subject to licensing and other requirements of the Banking Law.

and rural credit co-ops, MFIs, mobile phone companies, PSPs and internet-based financial service companies. Due to their physical infrastructure, technology and accessibility, these nonbank institutions are well-positioned (aside from certain legal and regulatory questions and constraints discussed below) to provide a broad range of financial services.

3.1 Bank and Nonbank Payment Terminals and Outlets

The main market for branchless banking is retail payments, which until recently has been dominated by banks, particularly Sberbank (due to a regulatory monopoly, that has only begun to be relaxed relatively recently). As of November 2007, there were more than 100,000 **automated payment terminals** (both cash terminals and card terminals) and approximately 80,000 additional payment or "cash-in" outlets (for example, supermarkets and staffed kiosks).

Although some banks have set up their own networks of terminals,[12] a significant percentage of terminals are owned and operated by **nonbank payment service companies**. These terminals offer the possibility to make utility and other bill payments (e.g., television, internet), payments of rent, prepaid telecommunication services as well as repayments of consumer credit and other types of consumer services (e.g., internet shopping, ticketing) to approximately 400 different providers. A large majority of the nonbank terminals operate without any specific (i.e., agency) agreement with a bank although the Association of Russian Banks and others argue that the Banking Law and CBR instruction 1842-U require that any such payment service be provided by a bank or an operator pursuant to an agreement with a bank.[13]

According to estimates, the payment terminals have more than 50 million users across the country and process US$ 1.9 billion in retail payments per month in the Moscow region alone. CyberPlat, the largest payment processing system in Russia, has at least 70,000 "cash acceptance" points that processed 1.2 billion transactions worth US$ 4.7 billion in 2007. RIK Bank, which has at least 43,000 terminals, has approximately 40 million customers initiating 150 million payments per month. The explosive growth over the past two plus years in payment terminals and other outlets is viewed, in part, as a response to two related problems faced by Russian banks: overcrowded branches and the high costs of setting up a branch. Other factors spurring such tremendous growth include (i) the 2006 amendment to the Banking Law, (ii) the shutting down of automated gambling machines (many of which were reconfigured to function as payment terminals), and (iii) the high demand for cash due to strict accounting procedures and the peculiarities of the tax code. Today, in Russia, cash can be sold at a not insignificant premium (estimated by some to be 6 to 12 percent). This situation has led to a

[12] Banks are increasingly replacing staffed terminals with automated terminals that offer cash-in services. The reasons for this appear to be relatively high labor costs and the time-consuming process of handling small transactions, which was leading to delays in serving other customers.

[13] The Banking Law also limits the types of payments bank agents may make (i.e., only payments for utilities, rent and telecommunications). Article 13.1.

burgeoning grey market and the phenomenon of "encashment operations."

3.2 Russian Post

An interesting player in the branchless banking space is the **Russian Post**, which earns 46 percent of its revenue from financial services and has a network of 42,000 post offices with 29,500 in rural areas and 12,000 in villages with fewer than 500 people. (By contrast, the majority of bank points of service are concentrated in cities with a population of at least 50,000.) Post offices are used for domestic and – to a lesser extent – international money transfers, for accepting payments and paying out pensions to people without a bank account. The Post pays out 23 million pensions (60 percent of total pension payments in Russia) with an annual volume of US$ 30 billion. Although the Post is not permitted to act as agent for banks, the volume of banking loans repaid by Post (performing a type of money transfer service for individuals) in 2007 was estimated to be $7-8 billion.

