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FOCUS NOTE

Protecting Branchless Banking Consumers: Policy Objectives and Regulatory Options

No. 64
September 2010

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In ever larger numbers, poor people in developing and emerging market countries are accessing financial services offered by formal providers outside of traditional bank branches. In Kenya, M-PESA provides money transfer services and the equivalent of a small balance transaction account to more than 12 million customers through cell phones and a network of over 16,000 agents. In Brazil, over 170,000 agent points, such as pharmacies, deliver a wide array of services on behalf of banks, processing approximately 2.5 billion transactions a year. Wal-Mart Bank in Mexico is using 1,000 Wal-Mart stores (totaling 18,000 points of sale) as agents to offer its clients financial services, including deposits and payments. These are not isolated examples, but rather evidence of how transformational branchless banking is rapidly changing the access to finance landscape.[1] Giving unbanked and underbanked people the opportunity to access a full range of needed formal financial services could be a significant step toward more equitable and efficient financial markets.

As with conventionally delivered financial services, consumers using branchless banking services face risks and challenges as well as benefits. Transformational branchless banking heightens the consumer-related concerns of regulators and supervisors because it combines the use of agents and technology-enabled devices to serve large numbers of less educated and inexperienced customers, potentially in a short period of time. However, even in markets where they have achieved massive scale, the benefits of such innovative models seem so far to outweigh the risks for consumers.

Regulation—whether created at an early stage or after new models are fully operational—should obey two principles: proportionality and effectiveness. Poorly designed or timed regulation can impede responsible providers from entering and competing profitably and on a level playing field. A well-balanced approach would recognize the trade-offs between protecting consumers and fostering financial access. It would be designed and implemented to address in a proportional manner the consumer risks inherent to the emerging models in that particular jurisdiction. It would also consider the supervisory capacity and other market monitoring tools necessary to ensure adequate regulatory compliance. Regulation can require providers to adopt common measures to protect consumers; ideally providers will have nonregulatory core business incentives to do so as well. In competitive markets, this means building a solid reputation and good levels of public confidence and satisfaction so as to attract and retain clients.

But how can these goals of proportionality and effectiveness be achieved? What priorities and trade-offs should policy makers, regulators, and supervisors focus on? Little has been published on consumer protection in branchless banking, despite increasing regulatory interest and action. This Focus Note seeks to shed light on these questions, drawing from CGAP's ongoing work on branchless banking. It shares insights gained from studying the regulatory and institutional setup for financial consumer protection in four countries—Brazil, India, Kenya, and Peru—and draws from the experience of other countries, such as the Philippines, South Africa, Russia, Colombia, and Mexico, as well as recent consumer experience research. Since each country context calls for a customized approach, our objective is not to prescribe uniform measures; rather, this Focus Note discusses policy objectives and regulatory options to achieve such objectives.

1 According to Porteous (2006), branchless banking can be either additive or transformational. It is additive when it merely adds to the range of choices or enhances the convenience of existing customers of mainstream financial institutions. It is transformational when it extends to customers who would not be reached profitably with traditional branch-based financial services.

Which concerns trigger consumer protection regulation in branchless banking?

Portfolios of the Poor (Collins, Morduch, Rutherford, and Ruthven 2009) documents how poor people struggle to manage their financial lives given the lack of services suitable to their tiny, highly variable, and uncertain incomes. The research builds a powerful case for innovation and expansion of appropriate financial services for the poor. Experience to date suggests that branchless banking models can play a part in delivering better, safer, and more reliable services than those usually available to the poor.[2]

Some regulators may perceive that financial services delivery through branchless channels and nonbank providers is higher risk than traditional banking. In the M-PESA case in Kenya, an innovative business model emerged and scaled rapidly in a safe manner, in the absence of an elaborate consumer protection framework. This challenges the perception of risk and the premise that substantial consumer protection rules are a precondition for healthy development of branchless banking.[3] The Kenya case suggests that there can be providers that have their own (nonregulatory) incentives—such as reputation and the need to build trust in the market for a new service—to act responsibly. M-PESA and other such providers have offered services transparently and adopted safeguards to protect consumers, including those with little or no prior experience with formal providers.

Regulators can use the alignment of policy goals with providers' incentives for responsible behavior to their advantage in the initial phase. Rather than developing detailed rules, regulators can prioritize screening providers at entry, monitor the market for potential consumer protection concerns, and interact closely with early movers if problems arise. This approach can be particularly appropriate at early stages of market development and in low-access countries, where capacity constraints and the opportunity costs of regulating and supervising are likely to be higher. However, as the market grows, the number of users accelerates (sometimes very rapidly),[4] and new providers emerge, the case for regulatory action becomes more compelling. It is necessary to set common minimum standards for a variety of providers offering similar services and to encourage the emergence of a healthy competitive market. It may be the market leaders, such as M-PESA, that develop market conduct standards that are then codified into the rules. The standards will, in turn, facilitate more consistent monitoring by financial and consumer protection authorities.

In some jurisdictions regulators and policy makers may be motivated to act at an early stage so as to introduce sufficient legal certainty for private investors. They may also experience pressure from other stakeholders, such as politicians and consumer rights bodies. In many cases the main question is not *whether* to regulate or not, but *how* and *when* to regulate consumer protection. This paper intends to provide guidance to those who, regardless of the motivating factors, are planning, drafting, or modifying their regulations. The focus is on identifying consumer risks and how they can be addressed and reconciled with financial inclusion objectives.

Balancing innovation and protection: Policy objectives and regulatory options

Branchless banking is not new.[5] What *is* new is the rapid expansion of services to large numbers of previously unbanked and low-income people who often migrate from informal services directly to electronic transactions offered by formal providers. Striking a balance between openness to innovation

2 So far, services available through branchless banking models are largely limited to payments and money transfers.

3 According to Lyman, Pickens, and Porteous (2008) consumer protection regulation is a "next generation" issue in branchless banking that is important for its success and sustainability, while flexible anti-money laundering regulations and permission to use agents are preconditions for the emergence of transformational branchless banking.

4 M-PESA users, for example, grew from 0 to over 12 million in less than four years, rapidly surpassing the total number of bank account holders in Kenya.

