

## Engagement of 'for-profit' Companies as Business Correspondents

### Introduction

1. The purpose of this paper is to seek the views / comments of banks, non-banking financial institutions, 'for-profit' companies, regulators, academicians, NGOs and the public at large on the discussion on whether there is a case for allowing banks to engage 'for-profit' companies as well as NBFCs as their Business Correspondents for expanding their banking outreach.

### Business Correspondent model

2. The Reserve Bank of India has taken several initiatives over the years for increasing banking outreach and ensuring greater financial inclusion. A significant step in this direction was the issue of RBI guidelines in January 2006 for engagement of Business Correspondents (BCs) by banks for providing banking and financial services. Since then, the regulatory framework for the BC model has been progressively honed to ensure that consumer protection is not compromised while facilitating enhanced outreach of banking services. The relaxation in the regulatory framework was made possible due to the rapid changes in technology – both in terms of Core Banking Solution as also relatively low cost biometric hand held devices for ensuring authenticity and fraud prevention. The circulars issued by the Reserve Bank on the subject are listed at the end of this paper (**Annex- 3**).

3. Business Correspondents are retail agents engaged by banks for providing banking services at locations other than a bank branch/ATM. Banks are required to take full responsibility for the acts of omission and commission of the BCs that they engage and have, therefore, to ensure thorough due diligence and additional safeguards for minimizing the agency risk. Basically, BCs enable a bank to expand its outreach and offer limited range of banking services at low cost, as setting up a brick and mortar branch may not be viable in all cases. BCs, thus, are an integral part of a business strategy for achieving greater financial inclusion.

4. BCs are permitted to perform a variety of activities which include identification of borrowers, collection and preliminary processing of loan applications including verification of primary information/data, creating awareness about savings and other products, education and advice on managing money and debt counseling, processing and submission of applications to banks, promoting, nurturing and monitoring of Self Help Groups/ Joint Liability Groups, post-sanction monitoring, follow-up of recovery. They can also attend to collection of small value deposit, disbursement of small value credit, recovery of principal / collection of interest, sale of micro insurance/ mutual fund products/ pension products/ other third party products and receipt and delivery of small value remittances/ other payment instruments.

#### **Entities eligible to act as BCs**

5. To start with, when the BC model was introduced in January 2006, the entities permitted to act as BCs included NGOs/ MFIs set up under Societies/ Trust Acts, Societies registered under Mutually Aided Cooperative Societies Acts or the Cooperative Societies Acts of States; Section 25 companies and post offices. As regards Section 25 companies, it was subsequently clarified in April 2008 that banks can engage such companies as BCs provided the companies are stand-alone entities or Section 25 companies in which NBFCs, banks, telecom companies and other corporate entities or their holding companies do not have holdings in excess of 10%.

6. The Committee on financial inclusion (Chairman: Dr. C. Rangarajan) observed that with increasing competition, banks are getting to be quite wary of the reducing margins available to them on financial intermediation and that small value clients (depositors) in remote locations get very little preference in accessing financial services. Emphasizing the need for having a BC touch-point in each of the 6 lakh plus villages in the country, the Committee recommended individuals like locally settled retired Government servants like postmasters, school teachers,

ex-servicemen etc may also be permitted to act as BCs. Further, Micro Finance – Non Banking Finance Companies (MF-NBFCs) may be allowed to act as limited BCs of banks for providing only savings and remittance services. The Committee also recognized that technology has to be an integral part in sustaining outreach efforts through the BC model. (Extract of recommendations of the Committee furnished in **Annex - 2**)

7. The list of persons who can be engaged as BCs was further expanded to include individuals like retired bank employees, retired teachers, retired government employees and ex-servicemen, individual owners of kirana / medical /Fair Price shops, individual Public Call Office (PCO) operators, agents of Small Savings schemes of Government of India/Insurance Companies, individuals who own Petrol Pumps, authorized functionaries of well run Self Help Groups (SHGs) which are linked to banks. Any other individual including those operating Common Service Centres (CSCs) are also allowed to act as BCs of banks.

