Role of Non-Banks in the Provision of Payment Services

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Content of the presentation

- Public policy objectives in retail payments
- Role of non-banks in provision of payment services, with some specific examples
- Public policy implications
- Approaches for regulating and overseeing non-banks

Public policy objectives in retail payments

- **Safety and Efficiency.** The safe and efficient use of money as a medium of exchange in retail transactions is particularly important for the stability of the currency and a foundation of the trust people have in it
- **Promote Affordability and Ease of Access to Payment Services.** A wide range of payment instruments is essential for supporting customers' needs in a market economy (both domestic and cross-border, e.g. remittances). A less than optimal supply of payment instruments may ultimately have an impact on economic development and growth
- **Promote Socially Optimal Usage of Payment Instruments**. Payment instruments could have associated costs for society – e.g. excessive usage of credit cards could be detrimental and ability to mask business transactions as person-to-person could have tax implications
- **Promote efficient infrastructure to support development of payment products.** Lack of efficient clearing and settlement mechanisms like payment card switches, automated clearinghouses and RTGS systems have implications on efficiency and safety of payment products, and also on competition and market structure

Growth of non-cash Payments outperforms growth in real economy

2012 (est.):
364 bn transactions

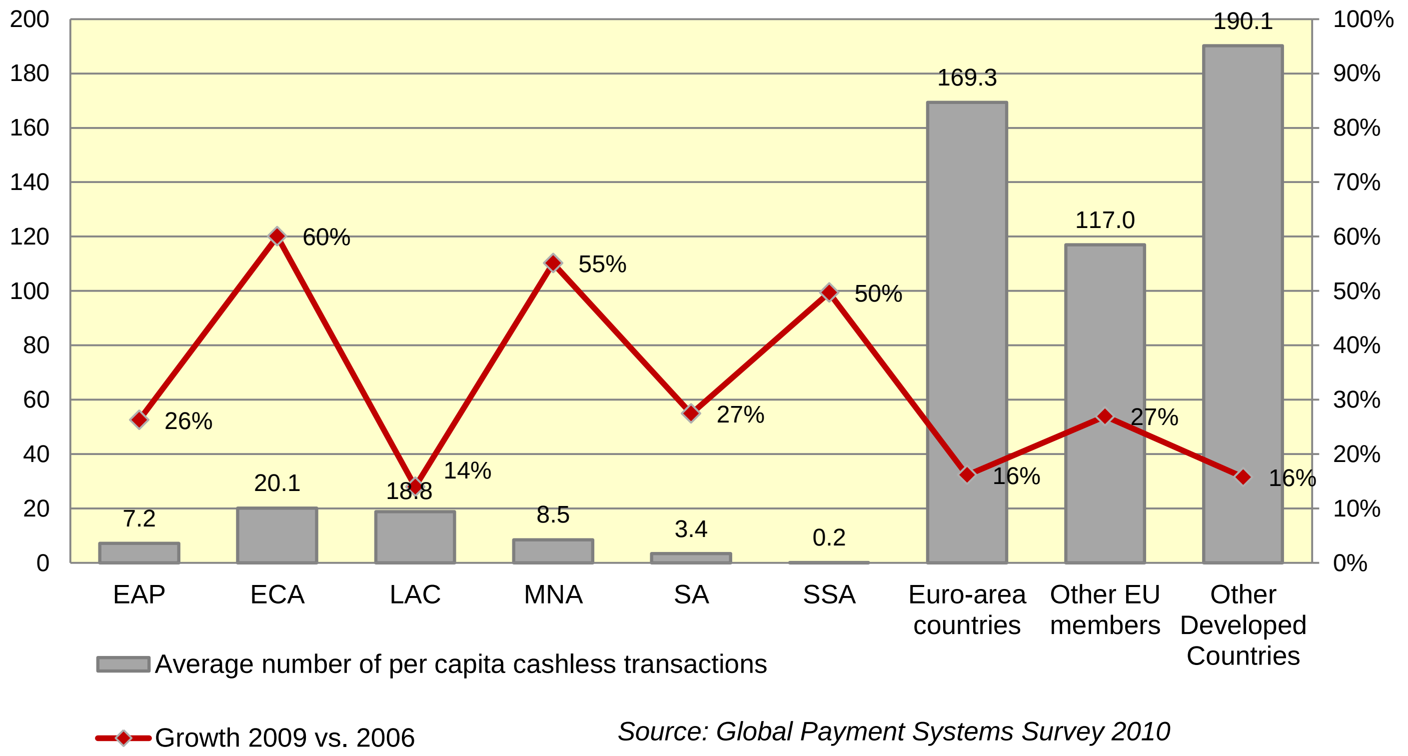
2012 (est.):
333 bn transactions

Volume of global non-cash payments: Different sources, different figures But agreement on the general trend

Makes market attractive for both banks and non-banks

**Sources: Capgemini World Payments Report 2013, and Boston Consulting Group's Global Payments 2013*

Emerging markets are narrowing the gap, but still have a huge potential to increase the number of cashless payments