5 For instance, the Basel Committee on Banking Supervision (BCBS) has been issuing pronouncements on electronic banking since 1998, and the Committee on Payment and Settlement Systems (CPSS) has done so since 1996.

and consumer protection may require approaches and rules different from those traditionally used, as regulators are likely to witness the emergence of new business arrangements with different economics.

From a regulatory and supervisory perspective, the key risks of branchless banking derive from the extensive use of outsourcing—more specifically the use of agents[6]—and technology-enabled devices, such as mobile phones. It is worth looking at how the Basel Committee relates outsourcing to consumer risks, since supervisors around the world adopt the Basel guidelines in their oversight.

The framework shown in Table 1 illustrates how regulators and supervisors can evaluate the risks of new businesses relying on outsourcing and having potential to scale up rapidly. The decision of when, and how to regulate will be more precise if it is informed by first, analysis of providers' incentives to adopt acceptable business practices, and second, monitoring of actual consumer issues.[7]

The consumer issues identified in our research[8] correlate with seven policy objectives (see Figure 1). The priorities, as well as the approach to implementation of regulatory and nonregulatory measures to achieve each objective, will differ from country to country, according to the emerging models and types of services being offered, the prudential framework, the level of financial system development, and the alternatives currently available to low-income and unbanked consumers.

1. Protecting client funds held as electronically stored value

Protecting client funds is a priority for any financial regulator, as loss of funds can have serious consequences for customers, as well as for public confidence in financial systems. Banks are usually required to comply with prudential rules created to ensure systemic stability and depositor protection. Bank deposits also are covered by insurance in many jurisdictions. In addition, governments may provide an implicit guarantee to bank depositors, especially when banks are systemically important. However, in

Table 1. Risks in outsourcing and consumer-related concerns according to the Basel Committee on Banking Supervision

Outsourcing risk (selected)	Major concerns (selected)
Strategic risk	-Failure to implement appropriate oversight of the outsource provider -The third party may conduct activities on its own behalf that are inconsistent with the overall strategic goals of the regulated entity
Reputation risk	-Poor service from third party -Consumer interaction is not consistent with overall standards of the regulated entity -Third-party practices not in line with stated practices (ethical or otherwise) of regulated entity
Compliance risk	-Privacy laws are not complied with -Consumer and prudential laws not adequately complied with
Operational risk	-Technology failure -Fraud or error

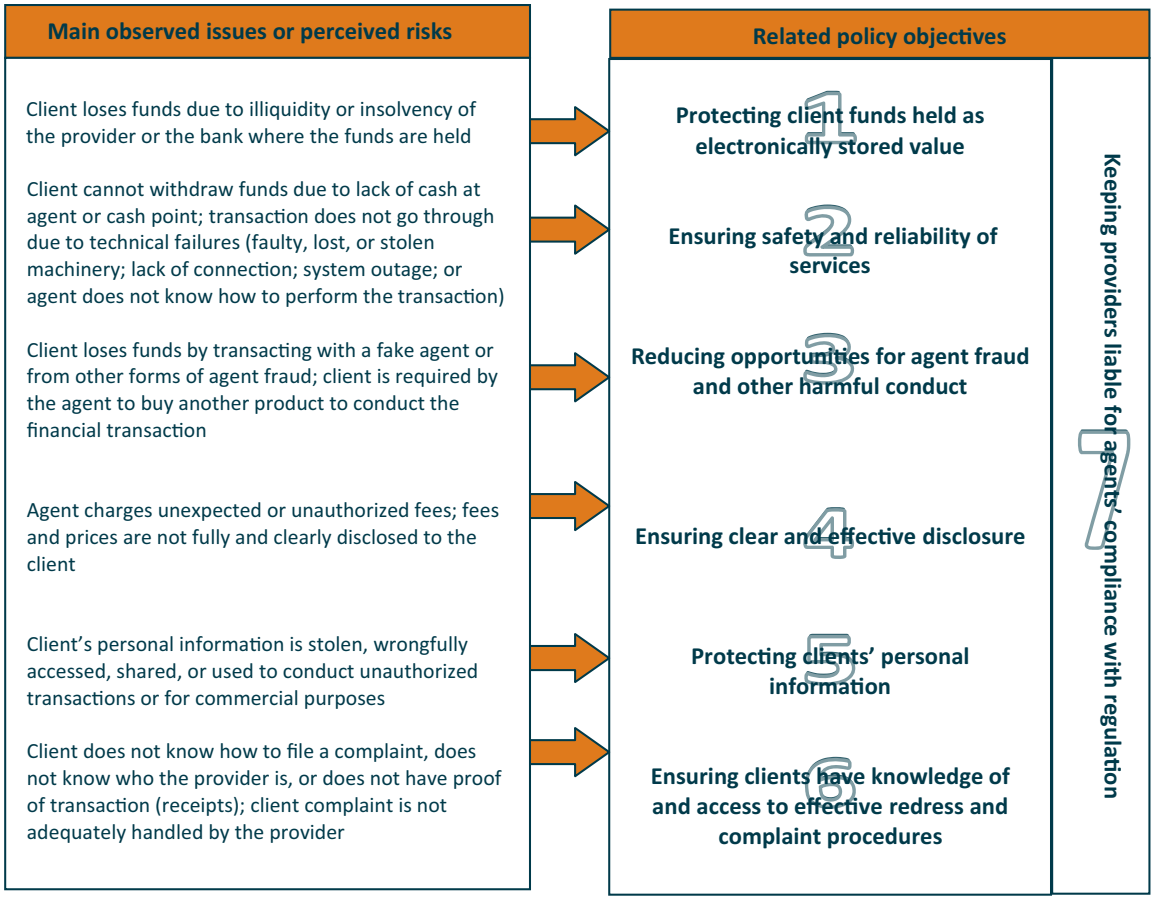
Source: BCBS (2005)

6 Not all outsourcing involves use of agents, but using agents is a type of outsourcing. Moreover, third parties involved in service delivery, such as retail outlets, may not be agents in the true legal sense in some business arrangements or in some jurisdictions. The word "agent" is used in this Focus Note to include any type of outsourcing of client interface activities to third parties, be it through a formal agency relationship, a joint venture, or other type of business arrangement.

7 Data on the customer experience in transformational branchless banking is limited. National authorities can reduce the knowledge gap by collecting complaint information (which in some jurisdictions may require coordination with consumer protection agencies), conducting consumer surveys and other qualitative research, carrying out mystery shopping, and adopting simpler practices, such as tracking local media for signs of stress or significant problems.