#### **Other major regulatory guidelines governing BCs**

8. With a view to ensuring adequate supervision over the operations and activities of the BCs by banks, every BC is required to be attached to and be under the oversight of a specific bank branch designated as the base branch. This guideline was issued in April 2008 along with the stipulation that the distance between the place of business of a BC and the base branch, ordinarily, should not exceed 15 kms in rural, semi-urban and urban areas and 5 kms in metropolitan centers. However, it was also provided that in case there was a need to relax the distance criterion, the District Consultative Committee (DCC)/State level Bankers Committee (SLBC) could consider and approve relaxation on merits in respect of under-banked areas etc. Subsequently, the maximum distance criterion in respect of rural, semi-urban and urban areas was raised from 15 kms to 30 kms.

9. Banks were encouraged to adopt Information and Communication Technology (ICT) solutions for implementing the model to ensure integrity and

fraud prevention. Banks are also required to ensure that their arrangements with BCs should specify suitable limits on cash holding by intermediaries as also limits on individual customer payments and receipts; it should also specify that the transactions are accounted for and reflected in the bank's books by end of day or next working day. The banks may, if necessary, use the services of the BC for preliminary work relating to account opening formalities. However, compliance with KYC norms under the BC model continues to be the responsibility of banks. The banks should also ensure that all agreements/ contracts with the customer clearly specify that the bank is responsible to the customer for acts of omission and commission of the BCs. Banks are required to comply with the RBI guidelines on managing risks and code of conduct in outsourcing of financial services.

Banks should constitute Grievance Redressal Machinery within the bank for redressing complaints about services rendered by Business Correspondents and Facilitators and give wide publicity about it through electronic and print media. The name and contact number of designated Grievance Redressal Officer of the bank should be made known and widely publicised. The designated officer should ensure that genuine grievances of customers are redressed promptly.

**10.** Initially, banks were not allowed to collect any charges from the customers for providing services through BC, close to the location of the customers. Subsequently, banks were allowed in November 2009 to collect reasonable service charges from customers in a transparent manner under a Board-approved policy. Considering the profile of the clientele to whom banking services are being delivered through the BC model, banks were advised to ensure that the service charges/fees collected from the customer for delivery of banking services through the BC model is not only fair and reasonable but also seen to be so.

**Banks' experience with BCs**

**11.** Although a variety of entities/ individuals have been permitted by the Reserve Bank to act as BCs, only a few have actually been so engaged by banks. Out of 50 public sector and private sector banks, only 27 banks have so far reported engaging BCs. Most of the banks that have engaged BCs have appointed Section 25 companies/ Trusts/ Societies as BCs. Further, almost all the Section 25 companies engaged as BCs have been floated by the technology service providers who had provided the smart card or biometric solutions for account openings, etc. FINO a technology firm working together with its non-profit partner Fintech Foundation, which acts as BC network manager has opened about 10 million accounts on behalf of 14 banks, Post Offices and nine Government agencies. A Little World (ALW) and its non-profit partner Zero Mass Foundation have also opened about 4 million accounts as BC for 20 banks. Eko is a similar technology focused company with Eko Aspire Foundation, a parallel non-profit organization operating as BC for State Bank of India. Similarly, Integra Micro Systems (Pvt.) Ltd, has also provided technology solution under the BC model to a few banks.

**12.** While many banks have taken some steps to adopt the BC model, only a few of them have scaled-up beyond the pilot stage. The difficulty experienced by banks in scaling up have been attributed to several factors including credit, operational, legal and reputation risks faced by banks in engaging a large number of BCs, low coverage by individuals acting as BCs due to their financial and other constraints, difficulty in assessing integrity of individuals acting as BCs, general lack of professionalism of BCs in matters of regularity, punctuality, maintenance of various records, delays in loan processing, disbursements, low volume of business generated by BCs and costs associated with low volume small value transactions.

### **International experience with BCs**

**13.** The limited access to financial services in most developing countries has been a real concern for the national governments and their central banks. Over the recent years, several initiatives have been taken for financial inclusion of the masses by extending the formal financial services through banks and their agents. Branchless banking has emerged as an alternative to the brick and mortar branches to reach out to the unbanked areas. This has been possible due to changes in the legislative and regulatory framework for provision of financial/ banking services supported by appropriate technology solutions. In countries like, Brazil, Kenya, Mexico, Philippines, South Africa, etc banks have been permitted to engage agents for rendering limited financial services.