3.3 Web-based E-Money Issuers

Another thriving sector is **web-based "e-money issuers"** (a term not yet defined under Russian law), which includes WebMoney, Yandex and Leader. Customers enter money into the system through banks, cash-in terminals and ATMs, the postal network, other web-based e-money systems (such as PayPal), and prepaid cards. The customer may use e-money for internet purchases, domestic and international money transfers, repayment of consumer loans, utility payments and other services. For the most part, customers are not identified and although some of the players state that they require notarized identity documents from customers, it appears that in fact this is only required if the customer is interested in making a transfer to a bank account or withdrawing funds from a bank. (For instance, with WebMoney, except for transfers to and from bank accounts, a customer is assigned a digital number but there is no assurance that the name entered by the customer is the customer's legal name.) These web-based e-money issuers have created a parallel settlement system in which customers can transfer funds with complete anonymity. It is not known how much money is actually circulating in this system, although WebMoney alone claims 3.6 million users and over 2 million transactions per month totaling approximately US$ 132 million.[14]

3.4 Mobile Network Operators

So far, only one of the three nationwide mobile network operators has demonstrated a significant interest in branchless banking. **Beeline**, one of the largest mobile operators,

[14] http://www.wmtransfer.com. In fact, WebMoney originally focused on Russian clients but now has users in 52 countries and enables customers to purchase "WM units" that have equivalence in six different currencies: Russian ruble, US dollar, euros, Ukrainian hryvnia, Belorussian ruble and Uzbek sum. Most recently (in the end of 2007), WebMoney purchased a non-bank settlement organization and provides WebMoney transfers through this institution.

together with Tavrichesky Bank, offers Beeline customers a prepaid financial product: PayCash Payment System**.** (In fact, the Tavrichesky Bank designed the product with the intention that it will be offered by various mobile operators.) Each Beeline customer opening a PayCash "account" signs an agreement with Tavrichesky Bank pursuant to which the customer agrees to deposit funds for her PayCash "account" into a designated account at Tavrichesky. (Although each customer must sign an agreement with Tavrichesky Bank, there is no requirement that she open a bank account.) This designated account is a pooled account for Beeline customers.[15] Individual "account" information is held by a processing center, which is a legal entity separate from Beeline and from Tavrichesky Bank. (Note that although Tavrichesky Bank intended to install bank employees in Beeline offices to conduct AML/CFT checks for customers who want to use the PayCash system to make retail purchases,[16] this plan is still in process and hasn't been completed yet). A customer pays a merchant for goods and services by placing an order with Beeline for the transfer of money to the merchant's Tavrichesky bank account. (Each merchant must also enter into an agreement with Tavrichesky Bank.) Customers can also do person-to-person transfers between each other's mobile phone accounts. Cash-in is possible through non-bank agents such as mobile phone payment outlets and payment terminals. PayCash is a pilot project which has not been advertised, yet according to Tavrichesky, 150,000 clients have signed up .

In contrast, many retail banks enable their customers to manage their accounts via mobile phone. For instance, there is a project involving Megafon (a nationwide provider with approximately 31 million subscribers), Sberbank and Visa International called "Verified by Visa." It offers the possibility of making payments from one's bank account in Sberbank via a mobile phone and is referred to by the sponsors as "a mobile wallet for electronic purchases." Last year, the Mayor of Moscow announced that Muscovites will be able to pay for their metro and possibly other public transportation using mobile phones. (The service would be pursuant to an agreement among Nokia, Visa International, the Moscow Metro and the Bank of Moscow. As of today, only particular Nokia phones would be able to be used, although it is expected in the future that other phone brands will also offer the service.) This service has not yet been implemented.

3.5 Moscow Social Card

In 2001, a joint project between the Bank of Moscow, the Moscow Government and Visa developed the "**Moscow Social Card**." (This card is one of many such cards that have been set up by municipalities in Russia.) The card allows for the redemption of social benefits, discounted travel on the Moscow Metro, and access to medical benefits. The card, which is issued to pensioners, students, schoolchildren, war veterans and other eligible people, carries a contactless chip, a bar code and magnetic strip, along with the

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[15] If the customer's agreement with Tavrichesky Bank is terminated, the customer must make a written request to use her PayCash balance to pay for Beeline mobile services. There is no provision in the model agreement requiring Tavrichesky or Beeline to refund the funds remaining in the account to the customer.

[16] Certain transactions below a specified amount are exempt from AML/CFT requirements, as discussed in Section 4.4 below; retail purchases are not exempt regardless of transaction size.