8 These are a summary of common problems and risks observed or perceived by regulators, financial firms, and consumer protection bodies in Kenya, Brazil, India, and Peru. This information was gathered mainly through interviews. Note that agents are used in all of the four countries, while mobile phone-based models are predominant only in Kenya.

Figure 1. Observed problems or perceived risks and related policy objectives



emerging branchless banking models, nonbanks may collect funds in exchange for electronically stored value, without being subject to the full range of prudential rules imposed on banks. Also, there may be models where even if client funds sit in a bank account, they receive a different regulatory treatment than those applicable to bank deposits.[9] How can client funds be safeguarded in such cases?

Countries with the most prominent branchless banking models have taken varied approaches to handling and protecting client funds. In the Philippines, Smart Money account balances are deposited in the client's name in a commercial bank, but are considered accounts payable on the bank's books rather than deposits. Hence, although it is a bank-based model, it has different regulatory treatment as to bank deposits. In the same country, G-Cash account balances are deposited in pooled accounts in various banks, in the provider's own name.[10] In Russia, Web-based stored-value services do not currently follow any regulatory standard for safeguarding client's funds.[11] Funds collected by M-PESA, which customers increasingly use as a short-term savings mechanism (Collins 2010), are deposited in pooled trust accounts at several commercial banks, for the benefit of the customers. No system is in place for customers to claim trust assets (e.g., in the event of insolvency).

9 The services referred to in this section may be called e-money in some jurisdictions, but there is no broadly accepted definition of e-money. This section focuses on account-based services provided by nonfinancial firms (i.e., funds that are entrusted by users to a nonbank entity to be converted into electronic value linked to an account issued by the nonbank), as well as models where the accounts are issued by banks but the funds are not considered bank deposits for regulatory purposes. Such electronic value can be used in purchases or in exchange of services provided by third parties outside the issuer's own network (e.g., gift cards are not included), as well as for peer-to-peer transfers. Also, although being important for regulations dealing with electronic stored-value instruments, the definition of a bank deposit, which varies across countries, is beyond the scope of this Focus Note. The key assumption of this section is that funds underlying the electronic value do not have the same regulatory treatment applicable to bank deposits.

10 Smart Money and G-Cash are prepaid accounts tied to a mobile phone subscriber information module (SIM) card, offered by nonfinancial firms in the Philippines. See CGAP "Update on Regulation of Branchless Banking in the Philippines," January 2010, http://www.cgap.org/p/site/c/template.rc/1.11.1772/

11 See CGAP "Update on Regulation of Branchless Banking in Russia, January 2010," http://www.cgap.org/gm/document-1.9.42403/Updated_Notes_On_Regulating_Branchless_Banking_Russia.pdf

When electronically stored-value sums are not considered bank deposits or when they are not in the customer's name, regulation can protect funds through complementary or alternative measures. While the approach should suit the particular context and business model(s), basically any regulation should provide simple and clear rules that ensure the following:

- *Liquidity of funds*—for example, by requiring providers to keep the equivalent of the outstanding electronic value issued in a bank account; limiting investment of the funds to low-risk, highly liquid assets; and prohibiting use of the funds for purposes other than withdrawals and transfers according to customer request
- *Ownership of funds*—for example, by requiring the accounts where funds are deposited to be individual accounts in the name of the customers or pooled trust accounts to the benefit of the customers; prohibiting providers from pledging the funds as collateral; and offering legal protection against other creditors in the case of insolvency of the issuer or the bank where the funds are deposited

The EU E-Money Directive (2009), for instance, requires issuers to safeguard client funds by either[12] (*i*) not commingling the funds and depositing them in a separate account in a bank, or investing them in liquid low-risk assets (in addition, the funds must be insulated against other creditors, in particular in the event of issuer's insolvency); or (*ii*) covering the funds with an insurance policy or comparable guarantee. Malaysia, Afghanistan, Cambodia, India, Indonesia, and the Philippines, among others, have created rules for electronically stored-value products issued by nonbanks with provisions similar to those of the EU E-money Directive. Some regulations include a maximum limit on the outstanding electronic value issued per provider and per customer, to cap the risk of loss of funds.

In addition to safeguarding customers' funds through liquidity and ownership, regulation can also set minimum standards for fund redemption to avoid undue restrictions on customers, including in the event of contract termination or insolvency of the provider or the bank where the funds are deposited. The EU E-Money Directive (2009), for instance, requires contracts to state clearly and prominently the conditions of redemption, including any fees, and limits charges on redemption to a few specific circumstances.

To avoid over- or under-regulating, regulators may experiment and retain some flexibility until the emerging service models are more fully understood, to be able to set requirements that address identified fund protection issues adequately.[13]

2. Ensuring safety and reliability of services

An important shortcoming typical of informal financial services is lack of reliability and continuity in the long run. Formal providers have clearer incentives to offer more reliable and safer services. Technology-enabled mechanisms may help achieve that goal. Evidence from the four country studies suggests that technical failures (e.g., equipment malfunctioning and other errors occurring during a transaction) are not a major issue in branchless banking. Similarly, research on consumer experience in Brazil shows that less than 5 percent of users have made a mistake and paid the wrong bill at an agent, sent money to the wrong account, or noticed that a payment or a deposit was never processed or received (Collins 2010). Less than 0.1 percent of M-PESA clients in Kenya report having lost money when sending it to someone else, and most customers say they believe their money is safe with M-PESA (Collins 2010). Lack of cash at cash points does not appear to be a widespread problem at this time, according to our in-country studies. Moreover, it appears that low-income clients may be willing to tolerate occasional liquidity shortfalls in exchange for continuity of service in the long run and the convenience of an extensive network.[14]

12 Directive 2009/110/EC. See also Directive 2007/64/EC (the Payment Services Directive).

13 The applicability of deposit insurance to electronic stored value issued by nonfinancial firms is still an emerging issue. For a more detailed analysis of fund protection in nonbank e-money issuing, see Kumar, McKay, and Rotman (2010).

14 Lack of cash is not an issue unique to transformational branchless banking, since automatic teller machines and even branches in some jurisdictions can run out of cash occasionally.