**14.** The range of services and the entities permitted to be appointed as agents vary from country to country. In Brazil, banks are permitted to offer services such as deposits, withdrawals and transfers; forwarding applications for account opening, loans; loan collection, etc through legal entities functioning as agents. Until last year, authorizations were required to be obtained by the banks from the Central Bank of Brazil for engaging agents. The Central Bank of Brazil does not need to authorize agents any more. The Central Bank of Kenya has issued guidelines to banks on agent banking under which limited liability companies are permitted to act as agents amongst other, but not-for-profit and NGOs are not permitted to act as agents. The South African regulatory framework gives wide discretion to banks to use non-bank third parties to offer banking services beyond their traditional branch network, either as agents or through outsourcing arrangements. The banks in other jurisdiction like Mexico and Philippines also are permitted to outsource certain banking services. Details of the legal framework for branchless banking in these countries are given in **Annex 1**.

### **The case for 'for profit' companies**

**15.** Achieving the objective of financial inclusion requires a combination of organisational innovation and technology application. Many of the ingredients for

this are in place, including the requirement that individual banks articulate their strategy for achieving the objective. However, it is clear that financial inclusion initiatives will be unsustainable unless it is commercially viable for all stakeholders – banks themselves and the entities they use as BCs to increase penetration. The diversity of conditions across the country makes it difficult to visualize a single approach to ensure viability. General regulatory principles would have to combine with adequate flexibilities to allow viable models to emerge in each region. In this context, the suggestion from some quarters is to allow banks to use corporates, including telecom companies, NBFCs etc as BCs. The BC model may evolve into two distinct patterns, viz. (a) banks could enter into a separate agreements with corporates for using their retail network with specific responsibilities and functions to be performed by the corporate for a fee while the retail outlet is directly appointed as agent of the bank (b) banks could make the corporate itself as the BC with no direct privity of contract between the retail outlet and the bank – in this model the retail outlet is a sub agent of the corporate BC. Under both models banks have to be responsible for all acts of the retail agent as it is the point of contact for the customer where banking transactions take place. The pros and cons of appointing corporate as BCs are examined below:

### **Pros**

- (i) Corporates with large and widespread retail network bring in larger resources, higher organizational strength and financial backing needed for a large network of BCs besides providing financial security to the bank.
- (ii) Corporates as BC would be more suitable to render banking services in accordance with the bank's internal policies and standards than individuals and other small entities.
- (iii) Over years, these companies have developed efficient systems of monitoring and control over the retail outlets/franchises, including cash management, which could be used to advantage. These outlets are already dealing with the local population and are familiar with them.

- (iii) The shopkeepers and other retail agents of the large corporates may be more comfortable dealing with the company that they are already used to and familiar with, rather than with the bank.
- (iv) Failure of large companies as BCs would mean a reputation risk to the company and endanger its substantive business. As such, the companies could be relied upon to ensure that their agents do not jeopardize their reputation.
- (v) A corporate is likely to continue as BC for a longer period than individuals, thus ensuring continuity of services.

### **Cons**

- (i) Banking and financial services are essentially “pull” products that are “sought out” and like postal services have to be accessible at affordable cost. Banking and financial services should not be “pushed” towards or at the customer, unlike other goods sold by retail agents. Companies may, in the interest of revenue maximization, use their resources and wide distribution network to push banking and financial products, unmindful of whether they are suitable or appropriate for such persons. In other words, there are concerns of mis-selling of banking products especially amongst uninformed and illiterate consumers.
- (ii) A retail agent of a corporate may tend to provide banking services only to those customers who patronize the corporate's products as that would enhance his earnings - this represents a conflict of interest.
- (iii) Corporate BCs could misuse customer related information for their own commercial interests.
- (iv) Unfair coercive practices by corporate agents for marketing the financial products / recovery of loans etc. would lead to reputation risks for the banks that have appointed them, besides affecting the confidence of the public in the banking system.
- (v) In case the corporate shrinks its business requiring it to discontinue its retail, it may become difficult for banks to find immediate



replacement/substitution of the BC thereby affecting continuity in services. In case of appointment of individuals directly as BCs, the impact of one agent discontinuing business may not be significant.