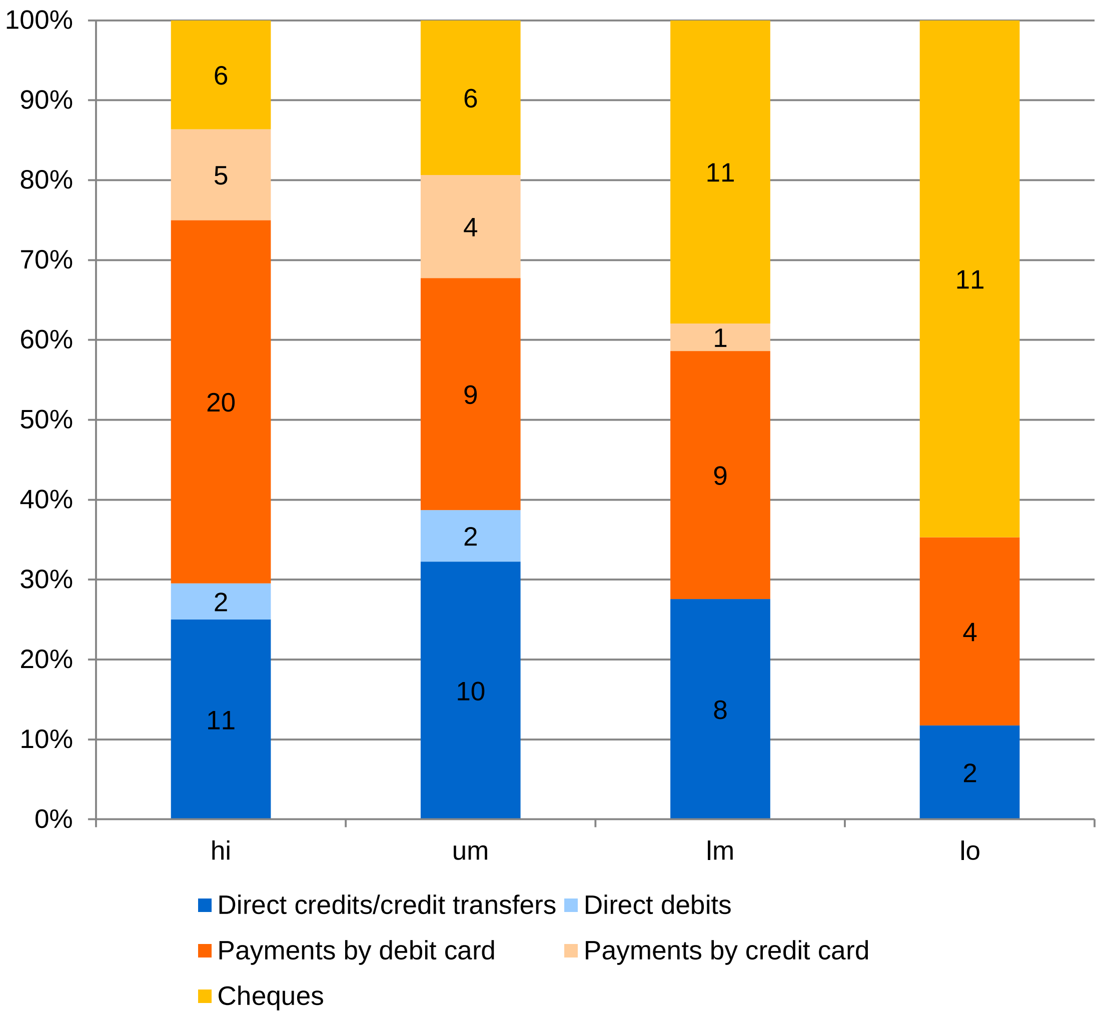


Source: Global Payment Systems Survey 2010

Retail cashless transactions per capita (2009)

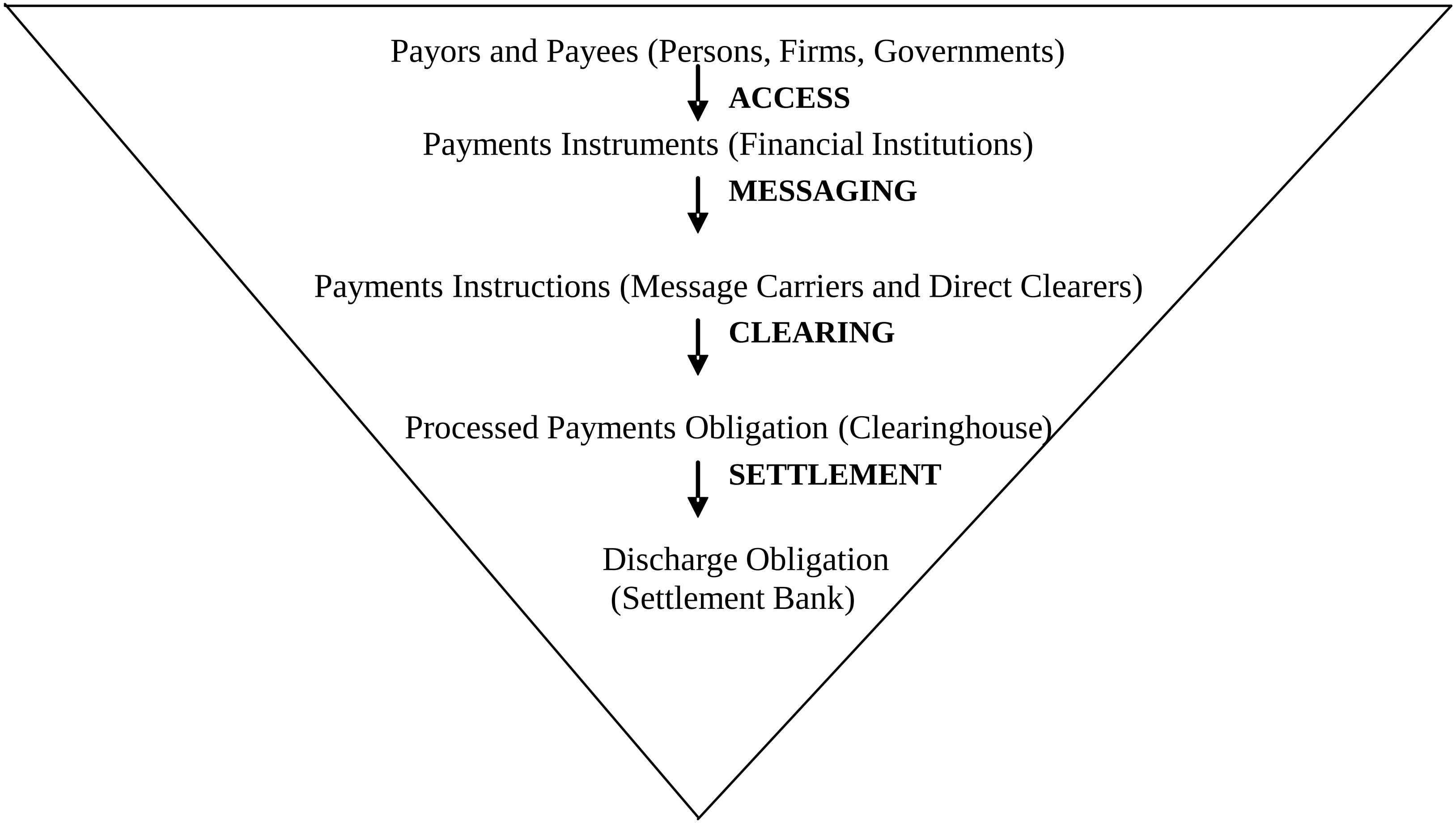
EAP: *East Asia and Pacific,*
ECA: *Europe and Central Asia,*
LAC: *Latin America and the Caribbean,*
MNA: *Middle East and North Africa,*
SA: *South Asia,*
SSA: *Sub-Saharan Africa*

