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11 October 2012

Subject: Comments on *From Remittances to M-Payments: Understanding "Alternative" Means of Payment within the Common Framework of Retail Payments System Regulation*

Dear Ms Chimienti,

The WB/CPSS paper *From Remittances to M-Payments: Understanding "Alternative" Means of Payment within the Common Framework of Retail Payments System Regulation* is a timely and important paper. Too many financial regulators have approached mobile payments as sui generis and therefore demanding entirely new regulatory frameworks to accommodate them. This has had a number of deleterious effects. It has delayed the introduction of such services in many countries while regulators have struggled to develop novel regulatory approaches from scratch. It has also led a number of regulators to issue guidelines that pertain specifically to mobile payments, an approach that, among other shortcomings, is unlikely to be durable given the pace of technological change.

In fact, the innovations in mobile payments and mobile banking with policy relevance have to do with channels: the use of third-party agents for the delivery of services and the use of mobile technology as a means of communicating with users (and/or agents). As such, we might expect that the main task of financial regulators when confronted with mobile banking and mobile payments would be to focus very narrowly on whether they have appropriate rules and supervisory capacity in place to govern the use of these channels in financial services.

But this has not been the case, for the simple reason that the emergence of mobile payments has exposed significant deficiencies in the overall framework of retail payment systems regulation in many developing countries. The paper dwells on the EU Payment Services Directive to demonstrate that new

mobile payment business models can easily be accommodated by such regulation. But the fact is that most developing countries have no equivalent in either legislation or regulation. So while it is true that there is no call "to depart from the basic principles of regulation of the retail payments sector," it is the case that these principles have not yet found their way into policy in many developing countries—the very places where mobile payments have the most potential.

What is needed in many cases, then, is an overarching framework for the regulation of retail payment systems. As the paper implies in Section 4.3, it is crucial that this framework embrace the role of nonbanks as participants. In every advanced economy, nonbanks are constructive players in retail payments. They play a valuable role in strengthening competition by providing an alternative to banks. And they often have distinctive capabilities or assets, such as distribution networks, that can be leveraged to offer services to customers at lower cost—thereby fostering participation in the formal financial system.

By pursuing this vision, developing counties can create space not just for mobile payments, but also for a wider range of payment instruments and services that enrich the lives of consumers and strengthen the financial system. Too often in the discourse about financial inclusion, forbidding nonbanks from offering payment services is described as a "choice" without serious consequences. But in fact excluding nonbanks retards competition, innovation, and inclusion.

Section 1.1

The description of the four archetypal forms that mobile payments can take in is useful. However, the description of the last two forms and the terminology used to describe them can be clarified.

If I understand the distinction that the authors intend, the third service is one in which customer money is fully "collateralized" by ring-fenced deposits made at a regulated bank (ideally held in trust), while the fourth is one in which customer money is not necessarily so collateralized. In the latter case, customer money might not be held a bank account at all; even if it is, those deposits will not be sequestered and might be used, for example, as working capital by the issuer.

First, it is important to emphasize that the GSMA is unaware of any mobile payment service offered by a network operator along the lines of the fourth archetype. The segregation and matching of customer funds as described in the third category is considered to be one of the most important prudential requirements of mobile money services, and, where e-money regulation does exist, the requirement that e-money they issue be fully collateralized by deposits in a regulated bank (ideally held in trust) is central. This ensures customers can always retrieve the money they have stored in the system, even if the issuer itself were to go out of business.

Given this, it is a bit confusing to invoke the term "e-money" to describe the fourth service and not the third, even though, of course, it is literally the case that both entail "electronic money" of a sort.

It is also important to be clear on the topic of "production of money," since in our experience this is an area of significant confusion and concern on the part of policymakers. In both the third and fourth cases, money creation may occur, but through different mechanisms. In the third case, banks holding pooled or trust accounts intermediate such funds just as they do with other deposits. This engenders money

creation, but on exactly the same terms, and at exactly the same scale, as when customers deposit their money directly into a bank account. In the fourth case, the production of money can also occur, but if it is effected by the issuer itself (and not a bank), it is subject to none of the ordinary oversight and controls to which banks are.