VISA Electron payment application issued by the Bank of Moscow. More than three million cards have been issued so far although only 18 to 20 percent of customers have activated the payment function of the card. (Some of the cardholders receive cash deposited on the card; the cardholder can withdraw the cash at any ATM that is part of the network of ATMs accessible by the card or use the card to make payments if the cardholder has activated the payment function.)

4. Legal and Regulatory Challenges to Branchless Banking

In Russia, branchless banking has the potential to increase poor people's access to financial services if, among other important preconditions,[17] regulation: (*a*) permits the use of a wide range of agents for a variety of services offered outside bank branches, thereby increasing the number of service points; (*b*) eases account opening (both on site and remotely) and customer identification and reporting requirements for all types of financial transactions while maintaining adequate KYC standards[18] and (*c*) permits a range of players (subject to appropriate supervision) to provide payment services and to issue e-money, thereby enabling innovation from multiple sources.

Banks' Use of Agents

Art. 5 of the Banking Law defines banking operations to include deposit-taking, crediting and investing deposited funds, opening bank accounts, clearing payments, collecting cash, bills and payment documents, buying and selling of foreign currencies, and remittances by individuals (who may or may not have a bank account). Unless the law provides otherwise (see below), any activity falling under the definition of one of the banking operations requires an institution to be licensed as a "credit organization," a term which, as used in the Banking Law, includes banks and non-bank credit organizations. As a result, many activities which in other countries are routinely undertaken by institutions falling outside the banking law – such as foreign exchange transactions and payment services – are, in Russia, in the exclusive domain of credit organizations licensed under the Banking Law.

In June 2006, the Banking Law was amended to permit commercial organizations operating without a CBR license to act as a bank agent "to remit money on the instruction of an individual without opening a bank account" (Article 13.1), subject to certain limited conditions. (Such organizations are referred to hereafter as "Article 13.1 organizations.") Specifically, an Article 13.1 organization may (i) accept cash from a natural person at the organization's place of business or at the *stationary location* of an

[17] In Russia, as elsewhere, appropriate regulation is only one of the necessary prerequisites for branchless banking to reach scale both quickly and with a manageable level of risk. The business case for branchless banking and client up-take are at least equally important prerequisites.

[18] The Financial Action Task Force (FATF) sets international AML/CFT standards and oversees compliance monitoring. It calls for national-level regulatory regimes to require that adequate CDD/KYC be undertaken on all new accounts and on once off cash transactions *over designated thresholds*. (Recommendation 5.) FATF permits, but sets limits, on outsourcing of CDD/KYC compliance (Recommendation 9); FATF also permits non-face-to-face business relationships and transactions (Recommendation 8).

affiliate and (ii) make payments on the persons' behalf to one of three types of service providers (telecommunications services, housing or utilities) at the service provider's bank or other credit organization. As it is not a commercial organization, the Post may not act as agent for banks under Article 13.1 (nor may any nonprofit MFI). The recently adopted CBR Instruction 1842-U prohibits agents operating under Article 13.1 from using sub-agents.

It is unclear what the impact of Article 13.1 will be. Aside from the question of whether others – such as nonbank PSPs - may engage in payment services without the involvement of a bank (as discussed in Section 4.2), it is not clear whether Article 13.1 absolutely limits the permitted activities of banks' agents to payments only (meaning that none of the other banking operations listed in the Banking Law could be carried out by agents).

CGAP Suggestions:

In order to maximize the potential for branchless banking, the Banking Law should be amended (i) to permit agents to engage in a wider array of services, such as loan processing and disbursements and deposit collection and (ii) to eliminate the limitations on those to whom bank agents may make payments and permitted payers (i.e., not just individuals). In addition, Instruction 1842-U, which does not appear to serve a useful function, should be revoked, especially given the language which permits the use of sub-agents to ensure the possibility of expanding outreach. Risk should be managed by imposing bank liability for agent actions and empowering regulators to supervise agent operations.