Regulators in some countries (e.g., Colombia and Mexico) create specific rules to address reliability of agent networks, such as requiring agent transactions to be online and in real time, while others (e.g., Brazil) may require the same through the supervisory review without issuing new regulations. In Colombia, agents must post signage informing clients that withdrawals depend on availability of cash at the agent. Where prescriptive rules (e.g., requiring a certain type of equipment to be used by agents) are deemed necessary, regulators should assess their impact on the ability and appetite of existing and potential providers to serve low-income clients. Detailed rules usually introduce complexity, rigidity, and even confusion among industry players and other stakeholders, such as policy makers and consumer associations.

Physical security is another common concern of regulators. In Brazil, for example, agents must deposit the cash received from clients in a bank branch no more than every other business day. This is intended to limit cash accumulation that can lead to robbery by third parties or even by the agent itself. The Mexican regulator, by requiring every agent transaction to be made against the agent's account at the contracting bank, does not reduce the risk of third-party robbery but eliminates the risk of agents misappropriating the accumulated cash, since the cash is in fact the agent's own. The simplest measure to reduce cash accumulation and its related risks may be requiring providers to set daily and monthly transaction limits for each agent and client. Regulators should avoid setting physical security standards similar to those imposed on bank branches, however, since this could have severe consequences for the viability of the service and hence access.

Agents may be unable to conduct financial transactions in a satisfactory manner, provide advice, or facilitate recourse, each of which can generate consumer complaints usually classified as "poor service" in the countries studied. Expectations of clients (and of consumer associations) should be managed by providers, as agents should not be required to perform all the same functions and have comparable knowledge to that of a bank employee. Regulation may limit itself to requiring that agents are qualified and trained to perform the outsourced functions, without imposing burdensome rules for agent selection, approval, and training. A more powerful measure is improving the classification of consumer complaints received and managed by supervisory bodies to monitor and address consumer issues in certain delivery channels, such as agents. Providers themselves have an interest in qualifying and training agents, for example, to reduce costs associated with agent turnover, fraud, or complaints handling.

Regulation should require providers to ensure reliability, continuity, and safety of their services and channels while refraining from prescribing specific technology, systems, and procedures. It should also be consistent with existing outsourcing guidelines, to the extent that such guidelines are relevant and adequate to transformational models. Effective regulation is based on constant monitoring of emerging consumer issues. In addition, the supervisor should have authority to examine the policies and systems adopted by all providers to ensure reliability, safety, and continuity and must have power to impose prompt remedial actions, including in outsourcing arrangements.

Continuity in the long run is highly valued by financial services users. Threats to continuity can arise from problems with the business models that reduce customer confidence (e.g., inadequate technological platforms) and from forces outside the scope of financial regulators. In Brazil, for example, labor unions are using the courts to demand pay equality with bank employees for agents. A draft law intends to subject agents to the same physical security requirements applicable to bank branches. In addition, the Brazilian sanitary agency has proposed to prohibit pharmacies (one of the most important types of agents in that country) to sign agent agreements. If successful, these measures

could seriously undermine the business case for using agents and leave millions of customers without a convenient channel to conduct financial transactions.

3. Reducing opportunities for agent fraud and other harmful conduct

Cases of agent fraud and misbehavior were reported in all the countries researched for this Focus Note. For example, "churning" was identified in Brazil (i.e., individuals subcontracted by agents offered credit to pensioners and subsequently resold the loan several times to different banks without the client's consent, to generate additional fees).[15] Agents may steer customers toward certain products to maximize fee income, regardless of the clients' needs (Central Bank of Brazil 2007). However, the incidence of these problems was relatively low. Such problems can result from the provider's limited ability (or unwillingness, given the costs involved) to oversee a large number of agents adequately.

Probably the most powerful measure to reduce the incidence and consequences for the customer of harmful agent conduct is requiring providers to screen, qualify, and monitor their agents. Care should be taken not to set minimum agent standards that could limit the investment in large agent networks (e.g., requiring minimum capital from agents by regulation). Even if the regulation is not explicit on this aspect, an important incentive for providers to screen and monitor agents (other than for the benefit of its own business) is when regulation holds them liable for agent compliance with applicable regulations, including answering consumer claims arising from agent transactions and acts even when agents act fraudulently (this topic is further developed in the discussion of policy objective 7). In any case, supervisors should review the providers' internal controls and processes to identify, measure, and mitigate these risks and ensure systems are in place to handle consumer complaints related to agent acts.

Nonetheless, there are some situations under which the provider clearly should not be held accountable, such as in the case of "fake agents" (i.e., commercial establishments or people pretending to conduct financial transactions on behalf of the provider). Examples of this were found in Brazil and Peru,[16] and although infrequent, they can be serious from a consumer protection perspective, because the provider will not—and should not—cover the loss. Regulation has a limited role to play in reducing this risk, while initiatives to increase consumer awareness (undertaken by regulators, policy makers, civil society, and/or industry), may have much greater impact. Customers who know that every transaction should produce a receipt and how to check if an agent is legitimate, for instance, are less likely to be deceived by a fake agent.[17]

4. Ensuring clear and effective disclosure

Transformational branchless banking can exacerbate information asymmetry when it involves multiple entities that charge separate fees for their services, making it challenging for customers to figure out the final cost of a financial transaction. For example, a fund transfer based on text messages may involve a fee to the bank and another to the mobile network operator. Agents can also—deliberately or accidentally—fail to disclose prices fully or charge unauthorized fees.

Countries have taken different approaches to these issues. Brazil and Mexico prescribe specific rules for price transparency at agents (e.g. agents should post signage with fees), whereas in India and Peru, such standards are set in general consumer protection regulations. In India and Brazil agents are prohibited from charging fees directly to customers, though banks may charge more for agent transactions—in

15 Interview with the Association of Brazilian Commercial Banks, November 2008.
16 Interviews with private banks, bank associations, and the bank regulators in Brazil and Peru, 2007, 2008 and 2009.
17 Of course, law enforcement has an important role in curbing this type of wrongdoing, but enforcement is weak in many of the countries where transformational branchless banking is taking place.

comparison with branch transactions—so long as the customer is informed. Regulations should require contracts to be as short and simple in language as possible, and to include all fees and charges.