As the discussion above suggests, the fourth model entails significantly more risk than the third; also there is no evidence of its existence. Clarifying these points would be helpful.

Section 1.3.1

The issues highlighted regarding fund protection are warranted but it would be useful to link these issues to the risk mitigation techniques which are often used in the models highlighted in Section 1.1. Namely, ring fencing of funds, 100% capital requirements against account liability etc. In regards to the link between m-payments and remittances, this section (1.3.1) makes an accurate association between the two. However, the previous discussion of models went beyond payments and implied the use of deposits and stored value. It would be useful to make a distinction at this juncture to confusion and allow the reader to associate the appropriate risks with the respective service (i.e. payments vs stored value).

Section 1.3.2

The issues regarding interoperability among payment services are more complex and less straightforward than this section suggests. Given that the scope of this paper does not permit a full discussion of these issues, many readers will likely find the assertion that nonbanks "should" ensure interoperability unsupported.

Section 1.3.3

The need for agents to be appropriately vetted is an unquestioned reality for safe reliable distribution networks. Regulators are often burdened by the assumption that this falls within their responsibility. Given that the paper notes that regulated financial institutions should be held responsible for operational risks (i.e. outsourcing) then it may be important to mention that although agents should be vetted, this responsibility can (and should) fall to the regulated entity. Compliance with agreed vetting standards would then fall within the regulatory authority's supervision and oversight responsibility, rather than approval or authorization of agents.

Section 2.2

The paper dwells on the distinction between payment and e-money institutions. It omits, however, perhaps the clearest way to distinguish between them: since both are expected to execute payments within one day (Article 43), only e-money issuers are permitted to store customer funds in their own accounts for longer durations. Payment institutions are expected to deliver them up to customers immediately. Under these circumstances, the paper would benefit from a brief description upfront on the distinction between payments, e-money/stored value, and deposit taking. This context is

fundamental to appreciating the various regulatory approaches and highlights the distinction between the different models discussed in Section 1.1.

Section 2.3

This section makes reference to capital requirements only in passing. However, since this is one of the more curious elements of the Directive, they are perhaps worth remarking upon. Banks are subject to capital requirements to ensure they do not take on excessive leverage using customer deposits. But given that the Directive requires payment institutions to safeguard customer funds by sequestering them and protecting them from the institution's creditors in the case of insolvency, the imposition of capital requirements is redundant or, at the very least, motivated by different concerns that those which justify capital requirements for institutions engaged in intermediation of funds.

Section 3

The EU Payment Systems Directive is one of the most thoughtful frameworks for the regulation of retail payments in the world, making it a useful benchmark for regulators struggling to cope with emerging payment schemes. The General Principles for International Remittances are perhaps less illuminating in that (1) as principles, they are rather more abstract than the Directive, which is written to be directly translatable into national policy, and (2) they pertain principally if not exclusively to payment services that take custody of customer funds only for the duration of the execution of the payment, whereas the Directive also encompasses services that store customer funds for a longer duration.

In this sense, there is an important conceptual continuity between the Directive and the Principles, and as such we should expect that the Principles would be largely in harmony with those principles that animate the policies pertaining to payment institutions set forth in the Directive. (Indeed, a useful exercise would be to identify the ways, in any, in which there appear to be conflicts between those principles that are implicit in the Directive and explicit in the WB-CPSS study.)

If we consider the EU to be a single regulatory jurisdiction, then the real insights that can be gleaned from the WB-CPSS's work are the special challenges of regulating cross-border services and transactions, which are indeed significant. However, the nature of these services and transactions themselves are not much different whether they are undertaken within national borders or across them.

Thank you for your consideration.

Sincerely,

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