### **Should NBFCs be allowed to act as BCs**

17. Another related issue for consideration is the case for allowing non banking financial companies (NBFCs), especially micro finance companies to act as business correspondents of banks. The pros and cons of this are discussed below:

#### **Pros**

- The Committee on Financial Inclusion (Chairman: Dr C. Rangarajan) had observed that NBFCs engaged in micro finance could be recognized as BCs of banks for providing only savings and remittance services. The rationale is that in case of such services there will not be any conflict of interest as NBFCs are not permitted to undertake such business.
- NBFCs have their own wide network of outlets and franchisees who are already trained in and have experience of providing all financial services such as loan , mutual fund and insurance products. They have the manpower, knowledge, skill and the requisite infrastructure to work as BC for Banks. There could be significant synergies if such networks are leveraged upon.
- NBFCs engaged in micro finance already have a large number of borrower clients who today do not have easy access to bank accounts, payments system, remittance services and insured deposits and if engaged as BCs can further the objective of financial inclusion.

#### **Cons**

- In case of deposit taking NBFCs there is a conflict of interest as they are engaged in the same business.
- If non deposit taking NBFCs are engaged only for deposit products and payments / remittance services, the objective of providing affordable credit as a major component of financial inclusion could be defeated. It is reported that

currently NBFC –MFIs charge between 20 and 35 per cent per annum for micro loans which is much more than what banks charge for small loans.

- There could be conflict of interest if the NBFC provides its own loan product as principal and bank's loan product as agent. There are also risks of co-mingling of funds.
- NBFCs mostly offer services through field officers and the branches are removed from the location where transactions take place closer to the customer. . Hence using them as retail outlets would be impractical.

### **Consumer protection measures/safeguards**

**18.** The regulatory framework for branchless banking is governed primarily by issues of consumer protection that need to be addressed if 'for profit' companies are to be allowed as BCs. The framework should emphasize transparency, creating better awareness, customer education and effective grievances redressal system. Some of the safeguards that could be taken are outlined below:

- (i) The retail outlet chosen by the corporate BC has to be personally introduced by the bank official in the presence of village leaders and government functionaries in a public meeting so that there is no misrepresentation.
- (ii) A corporate BC may represent more than one bank. A retail agent could represent several corporate. However, at the point of customer interface, a retail outlet/outpost of the corporate BC can represent only one corporate and provide the banking services only of one bank. .
- (iii) Each retail outlet may be required to post a signage indicating their status as service providers for the bank as also disclose the name of the corporate BC, the telephone number of the base branch/controlling office of the bank and the Banking Ombudsman and the fees for all services available at the outlet.
- (iv) Financial services offered by the retail agents of corporates should not be tied to the sale of any product of such company.

- (v) BC model should be IT enabled so as to ensure that the transactions are immediately uploaded in the bank's records. The technology should be such that information regarding customers and their transactions flow directly to the bank from the BC so that the confidentiality of the relationship between the bank and its customers is not compromised.
- (vi) Commission structure or incentive mechanism should be devised in a manner that mere increase in the number of clients served or the transaction volume does not drive the commission. The remuneration should combine fixed and variable parts dependent, inter-alia, on some indication or measure of customer satisfaction. Some part of remuneration should be back loaded to ensure "skin in the game."
- (vii) The internal control mechanism in the bank should include visits to BCs at least once a quarter.
- (viii) As a measure of social audit, there could be quarterly block level meetings where members of public are invited along with the BCs operating in the area as also the linked branch managers to enable an articulation of the difficulties faced and feedback provided. Lead District Manager (LDM) of the lead bank could attend such meetings in the district to get a direct feedback and provide such feedback to the controlling offices and the RBI.
- (ix) Financial literacy and customer education should form an important part of the business strategy and should form part of the commitment by banks adopting the BC model.