In addition to disclosing fees and charges, in Peru, Brazil, Colombia, and Mexico, agents must disclose their status as an agent of a licensed financial institution. This is done through signage posted at agents and printed marketing materials, as well as in transaction receipts that contain information about each transaction. This disclosure helps consumers identify the responsible entity when problems arise, thereby facilitating complaint filing.

Regulators also should consider how providers communicate product features to their clients, especially in the case of electronic stored value services. If the customer loses the device (e.g., mobile phone, prepaid card), this may lead to loss of the funds in some models but not in others. Regulators should be aware of these differences when creating disclosure rules.

Sometimes providers go beyond the minimum standards in helping ensure that customers understand new services, for their own business reasons. For example, without a formal regulatory requirement, BCP, the largest bank in Peru, distributes printed materials to consumers to explain the services provided by its agents. In Brazil, banks use videos played in their branches, elevators, and buses to make people aware of agents and how to use them.

Protecting clients' personal information

As transaction and personal data are transmitted increasingly through means such as mobile phone networks, handled more often by third parties such as agents, and accessed remotely by customers and financial institution employees, the risk of inappropriate access and usage rises. Besides the technological aspect, consumers' lack of education and lack of experience with formal financial services and technology may raise data security risks. For example, research conducted by Morawczynski and Pickens (2009) found that some M-PESA clients were giving account passwords to agents, and while there is no evidence this has led to loss of funds or misuse of customer information, the risk could be significant.

A brief examination of data privacy and bank secrecy regulations in developing countries reveals a patchwork of rules issued by a variety of agencies with overlapping jurisdiction and oversight (Lyman, Pickens, and Porteous 2008). As an example of differences among countries, bank secrecy rules do not explicitly apply to agents in India, whereas they do in Brazil, Peru, Colombia, and Mexico. (In India, however, providers are liable for the acts of omission and commission of their agents in all respects, including bank secrecy.) While Peru and India have data privacy regulation, Brazil has none. Peru, India, and the Philippines require providers to train their agents with respect to bank secrecy, anti-money laundering, and data privacy compliance, while Kenya currently has no rules for agents of mobile payments providers such as M-PESA. Mexico and Colombia have extensive and detailed data security regulations, while Brazil has very little.

Design and enforcement of data privacy and security rules require some level of coordination between supervisory and regulatory authorities, as branchless banking cuts across different sectors such as banking and telecommunications. Regulations should be consistent and robust enough to hold providers responsible for data privacy, and they should be liable for privacy breaches and misuse of customer data. Agents also should be held accountable, although the provider should be primarily responsible for addressing consumer grievances in this area (this point is further elaborated in the discussion of policy objective 7). Regulation also needs to be technology neutral, since imposition of specific standards and protocols in a rapidly evolving industry is likely to hinder innovation. Specific requirements should be imposed only to correct identified problems in existing businesses.

There is a trade-off between enhancing data security and keeping the costs down to allow profitability of low-value financial transactions. The low-end market may require technologies that are somewhat less safe than others, based on availability (e.g., security

features that can be implemented in less expensive mobile phones) and customer user-friendliness (e.g., interfaces that are most appropriate for low-income customers).[18] Also, data privacy concerns may pose barriers to cross-border data transmission, inhibiting the ability of providers to offer faster and more reliable remittance services through electronic channels. In most situations, providers and regulators will be able to agree on technological platforms and business models that align each other's goals, but this requires an open dialogue between them, particularly when there are major current regulatory obstacles to overcome.

In any case, regulation will not eliminate security and privacy risks. Supervisors should evaluate the provider's risk management and mitigation systems and its procedures to handle cases of privacy and security breach. In cases such as Kenya, the regulator has engaged closely with the providers to help identify system and in-built technology solutions to observed and potential consumer problems. Supervisors should also be satisfied with the terms of outsourcing and partnership agreements to make sure such terms do not impact responsiveness to consumer claims related to data privacy and security, including when agents are involved.

6. Ensuring clients have knowledge of and access to effective redress and complaint procedures

Even when providers are compliant with consumer-related regulations and offer out-of-court complaint and redress procedures, resolving a problem often is not easy. Available recourse mechanisms may not be effective, convenient, widely publicized, or affordable—problems that can be exacerbated when the customer interface is done exclusively by third-party agents and customers are less educated and experienced in the use of formal financial services. In the countries studied, a common channel to lodge complaints is the telephone, but call centers seem to present many challenges and can be particularly burdensome for low-income customers.[19] Nonjudicial redress and complaint mechanisms may be almost nonexistent, as in Russia, where a network of over 250,000 automated payment terminals rarely offered means for customers to file complaints and solve problems until fairly recently.[20]

Box 1. Ensuring data privacy and security—beyond regulation

Often it is customers themselves that undermine the safety and privacy of their own data. Providers, regulators, and policy makers should engage in consumer awareness efforts, although providers may have the strongest incentives to do so, as part of their own business strategy. In South Africa, WIZZkids (young people who promote and sell mobile phone-based services offered by WIZZIT, a nonbank) teach customers how to use mobile phones to conduct financial transactions. In Peru and India, providers use minority languages in informational materials to educate customers on the use of agents.

Holding providers liable for complying with applicable regulations when they use agents is an important step for ensuring adequate redress. But it is not sufficient. Regulations can set minimum standards for internal dispute resolution channels and procedures, and some standards will need to be tailored to branchless banking. For example, modes of redress should be consistent with modes of transacting. If the only client interfaces are mobile phones and agents, customers should be able to use these channels to file complaints.[21] Providers should offer at least one

18 For more on this topic, see Ivatury and Mas (2008).
19 Interviews with financial services providers and regulators in Brazil, Peru, and Kenya, December 2008.
20 See CGAP's "Update on Regulation of Branchless Banking in Russia," January 2010, http://www.cgap.org/gm/document-1.9.42403/Updated_Notes_On_Regulating_Branchless_Banking_Russia.pdf
21 Although physical distance between the legal service provider and the customer may exacerbate weaknesses in redress, in some instances agents may play an important and positive role in customer care. One common way complaints are reported to Safaricom is through M-PESA agents, who often present the complaint by phone on behalf of the client. M-PESA agents were also found to be resolving client complaints and problems directly. In such cases, the complaints never reach the provider's customer care service.

free remote (and efficient) complaint-filing channel, such as a toll-free line. Other channels (e.g., text messages) should be considered as well, depending on the business model. Each transaction should produce a receipt (electronic or paper-based) with basic transaction details, which can be used to document complaints for purposes of internal dispute resolution or in the courts or alternative dispute resolution mechanisms. In Russia, formerly there was no regulatory requirement for payment services providers using electronic payment terminals to produce a receipt. Nowadays every transaction is required to produce a receipt with basic transaction information.