The government should permit post offices to operate as bank agents as a means of extending bank services to remote unbanked populations. Although initially the post office may be the most effective way of rapidly expanding banks' use of agents, it is important to consider the possibility and utility of having a broad range of actors serve as bank agents.

Payment Systems Regulation

Under law, the Central Bank has, as one of its three stated objectives, to ensure an efficient and uninterrupted payments system.[19] However, there is no payment systems law in Russia.

Until the June 2006 amendment to the Banking Law, many argued that providing payment services was the exclusive domain of banks and the Russian Post. (The Russian Post is exempt from the requirement to have a bank license when offering money transfer and payment services) As stated above, the 2006 amendment to the Banking Law enabled banks to outsource certain payment services (i.e., payments by natural persons to three types of service providers - telecommunications services,

[19] Art. 3 of the Federal Law on the Central Bank. The other two objectives are (i) to protect and provide for a stable national currency and (ii) to develop and consolidate the Russian banking system.

housing and utilities - at the service provider's bank or other credit organization). All other payments services, including domestic and international money transfers, arguably may still only be provided by prudentially regulated credit organizations or the Russian Post.

Notwithstanding the amended Banking Law, nonbank PSPs arguably operate pursuant to the Civil Code – specifically, the provisions on agency. The Civil Code permits a principal to delegate duties to an agent who is then authorized to act in the name of the principal.[20] There is no limitation in the Code on the services that can be contracted to an agent although there is specific provision permitting an agent to engage in payment collection on behalf of the principal. Initially, when mobile network operators started using agents to collect payments on the companies' behalf, they relied on the Civil Code.[21] These agents eventually began collecting payments for multiple companies, including companies not engaged in telecommunications.[22] Today, such companies operate both manned outlets as well as payment terminals. (In effect, a payment terminal is an unmanned version of a collection agent with ties to multiple principals.)

Some argue that the Banking Law's provisions (specifically, Article 13.1, requiring that a bank be involved if an agent is collecting payments on behalf of a service provider) trump the general agency provisions of the Civil Code. Others argue that the Banking Law and the Civil Code are of equal stature under the Russian legal system and that the Civil Code permits a principal to engage an agent to collect payments on the principal's behalf without requiring the involvement of a bank. The Association of Russian Banks has drafted a letter requesting clarification of the import of Article 13.1. Specifically, the letter requests MinFin and the CBR to clarify that aside from payments to mobile phone companies (which are permitted to receive payments via agents pursuant to rules issued by the MoITC[23]), an agent may only collect payments pursuant to Article 13.1.

The recently adopted CBR Instruction 1842-U requires any company acting as a

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[20] Chapter 52, Sec. 1005.

[21] Today, mobile operators can also rely on various legal rules providing the operator with the right to engage an agent both to sign an agreement on behalf and at the account of the operator and to perform settlements with clients on behalf of the operator. Rules of Provision of Mobile Communications, approved by Decree of the Government of the Russian Federation # 328 on 25 May, 2005; Rules of Provision of Communication Services for Data Transfer, approved by Decree # 32 on 23 January, 2006; Rules of Provision of Local, Intra-Zone, Country and International Long-Distance Telephone Communications, approved by Decree # 310 on 18 May 2005; Rules of Provision of Telematic Communication Services, approved by Decree # 575 on 10 September, 2007.

[22] In contrast to the arrangement under the Banking Law, which involves four parties – the payer, the agent, the bank, the payee – the Civil Code arrangement has only three. Under the bank arrangement, the payer's obligation is discharged not when she makes the payment to the agent but when the bank receives the payment. (This point was clarified in the amendments to the Consumer Protection Law adopted in 2006 along with the amendments to the Banking Law.) In contrast, with the nonbank arrangement, the payer's obligation is satisfied (to the extent of the payment) when the agent collects the funds from the payer.

[23] The position of the letter is questionable as these rules, which are inferior to legislative acts under the Russian legal system, cannot modify something provided or required by law.

payment agent without a banking license to enter into an agreement with an institution licensed under the Banking Law. However, given the lower status of a CBR Instruction as compared with a duly enacted law, the import of the instruction on non-CBR licensed institutions would depend entirely on the answer to the question framed above: whether the Banking Law should be interpreted to trump the Civil Code or vice versa.