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**Legal Framework for Branchless Banking-International Experience\*****1. Brazil**

All Central Bank of Brazil(CBB)-licensed institutions are permitted to offer the following services through legal entities functioning as agents: deposits, withdrawals, and transfers; consultations; prepaid mobile phone top-ups; bill payments; receiving, reviewing, and forwarding applications for account openings, loans, and credit cards; preliminary credit analysis; loan collection; and international transfers. Until last year, CBB authorization was required if an agent were to engage in “banking services”—namely checking and savings account transactions (e.g., account opening applications, deposits, withdrawals, investment funds, and payments). However, CBB does not need to authorize agents anymore. The process is simple, and banks are required to register their agents online. Other services (not explicitly permitted by regulation) may also be outsourced to agents if authorized by CBB. With the intent of reducing the risk of agent fraud, CBB regulations prohibit the use of an agent whose primary or sole activity consists of services that are considered “banking services” as defined earlier.

The principal is fully responsible for the services rendered by its agents. CBB requires the principal (i) to control the activities of each of its agents by setting transaction limits and implementing mechanisms to block transactions remotely when necessary and (ii) to ensure compliance with all applicable legal and regulatory provisions, such as AML/CFT, customer protection, and data privacy. An agent must post a notice in its establishment that it acts on behalf of the bank.

The agency agreement and all supporting documentation related to the services rendered by the agent are open to scrutiny by CBB, which conducts onsite and offsite inspections through the principal. If necessary, CBB may conduct inspections directly (e.g., if customers are charging an agent with fraud or if the principal’s controls are deemed weak). Although the systemic risk of the agent

business is deemed low by CBB, there is concern with avoiding large-scale wrongdoing.

### **Regulatory provisions to minimize agent risks and permit supervision by CBB**

- All agents must be registered in CBB's online system.
- If banking services are delivered, being an agent cannot be the main or only business of the agent.
- An agent cannot use the word "bank" in its name without CBB authorization.
- CBB has unrestricted access to all information and documents related to agents and subagents. CBB can also directly inspect agents if necessary.
- Regulation sets obligatory clauses to be included in service agreements.
- Financial settlement between the agent and the bank must occur at least every two business days (accounting settlement is real time for every transaction).
- Agents cannot give cash advances to clients, guarantee transactions, or charge extra fees.
- An agent is required to post (and the bank is required to ensure compliance of this requirement) the following:
  - signage indicating its status as a service provider for the bank
  - telephone numbers of the bank ombudsman and bank customer care representative
  - fees for all services available at the agent

CBB monitors and evaluates the largest agent networks by focusing on the bank's internal controls and information technology infrastructure as well as its policies and procedures for hiring and managing agents, which must include criteria for setting transactional limits for each agent and implement mechanisms to remotely block transactions when needed.

Although the framework for the use of agents by financial institutions is based on CBB's regulations, CBB does not have a clear mandate under law to regulate

outsourcing. The Labour Law therefore has precedence over CBB's regulations on agents. As a consequence, there are several actions against banks (brought by agents and by bank employee unions) demanding wage equality between bank employees and agents. Most rulings so far have been in favour of the banks, but the continuity of the agent model is threatened by these demands, since the model's core feature—low cost—is potentially in jeopardy.

Also threatening the agent model are draft laws applying branch security requirements to agents (one of them being pushed by the Federal Police), in addition to a recent regulation by the National Health Surveillance Agency that questions the use of pharmacies and drugstores as bank agents. CBB has been analyzing these threats and possible actions, but no concrete action has been taken. The two bank associations have been pushing for a law that would define the agent business and give clear powers to CBB to regulate it without the risk of being questioned by other regulatory bodies, but it is pending approval by legislators and does not have formal support from CBB (by principle and tradition, CBB does not offer support to draft laws). CBB and banks agree that these legal issues threaten the viability of the agent business. A disruption in the agent business could have disastrous consequences for consumers, particularly for low-income people in isolated areas who rely on local agents to conduct their financial transactions, but also for millions of urban poor.

## **2. Kenya**

In November 2009, Kenya amended the Banking Act to include provisions on financial institutions' use of agents to provide banking services. Prior to the 2009 amendment, the Banking Act did not specifically address the issue of banks using agents to carry out banking activities, nor were there any regulations explicitly governing the outsourcing of functions by banks. Instead, Central Bank of Kenya (CBK) approved such arrangements on a case-by-case basis.