Minimum requirements for publicizing redress mechanisms can also be set by regulation (e.g., requiring agents and other transaction points to post prominent signs with the provider's customer service number and other means for making inquiries and filing complaints). While in Peru customers need to go to a branch to find out how to complain, in Brazil, Colombia, and Mexico, agents are required to post this information, and in Brazil they must post the bank ombudsman's number.[22] Attention should be given to potential lack of clarity regarding the applicability of recourse standards, especially when the provider is a nonfinancial firm. For example, mobile network operators offering financial services may claim that a regulation issued by a financial consumer protection body—as opposed to a telecommunications regulator—does not apply to them regardless of the type of service being offered. Also, even if there is clarity regarding applicability, some pre-existing rules may need clarification when applied to branchless banking. For instance, if the legal text requires disclosure of redress channels at "bank premises," does this include agents?

Lastly, supervisors should be able to evaluate and require improvements in complaint handling policies and procedures of firms under their supervisory scope. They should monitor trends in consumer complaints in branchless banking, as a means to identify weaknesses and any need for regulatory action. Supervisors in Peru, Brazil, and Mexico require periodic reports from banks on their agent-related complaints, to help monitor market developments and emerging consumer issues.

7. Keeping providers liable for agents' compliance with regulation[23]

The seventh policy objective is a fundamental, overarching one that, if achieved, facilitates implementation of the six objectives described so far. Since many transformational branchless banking models rely on agents for customer interface, it is necessary to ensure that providers comply with applicable regulations when using third parties just as if the services were rendered directly by the providers. The private sector sometimes interprets specific wording of legal texts and research as implying more than retaining the provider's liability for regulatory compliance, that is, to encompass legal liability for any and all acts of their agents. This is not necessarily the case or desirable from a business and policy perspective. Legal liability for agents simply means limiting opportunities for providers to circumvent applicable regulations, including conduct-of-business rules. The Brazilian regulation, for example, holds financial firms "fully responsible for services provided by agents." The Colombian regulation is more precise and holds the provider "fully responsible to the client, for the services offered through the agent." In practice, the regulations have the same meaning: the provider cannot refuse to address customer complaints related to agents charging unauthorized fees to receive payments, for example, or require customers to purchase products in order to conduct financial transactions.

This type of regulatory provision intends to clarify that there is one single legal provider of the services,

22 In the Brazilian case, the bank ombudsman is a specialized and independent unit that every financial firm must have. It is responsible for solving complaints that were not resolved by the regular customer care service and proposing improvements to the board based on the analysis of customer complaints. The Central Bank of Brazil has a specific inspection program to monitor performance of bank ombudsmen.

23 As mentioned earlier, the word "agent" is used in this Focus Note to include any outsourcing of the client interface function to third parties, be it through a formal agency relationship, a joint venture, or other type of business arrangement. The recommendation in this section is intended to apply also to cases where third parties are not agents, in the true legal sense, of the financial or nonfinancial firm on whose behalf they interact with customers.

Box 2. Liability Requirement in the EU Payment Services Directive

Article 17—"The outsourcing should not result in the delegation by senior management of its responsibility; the relationship and obligations of the payment institution towards its payment service users shall not be altered."

Article 18—"Where payment institutions rely on third parties for the performance of operational functions, those payment institutions [should] take reasonable steps to ensure compliance with all regulations and remain fully liable for any acts of their employees, or any agent, branch or entity to which activities are outsourced."

even though third parties are involved in service delivery. The provider should respond to consumer claims even if the agent acts fraudulently (e.g., it should not avoid regulation and evade responsibility in a case where the agent accesses client bank information and withdraws money from the client's account). Obviously the provider can seek redress against the agent, but the customer should be able to file a complaint with the provider, who should be responsible for ensuring data privacy and security. A useful analogy is a case of data security breach in outsourced technology companies managing bank client information. If a criminal breaks into the company's database, few would expect (or accept) banks to instruct clients to file a claim against the company instead of assuming customer losses and then seeking redress against the outsourced party.

Failure to hold providers liable for agent compliance may hinder regulators' ability to achieve the policy objectives discussed in this paper, as implementing rules for protecting customers when third parties are involved in service delivery becomes challenging in practice. It essentially shifts the burden for monitoring agents from the supervised entity to the supervisor (with significant added supervisory costs) and to consumers (with significant added social costs, especially when dealing with low-income customers). Thus, provider liability for the acts of commission and omission of agents is a fundamental principle for outsourcing in financial services. With a specific focus on the agent actions related to delivery of branchless banking services, it does not create unlimited liability and should not create unreasonable burdens on providers. As in other types of outsourcing, regulators should expect to see effective risk management systems in place and timely and appropriate actions by providers (including redress for consumers) when problems with agents are detected.

Ensuring provider liability by regulation (and indeed, implementing other measures discussed in this paper) does not require making new business models proposed by nonfinancial firms wait until a complete regulatory framework is developed. Let's look at the Kenya case. Here the regulator pursued a "test and see" approach to permit a new service model to develop. Safaricom was not subject to consumer protection rules set by the financial regulators, and its agreements make it clear that Safaricom does not have legal liability for the acts of M-PESA agents.[24] Yet Safaricom has been responding to consumer issues involving agents. Apparently the costs are not prohibitive, and the business motivations to do so are sufficiently compelling.

Does the Kenya experience suggest that regulators should hold off on market conduct rules (including establishing explicit provider liability for agent acts) until the branchless banking market is more developed? We would argue that in most cases there are advantages to taking basic actions at inception or early on, and certainly at the point at which multiple providers are entering the space and the service is scaling up. This type of regulation will serve three purposes: (*i*) prevent problems, by setting minimum business practice standards; (*ii*) give legal tools for regulators and consumers to solve problems when they arise; and (*iii*) create a level playing field that fosters competition and healthy market development. These are important policy objectives. Furthermore, we do not find evidence that the provider costs of

24 The service level agreement between Safaricom and the retailers delivering M-PESA services does not create an agent–principal relationship in the true legal sense.

assuming liability for agent acts (within the scope of the outsourced functions) are prohibitive.