CGAP Suggestions:

As the Ministry of Finance has suggested, Russia would benefit from a national payments system law. This law would clarify the situation of nonbank PSPs. In addition, the law could authorize the CBR to set minimum requirements for the establishment and operation of nonbank PSPs, including requirements for minimum capital and liquidity and restrictions on permissible investments and reporting requirements. In addition, the legislation could authorize the CBR to conduct on-site inspections of nonbank PSPs (as it is already authorized to do with respect to banks and credit institutions providing payment services).

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Regulation of e-Money

Russia has no laws, regulations, or policies defining e-money or specifically governing e-money and the transfer of or payment by e-money. CBR has an agenda to define what constitutes e-money and how it is issued, and to determine whether to regulate e-money under existing banking regulations or under some other authority.

In the meantime, e-money issuers defend e-money issuance over the internet and by mobile service operators by arguing the applicability of a variety of laws. For example, WebMoney, which describes the transfer of e-money as an "agreement on property rights transfer by means of digital units," has invoked a 1929 Russian decree as the legal basis for issuing e-money. Some have argued that a bank may issue e-money as a "virtual" card pursuant to a 2004 Central Bank instruction which permits a bank "to issue a bank prepaid card (or other card) in electronic form."[24]

CGAP Suggestions:

CBR has already specified its agenda for e-money: define e-money and who can issue it, designate a regulatory authority and regulatory provisions. Branchless banking would benefit from the establishment of clear lines regarding the roles of the bank regulator and the telecommunications regulator as well as clear, safe and secure modes of transacting e-commerce. E-money regulation should be proportionate to the risks involved. Non-credit organizations that issue e-money (including the existing web-based e-money issuers) should be subject to requirements such as per-customer maximum transaction and e-money balance

[24] Regulation No. 266-P, "On the Issuance of Bank Cards and on Transactions Carried Out with Payment Cards" dated December 24, 2004, as amended through September 21, 2006.

caps, liquidity and solvency protections, and the holding of net e-money proceeds in trust for customers.

AML/CFT

AML/CFT issues are regulated under the 2001 Federal Law on Countering the Legalization of Illegal Earnings (Money Laundering) and the Financing of Terrorism ("AML/CFT Law"). The AML/CFT Law applies to a number of institutions, including credit organizations, the postal network and Article 13.1 exempt organizations.[25] The statutory AML/CFT control obligations are not imposed on mobile phone providers, although there are limited customer identification requirements under the Law on Communications. Because the AML/CFT Law **applies to institutions and not functions**, payment system providers and e-money issuers are only covered under the law if they operate under any of the legal forms mentioned.

KYC rules can be found in the AML/CFT Law itself and in regulations and instructions issued by the Federal Service for Financial Markets (FSFM) and CBR. Subject to certain exemptions described below, the law requires, among other things, that subject institutions (i) identify the customer through government issued identity documents and (ii) establish the customer's residential address.[26] A CBR instruction on account opening by credit organizations requires that an **official from the credit organization personally carry out the identification** of the client, thereby prohibiting remote account opening and requiring the client (or his or her representative) to be physically present in a bank branch to open an account.[27] (This is not a requirement under the AML/CFT Law itself.) This Instruction excludes the possibility of a credit organization opening an account through a bank agent.

The AML/CFT Law exempts certain payments by natural persons below Rb. 30,000 (approx. US$ 1,280) from mandatory identification requirements. Among the list of transactions exempted are rent, telecommunication and utility payments as well as tax payments and other payment to government bodies.[28] Buying and selling of foreign exchange is also exempted from KYC if the amount is below Rb. 15,000 (approx. US$ 640).[29] All domestic and international money transfers are subject to the general KYC requirements under the AML/CFT Law as long as they are provided by credit organizations or the Russian Post.