Relative importance of non-cash payment instruments (based on number of transactions)



- Each payment instrument was ranked based on the number of transactions, from "1" or most important to " 5" or least important. Chart shows % and # of countries in which each payment instrument is considered "most important"
- Analysis by income clearly shows preference of lo countries for cheques (cheque is the most used payment means in 65% of low income countries, followed by debit cards). The divide with hi, um and lm is also evident (13%, 19%, and 37%)
- Cheque usage is substantial in SSA, SA, and LAC regions
- EU countries show stronger preference than other regions for direct credit/credit transfers (45%-47%) and credit cards (27%-55%)

Retail payment instruments and services



Non-banks active across the value chain, except perhaps in settlement

Factors behind increasing importance of non-banks

- Increasing trend towards outsourcing by banks, payers and payees – *for (e.g.) Billers outsourcing bill collection; and, Corporate outsourcing salary payments.*
- Changing payments landscape:
  - Increased prominence of ecommerce and ePayments in general
  - Changing payment needs
    - Social networks
    - Small value real-time payments
    - Financial inclusion
    - Shift of Government payments to electronic means
    - Complexity of payment processes
  - Innovation – by both existing and new players
    - Based on technology
    - Process innovation

Role of non-banks in the provision of innovative payment services

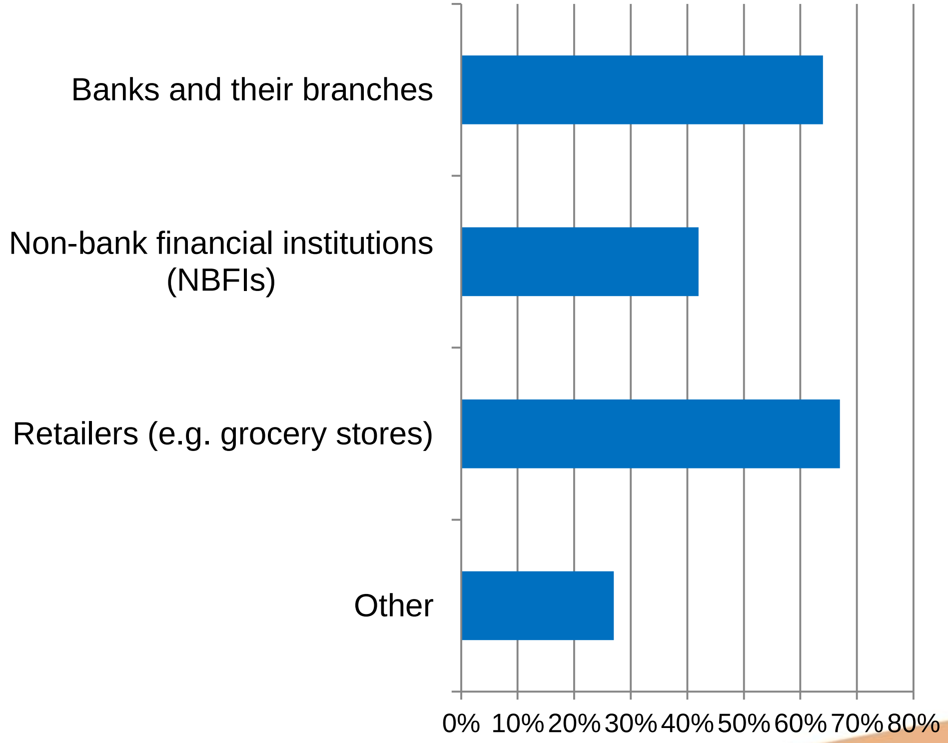
- *Role of banks still dominant - but in (contractual) collaboration with other entities:*