Safaricom, a multinational mobile network operator partially owned—in Kenya—by the national government has strong incentives to protect its reputation and treat its customers responsibly by addressing problems caused by M-PESA agents. Many regulators would be willing to permit a player of this type to experiment with a new approach to service delivery without a complete regulatory framework, particularly given the potential to serve the unbanked. Hypothetically, however, let us consider a scenario where the "first mover" chose to act less responsibly with regard to problems involving agents. Without basic regulations in place the regulator would have little legal means to hold it liable for agent misconduct or errors. Furthermore, a strategy that relies on the provider's reputation risk and the regulator's engagement and moral suasion—rather than unambiguous liability, which provides the legal foundation for other regulatory protections including effective recourse—may create a bias toward permitting only big players (with obvious reputation to protect) to engage in branchless banking. Thus, over time the lack of basic rules could produce the unintended consequence of uneven treatment of providers offering similar services and hinder entrance of smaller players that might have viable models offering better value to consumers. This may also create ground for regulatory capture and arbitrage.[25] A further consideration is that regulatory and legal uncertainty might deter entry and innovation.

Finally, it should be underscored that although the liability requirement is a safeguard for regulators and supervisors, both should understand that, as in any other regulatory area, it is not feasible to eliminate the risk of regulatory noncompliance. Rather, the focus should be on overseeing the provider's risk management systems to detect problems in agents and its problem-solving mechanisms and performance.

Box 3. An uneven regulatory framework for using agents

In Kenya, M-PESA agents are subject to almost no regulation. Recently issued guidelines now allow prudentially supervised banks and certain other regulated financial institutions to offer basic banking services through agents. The guidance sets minimum standards such as the provider's liability for agents' compliance with regulation. The new rules do not solve the uneven playing field problem completely, however, since nonfinancial firms, such as Safaricom, continue to operate under very little regulation pertaining to delivery of branchless banking services, at least until specific regulation for this type of provider is issued.

Legal authority for regulating and enforcing consumer protection in branchless banking

Few of the policy objectives and regulatory measures mentioned can be pursued or implemented effectively without the legal authority to regulate and supervise branchless banking providers—particularly nonfinancial firms, such as mobile network operators and technology companies, that transmit or manage transaction details.

It is likely that some emerging models will fall within a gray area between those sectors subject to supervision by a financial authority and those that are not (e.g., a mobile network operator providing money transfer services). Regulators should monitor

25 Regulatory capture occurs when a regulatory agency acts in favor of special interests of the industry it is charged with regulating. It happens when private actors with vested interests are successful at "capturing" influence with the staff or commission members of the regulatory agency, so that policy outcomes favorable to the private actors are implemented. Regulatory arbitrage happens when a regulated entity can choose a place, institutional form, or other characteristic of its business that is associated with the least costly regulatory framework.

market developments, focusing on types of services rather than on types of entities, and take action as necessary to ensure similar rules are applied to firms providing similar services. The Reserve Bank of India, like peers in Malaysia, Indonesia, the Philippines, and other countries around the world, has created rules for e-money issued by nonbanks to address a previous regulatory vacuum. In contrast, the Central Bank of Kenya lacks clarity, at present, as to its legal authority to regulate and supervise services like M-PESA and others being provided by nonfinancial firms in the country. With regard to agents, regulation should allow for supervisory and regulatory action, consistent with common practice in other outsourcing arrangements in financial services. In Mexico, for example, a 2008 regulation gave clear powers to the banking supervisor for the first time over agency schemes set up by banks, allowing direct inspection of agents if necessary. Similar powers have been granted to supervisors in Brazil, Peru, India, and Colombia.

In some jurisdictions the regulator will need clear authority to issue and enforce consumer protection rules in financial services. In Brazil, the applicability of the consumer protection law to financial services is not entirely clear, nor is the power of the financial supervisor to issue and enforce consumer protection rules. Overlapping or unclear authority can create opportunities for undesirable business practices and reduce effectiveness of supervision as supervisor's actions may be questioned by providers. When more than one regulatory body is involved, coordination and cooperation is important, particularly for branchless banking, since it cuts across different sectors such as banking and telecommunications, which can have separate consumer protection regulation. The Communications Commission of Kenya, for example, recently issued substantial consumer protection regulations with implications for mobile payment services (Kenya Gazette, 23 April 2010).

Box 4. Increasing interagency cooperation to overcome regulatory weaknesses

Because it lacks unambiguous authority to enforce compliance with the general consumer protection law, the Central Bank of Brazil has sought to establish cooperation agreements with government bodies that hold primary legal responsibility for enforcing the law. For instance, it has a cooperation agreement with the National Social Security Institute (INSS) to examine complaints filed at INSS by pensioners, in an attempt to reduce fraud in loan underwriting and churning. The agreement will also allow both agencies to monitor indebtedness levels that might result from branchless banking, by increasing information sharing. Agreements of a similar nature have been signed with the consumer protection and the competition watchdogs as well.

Conclusion and New Frontiers

Consumer risks exist in transformational branchless banking as in any other type of financial services provision overseen by financial regulators and supervisors. There is no single regulatory approach to consumer protection that will work in all contexts, and obviously none will eliminate risks. The evidence to date shows that the benefits of these new services far outweigh the risks, and many times they reduce important shortcomings commonly associated with informal providers, such as loss of customers' funds or service discontinuity. This calls for a balance between allowing innovation that increases financial access and ensuring a minimum level of consumer protection.

Based on insights gained from diverse country contexts, this Focus Note identifies seven priority policy objectives to guide consumer protection regulation in transformational branchless banking. It provides examples of regulatory measures to achieve those objectives. It identifies one overarching policy objective—holding providers liable for compliance with applicable regulations when using agents—that can affect the ability to use regulation to reach other objectives effectively. It also suggests the role that nonregulatory measures, such as voluntary industry standards and practices, can play in protecting branchless banking customers.