All institutions covered under the AML/CFT Law must **report all "mandatory controlled transactions" as well as any suspicious transactions to the Federal Financial Monitoring Service** (established in November 2001) by the end of the next working

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[25] Art. 5 of the AML/CFT Law.

[26] Art. 7 item 1 of the AML/CFT Law.

[27] Instruction 28-I, Art. 1.7

[28] Art. 7 item 1.1 of the AML/CFT Law.

[29] Ibid, Art. 7 item 1.2.

day.[30] In the year 2006, eight million transactions were reported, of which 1,500 were investigated. This led to 120 criminal cases and ultimately 15 court sentences.

CGAP Suggestions:

The current KYC rules for account opening and financial transactions risk making access-enhancing branchless banking models unduly costly or even impossible. It is proposed that the FATF framework for a risk-based approach should be implemented:

1. *Allowing simplified KYC requirements for low risk, low value accounts and low risk financial transactions below a stated maximum.*
2. *Permitting the remote opening of bank accounts to facilitate banking among isolated populations who find it difficult to reach a bank branch. The risk associated with such accounts could be minimized through balance, transaction and other appropriate restrictions.*
3 *Permitting agents to facilitate the opening of low risk, low value accounts and the performance of KYC procedures.*

In addition, to address the problems with anonymous cash transfers, it will be advisable either to expand the range of institutions covered by the AML/CFT Law or to focus the application of KYC procedures on the functions performed rather than the type of institution.

Other Issues Relevant to Branchless Banking

Consumer protection is covered under the Consumer Protection Law, which includes amendments adopted simultaneously with the 2006 amendment to the Banking Law. These amendments ensured consumers the same protection in their transactions with bank agents as they would have in their transactions with banks. Among other things, this law specifies certain minimum requirements for the remote sale of commodities, which also apply to e-commerce.[31]

Data privacy and protection issues are regulated by the Law on Personal Data Protection, which requires handlers of personal data to ensure that any international transfer of personal data is to a jurisdiction which adequately protects the rights of the individuals whose data was transferred (unless the individual otherwise consents).[32] This law, however, is not fully operational as the supervisory authority (the MoITC, which has established a particular division for this purpose) has yet to take any enforcement action. In addition, the Banking Law requires employees of a credit organization to keep secret transactions, accounts, and deposits of its clients and correspondents, as well as

[30] Ibid, Art. 7.4. Mandatory controlled transactions apply only to transactions involving more than RUB 600,000 (approx. USD 24,500).

[31] Art. 26.1 of the Federal Law on the Protection of Consumers' Rights No. 2300-I.

[32] Art. 12, Federal Law No. 152-FZ on Personal Data.

any other information specified by the credit organization.[33]

Competition issues are dealt with by the Federal Antimonopoly Service (FAS), which has authority over all sectors of the economy. The FAS is closely following changes in the competitive landscape in banking caused by the use of information and communications technology. Concerns include the still dominant market position of Sberbank and the high concentration of bank operations in a few cities and regions leaving other areas severely underserved. In contrast to the banking sector, the telecommunication sector is seen as being highly competitive.

[33] Art. 26 of the Law on Banking and Banking Activities.