73% Banks are involved in the operation of the innovative product in terms of being responsible for signing up new customers, setting up account and managing customer service, BUT in only

33% banks are solely responsible

9% schemes are operated by explicit joint venture between banks and non-banking entities

43% of the products surveyed use agents, with highest usage of agents found in low-income countries (75%), EAP (100%) and SSA (71%), and large countries >30 million inhabitants (49%)



Classification of non-banks

Front-End Service Provider

- Provides services to Payers or Payees in association with / On Behalf of Payment Service Provider (PSP)
- Examples: Agents, Payment Gateways

Back-End Service Provider

- Provides services to the PSP
- Examples: Operation of IT infrastructure, Customer service Center

Payment System Operator

- Operates a payment system for participating payment service provider
- Examples: Operator of Card Switch, ACH

Independent provision of payment Service

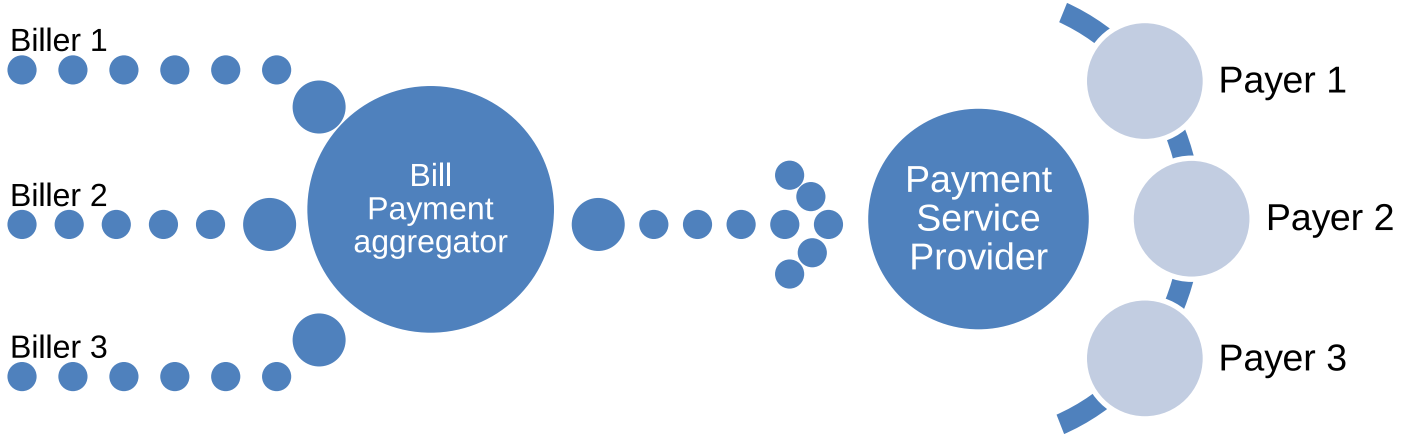
- Offers services to payers and payees independently
- Examples: Mobile Money, Remittance Service Provider

- Not the only way of classifying
- Similar entities could organize themselves differently in different situations
- There could be potential overlaps

Payment gateway – reduces complexity for merchants and acquirers

- Can be seen as providing service to Merchant on behalf of the acquirer to aggregate different types of payment mechanisms each with its own processing requirements.
- Additional services provided could include: MIS, reconciliation, fraud management, merchant management etc.
- In some countries Merchants contract with payment gateway, in others acquirers contract with payment gateway and offer to all their merchants

Bill payment aggregator – how to classify ?