Policy objective	*Regulatory options and considerations*
1. Protecting client funds held as electronically stored value	-Create basic regulation with simple and clear rules to ensure appropriate *liquidity and ownership* of funds collected against electronic value issued. -Regulation can also set minimum standards for fund redemption to avoid undue restrictions on customers, including in the event of insolvency of the provider or the bank where the funds are deposited. -Regulators may experiment with ad-hoc approaches until the emerging service models are more fully understood.
2. Ensuring safety and reliability of services	-Monitor emerging consumer issues and decide *when* and *what* type of regulatory action is necessary and effective to avoid loss of confidence or curb abuse by providers. -Require providers to ensure reliability, availability, and safety of services, without prescribing specific technology, systems, and procedures. -If prescriptive rules are necessary, evaluate potential impact on the ability and appetite of providers to serve low-income clients. Detailed rules usually introduce complexity, rigidity, and even confusion. -Require providers to have policies to select and qualify agents. -Avoid imposing overly burdensome physical security standards on agents. -Improve classification and analysis of consumer complaints in branchless banking channels. -Beware of threats that are outside the scope of financial authorities (e.g., laws on physical security requirements).
3. Reducing opportunities for agent fraud and other harmful conduct	-Hold providers liable for agents' regulatory compliance. -Examples of other regulatory provisions: -Require providers to set transaction limits for agents and monitor compliance. -Set principles for agent selection and monitoring, without creating overly burdensome minimum standards, such as minimum capital requirements, for agents. -Require providers to screen, qualify, and monitor agents. -Review the providers' internal controls and processes to identify, measure, and mitigate these risks and ensure systems are in place to handle consumer complaints related to agent acts. -Assess whether initiatives to increase consumer awareness may have greater impact than regulation in some situations.
4. Ensuring clear and effective disclosure	-Evaluate need to create specific rules such as: -requiring agents to post applicable fees -requiring price disclosure through devices used for transacting, e.g., mobile phones -prohibiting agents from charging extra fees without clear disclosure to customers -requiring contracts to be simple and include all relevant fees and charges -requiring agents to disclose their status as an agent of a licensed institution
5. Protecting clients' personal information	-Keep providers responsible for compliance with data privacy and bank secrecy regulations even when using agents. -Make sure existing rules apply to emerging models and evaluate the need to issue specific rules. -Increase interagency coordination for designing and enforcing rules. -Be sensitive to the trade-off between the cost of implementing security requirements and profitability in serving low-income clients. Be flexible to consider less safe models suitable for low-value transactions. -Avoid overly prescriptive rules that introduce complexity, rigidity, and confusion. -Avoid prescribing specific technological standards and protocols.
6. Ensuring clients have knowledge of and access to effective redress and complaint procedures	-Ensure existing rules for out-of-court redress and complaint channels apply to branchless banking or set specific standards tailored to new models as necessary. Examples include requirements where: -Channels of redress match transacting channels -Each transaction produces a receipt (to document complaints and for use in courts) -Redress procedures and channels meet minimum standards -Redress avenues and procedures are communicated clearly and consistently to customers -Monitor trends in consumer complaints in branchless banking.
7. Keeping providers liable for agents with regulation compliance	-Ensure the provider is kept legally liable for ensuring regulatory compliance when using agents. -Focus provider liability on agent actions related to delivery of branchless banking services, so as not to create unlimited liability for, or unreasonable burdens on, providers.

When creating new rules, regulators should obey two principles: proportionality and effectiveness. Rules should be proportional to the consumer risks they intend to mitigate and consistent with policy objectives and supervisory capacity. To be effective, rules should be based on a good understanding of market development, including consideration of the access impacts of existing or proposed rules and the compliance cost they would impose on providers. Regulators should monitor consumer issues to decide how, and when to take regulatory action. Such an approach is likely to require extensive consultation with the industry and different policy-making, regulatory, and supervisory bodies. Effectiveness can also be improved (and regulatory costs driven down) by consumer testing of proposed regulatory measures before implementation. Also, detailed and prescriptive rules generally should be avoided, unless clearly necessary to correct identified problems.

Market-based incentives should be considered. As noted, a responsible provider's interest, such as protecting its reputation and brand (especially if there is some healthy competition in the market), may be aligned to the policy objectives of the regulator. This is a particularly useful consideration for low-access countries and in early stages of business development, where the cost of regulating is likely to be higher. In such situations the initial focus should be on screening providers and monitoring consumer issues while the base is being laid for a comprehensive regulatory and supervisory framework. The same applies for jurisdictions with low enforcement capacity. However, as noted, care should be taken to avoid a bias in entry requirements in favor of large firms that would limit competition. And entry screening may prove to be an insufficient tool if consumer protection problems become widespread. As markets develop and pioneer business models mature, regulators should build a minimum regulatory framework with clear conduct-of-business standards and screening criteria, ideally covering all the areas discussed in this Focus Note.

Finally, regulation and supervision are not sufficient to deal with all consumer protection problems. Sometimes problems are rooted in consumers' lack of understanding, knowledge, and awareness with regard to financial services and redress mechanisms. Well-targeted initiatives to improve financial capability and increased awareness can play an important role in reducing risks for consumers and increasing effectiveness of regulatory action. Efforts in this area should involve a range of actors, from policy makers to financial institutions to consumer advocates and other civil society actors.

Customer mobility (i.e., ease of switching providers), cross-selling of services, product suitability, and deposit insurance in nonbank e-money issuing are some of the next generation consumer protection regulatory topics in branchless banking that require further research and experimentation. This future regulation and supervision agenda needs to be informed in turn by analysis that quantifies and explores in more depth the behavior and perceptions of branchless banking consumers, and the nature, incidence, and consequences of the problems they face in different markets.

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CGAP

No. 64
September 2010

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Denise Dias and Katharine McKee of CGAP are the authors of this Focus Note. The authors thank the Central Bank of Brazil and the Superintendence of Banks, Insurance and Pensions of Peru, as well as researchers Simone di Castri and N. Srinivasan and reviewers Kate Lauer, Timothy Lyman, Mark Pickens, and Michael Tarazi. This Focus Note was supported by the Technology Program at CGAP, which is co-funded by the Bill & Melinda Gates Foundation, CGAP, and the UK Department for International Development.

The recommended citation for this Focus Note is as follows:
Dias, Denise, and Katharine McKee. 2010. "Protecting Branchless Banking Consumers: Policy Objectives and Regulatory Options." Focus Note 64. Washington, D.C.: CGAP.