List of Persons Met

Organization	Participants	Designation
RF Central Bank	Sukhov Mikhail Igorevich	Member of the CBR Board; Director, Department of Licensing
	Voronin Boris Borisovich	Chief, Central Catalogue of Credit Histories
	Simanovsky Alexei Yuryevich	Member of the CBR Board; Director, Department of Banking Regulation and Supervision
	Odintsov Andrey V.	Deputy Director Department for Financial Monitoring and Foreign Exchange Control
	Shamraev Andrei V.	Settlement Regulation Department
	Kuznetsov Vadim	Settlement Regulation Department
RF Ministry of Finance	Savatyugin Alexei Lvovitch	Director, Department of Financial Policy
	Lukov Vladimir Valentinovitch	Deputy Director, Department of Financial Policy
	Satina Natalia Antonovna	Head of Banking Division of the Department
RF Ministry of Economic Development and Trade	Popova Anna Vladislavovna	Director, Department of Corporate Governance
	Menshikova Anna Sergeevna	Head of corporate and financial legislation subdivision
	Skripichnikov Dmitry Valerievich	Deputy Director, Department of Corporate Governance
	Gritsay Olga	Corporate and financial legislation subdivision
RF State Duma	Aksakov Anatoly Gennadyevich	Deputy Chairman, Committee for Credit Institutions and Financial Markets
RF Federation Council	Vassilyev Sergey Alexandrovich	Chairman, Committee for Financial Markets and Currency
RF Ministry of Information Technologies and Communication	Vasiliev Eugeny Sergeevitch	Head of “Mobile Commerce” Committee
	Paramonov Leonid S.	Head of Division for innovations
Federal Anti-Monopoly Service (FAS)	Tsyganov Andrei Gennadyevich	Deputy Chief
	Bondareva Julia	Head Department for control and supervision over financial services market

Organization	Participants	Designation
International Confederation of Consumer Societies (ICCS)	Yanin Dmitry Dmitryevich	Chair of the Board (Director)
Federal State Unitary Enterprise "Russian Post"	Mandrykin Igor Anatolyevich	First Deputy CEO
	Pavlenko Elena Anatolievna	Financial Coordinator of the Commercial Programs Direction
	Kouzmin Alexei V.	Deputy CEO
Beeline (Vympelcom)	Markelov Victor	Product Director
VTB24	Suchkov Sergey Valeryevich	Chair of the Board, Director, Department for SME Lending
	Vorobyev Vyacheslav Victorovich	Deputy Chair of the Board, Retail Business
Forus	Schrader Stacey	Chair of the Board
Russkij Investment Club	Yevdakov Kirill Vladimirovich	Partner
	Solonin Sergey A.	Chairman of Board of Directors
	Panferova Maria	Vice Chairman of the executive Board
Citibank	Nikolayeva Natalia Yurievna	Vice President
Microfinancial Center (MFO)	Sigal Pavel Abramovich	President
Delta Systems	Yarynich Mikhail Vassilyevich	Deputy CEO

Organization	Participants	Designation
Industrial Credit Bank (InCredBank)	Sinitscin Sergey Petrovitch	Deputy Chairman of the Board
	Lefler Yana	Chairman of the Board
	Vilkul Olga	First Vice-President
Rosbank	Korolchenko Igor Vladimirovitch	Marketing Division Head
	Skorobogatova Olga N.	Director Retail Operations Departament
	Khvostikov Anatoly	Head of SME Department
Russian Woman Microfinance Network (MFO)	Gvozdev Leonid	CEO
Eleksnet	Maltsev Yuri Valentinovich	President
Moscow Social Card Issuer “ROSAN”	Bystrov Leonid	Deputy Director
VISA International	Naumovski Lou	Chief of Representative Office
	Vishnyakov Dmitry	Chief of Public Affairs Department
IFC	Mr. Telma Tomasz	Principal Banker
	Bourganskaia Elena	Principal Investment Officer Central and Eastern Europe Department
Tavrichesky Bank	Shishlo Andrei Mikhailvitch	CEO of Bank’s Processing Center LLC “Mobilnye Platezhnye Sistemy”
Non-Banking Credit Organization “Network Clearing Chamber”	Yarmolinsky Sergey Vladimirovitch	Chairman of the Board
Web-Money	Darahvelidze Piotr G	External Relations Director
	Belenkaya Eugenia Yu	Senior manager of development’s division

Organization	Participants	Designation
	Boryatinsky Victor A.	Board Chairman's Advisor
Fair Play	Trubetskaya Anna	Chief of Marketing Dept
Association of Russian Banks	Emelin Andrew V.	Doctor of law sciences executive vice-president
	Shipilov Valery V	Executive Director
	Tosunyan Garegin A.	Professor, Doctor of Law Sciences, President
Finance Media	Salnikov Denis Mikhailovich	Director
ITAR TASS	Aitov Timur	Adviser