- Provide ability to offer a one-stop bill payment option of a wide set of billers.

- Models:
  - Can be contracted by a payment service provider: *Bill Desk in India*
  - Bill Payment Aggregator itself could contract a payment service provider and accept various payment instruments: *Several entities in USA*
  - Platform to bring together billers and payment service providers: *SADAD, Saudi Arabia; CISMP, Azerbaijan*

- Provides various services:
  - Billers - MIS, reconciliation, Settlement
  - Payers – presentment, reminders, preauthorized arrangements, various instruments

Mobile money – confluence of technology and process innovation

- Need for clarity on Terminologies:
  - ✓ Mobile Banking: Akin to internet Banking
  - ✓ Mobile Money: Variant of e-money
  - ✓ Mobile Wallet: Holder of several mobile money / mobile banking interface
  - ✓ Mobile Payments: Payment made using mobile money

- Mobile Money is a confluence of three independent innovations, two of them already well-established retail payments concepts:
  - ✓ E-Money – Prepaid Payment Product where the underlying funds are stored on a device (e.g. chip card), or in the system of the issuer (e.g. PayPal) which is then accessed through various channels – for example using a card or at the internet etc. In some jurisdictions the issuer need not be a bank, as the product is not deemed to be a deposit product **<<Europe and many countries have had this for at least a decade>>**
  - ✓ Rapid spread of mobile telephony (incidentally mostly using prepaid connections as opposed to post paid), coupled with inherent capability to exchange data and basic computing capability **<<This is akin to the development of internet as a channel for exchange of payment information>>**
  - ✓ Concept of business correspondents/agents – leveraging existing businesses/shops as a channel to offer payment services using their own cash/flow, leveraging technology developed for card payments at the point of sale **<<Brazil introduced this many years ago>>**

Role of business correspondents and agents

- In developing countries, expanding the coverage for retail payment instruments is key. Business correspondents and agents can play an important role in promoting access to non-cash payment services by:
  - ✓ Improving the means through which non-cash retail payment instruments can be channeled to the traditionally un-served populations
  - ✓ Promoting technological and institutional innovation to reduce the cost of access and improve the availability of payment instrument
  - ✓ Ensuring a reliable customer interface that promotes faster adoption of non-cash payment instruments

Entry of non-banks – regulatory considerations

- **Safety of Customer Funds** – operational reliability issues and bankruptcy of issuer. Even where a bank is the issuer, existing treatment for deposit accounts might not be legally applicable to prepaid payments account. Measures like trust funds, segregation of funds, requiring basic operational reliability measures etc. can be used to mitigate risk
- **Heightened AML/CFT risks**. The way non-bank sets up accounts, operations are overseen and transactions are conducted could create higher AML/CFT risks – but could be addressed effectively through simple measures, e.g. limit transaction size and frequency
- **Weaker authentication could lead to higher fraud risks**
- **Consumer Protection.** The profile of customers targeted could be first time users of payment products. Need to ensure they understand the terms and conditions
- **Need to ensure competitive market conditions.** Regulation should adopt a holistic retail payments view, else it could lead to situations like banks being constrained with banking regulations while new players have relaxed or no regulatory requirements; also, non-banks not having adequate access to key elements of the national payment systems may impede their ability to effectively compete with banks.

Regulatory considerations – the specific case of business correspondents / agents

- **Safety of Customer Funds** – Potential for incorrect recording of transactions and safety of underlying funds.
- **Heightened AML/CFT risks** – Potential weaknesses in enforcing AML/CFT checks.
- **Weaker authentication could lead to higher fraud risks**
- **Consumer Protection –** Ability of customer to resolve any service issues with the issuer
- **Need to ensure competitive market conditions –** Exclusivity contracts.
- **Liquidity –** Ability of agent to honor customer transaction requirements
- **Monitoring of agent network –**
    - Single tier vs Multiple tier;
    - Licensing vs Notification;
    - Type of entities that can be business correspondents / agents; and,
    - Agent Network Managers

Appropriate choice of technology and oversight by issuers and regulators can address all the above concerns adequately

Potential approach to regulation of non-banks

- **Establish a regulatory framework** – Objectives and Mechanisms. The General Principles for International Remittances provides a valid framework
  - **Objectives** – Safety, Efficiency , Affordability
  - **Mechanisms:** Could be varied by type of non-bank
    - Registration ***<<Front-End Services>>***
    - Licensing ***<<Payment System Operator and Independent service provider>>***
    - Making Licensed Entity responsible for non-banks used by it, establish reporting and minimum requirements for monitoring. ***<<Back-end Services>>***
    - Powers to audit ***<<All>>***
    - Data collection and Analysis ***<<All, with differing levels>>***
- **Establish Oversight Framework**
  - Which entities to oversee ?
  - **Tools**:
    - Establish standards as part of licensing or independently
    - Data collection and analysis
    - Ongoing discussions through forums like National Payments Council

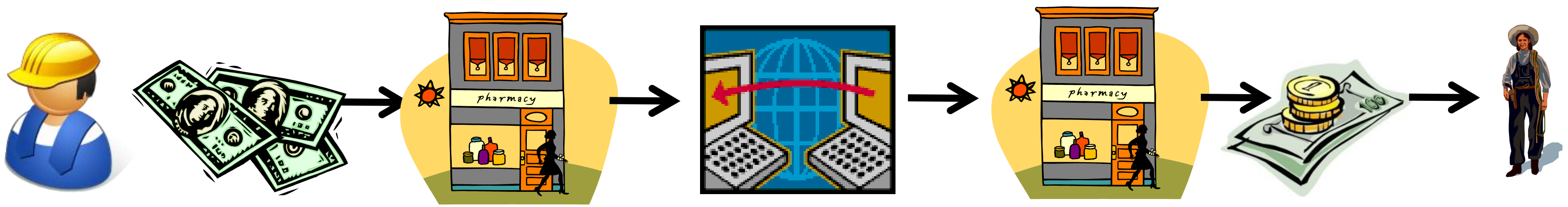
World Bank-CPSS General Principles for International Remittance Services – a valid framework for non-banks in general

- **GP 1: Transparency & consumer protection**
  The market for remittance services should be transparent and have adequate consumer protection
- **GP 2: Payment system infrastructure**
  Improvements to payment system infrastructure that have the potential to increase the efficiency of remittance services should be encouraged
- **GP 3: Legal & regulatory environment**
  Remittance services should be supported by a sound, predictable, non-discriminatory and proportionate legal and regulatory framework
- **GP 4: Market structure and competition**
  Competitive market conditions, including appropriate access to domestic payments infrastructure, should be fostered in the remittance industry
- **GP 5: Governance & risk management**
  Remittance services should be supported by appropriate governance and risk management practices

- **Responsibility of Remittance Service Providers** to support implementation
- **Responsibility of regulators and public authorities** to ensure implementation, Establishing effective oversight a key responsibility.

Why CPSS-WB General Principles for Remittances

- Remittances are a type of payment – in fact can be seen as two payment transactions.
- Strong presence of non-banks
- Increasingly remittances are using retail payment instruments
- Remittances make extensive use of agents
- Very similar regulatory considerations for remittances and innovative payment service providers



Closing Remarks

- Non-banks can play a key role in enhancing efficiency and accessibility of payment services
- Non-banks could enhance certain types of risks due to their structure and operating model; however risks need to be also seen in context of the nature and type of transactions they support and availability tools to mitigate the risks.
- Non-banks are very varied and need a robust regulatory and oversight framework to achieve proportionality
- The World Bank – CPSS General Principles for International Remittances could provide a framework for developing regulatory and oversight approach for non-banks as well

Thank you

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