The amended law establishes “agency” as “an entity contracted by an institution and approved by the Central Bank to provide the services of the institution on

behalf of the institution, in such manner as may be prescribed by the Central Bank.” CBK has issued the guidelines on agent banking on April 30, 2010. A few provisions of the guidelines are as under:

**Entities eligible for appointment as agents#**

The following entities are eligible for appointment as agents under the guidelines:

- i) Limited liability companies.
- ii) Sole proprietorships.
- iii) Partnerships.
- iv) Societies.
- v) Cooperative societies.
- vi) State corporations.
- vii) Trusts.
- viii) Public entities.
- ix) Any other entity which the Central Bank may prescribe.

Any entity which is faith-based or not-for-profit, a non-governmental organization, an educational institution, forex bureau or any other entity which, under any applicable law is not allowed to carry on profit-making business shall not engage in agent banking business.

Any entity which is subject to any regulatory authority under any written law or is a public entity, shall obtain the consent of the regulatory authority or the appropriate oversight body or authority prior to being appointed an agent.

**Permitted Activities**

An agent may provide any of the following banking services as may be specifically agreed between it and the institution.

- i) Cash deposit and cash withdrawal.
- ii) Cash disbursement and cash repayment of loans.
- iii) Cash payment of bills.
- iv) Cash payment of retirement and social benefits.
- v) Cash payment of salaries.

- vi) Transfer of funds.
- vii) Balance enquiry.
- viii) Generation and issuance of mini bank statements.
- ix) Collection of documents in relation to account opening, loan application, credit and debit card application.
- x) Collection of debit and credit cards.
- xi) Agent mobile phone banking services.
- xii) Cheque book request.
- xiii) Cheque book collection by customers.
- xiv) Collection of bank mail/correspondence for customers.
- xv) Any other activity as the Central Bank may prescribe.

It shall be the responsibility of the institution to determine, based on agent risk assessment, which services a particular agent should provide. All monetary transactions conducted through an agent shall be denominated in Kenya shillings.

#### **Prohibited activities#**

An agent shall not;

- i) Operate or carry out an electronic transaction when there is communication failure in the system.
- ii) Carry out a transaction when a transactional receipt or acknowledgement cannot be generated.
- iii) Charge any fees directly to the customers.
- iv) Carry out agent banking business when, in the opinion of the institution the initial commercial activity has ceased or is significantly diminished. The commercial activity should be viable and able to financially support the agent banking business.
- v) Offer any type of guarantee in favour of any institution or customer.
- vi) Offer banking services on its own accord (provide on its own account banking services similar to those provided by it under an agency contract).
- vii) Continue with the agency business when it has a proven criminal record involving fraud, dishonesty, integrity or any other financial impropriety.



- viii) Provide, render or hold itself out to be providing or rendering any banking service which is not specifically permitted in the contract.
- ix) Open accounts, grant loans or carry out any appraisal function for purposes of opening an account or granting of a loan or any other facility except as may be permitted by any other written law to which the agent is subject.
- x) Undertake cheque deposit and encashment of cheques.
- xi) Transact in foreign currency.
- xii) Provide cash advances.
- xiii) Be run or managed by an institution's employee or its associate.
- xiv) Subcontract another entity to carry out agent banking on its behalf.

An institution may in the contract document specify other activities which the agent is prohibited from undertaking.

### **3. Mexico**

Banks have been using agents for many years in Mexico, although the underlying regulatory framework has changed significantly over time. Until 1993, banks could use agents—known as *comisionistas*—to deliver a variety of services. The outsourcing was subject to the *Comision Nacional Bancaria y de Valores* (CNBV)'s supervision and the bank was held responsible for the agent's acts. From 1993 until early 2008 banks were prohibited from using agents. Nevertheless, banks continued "outsourcing" services simply based on the fact that there is no legal obstacle for a *comisionista* to be an agent of a customer: the agent had an implicit agency contract with the client, not with the bank (although the client typically did not know that). The bank held no responsibility for the agent's acts and the CNBV had no supervisory authority over the agency business. Moreover, the *Financial Consumer Protection Code* did not cover these agency relationships.

To overcome the pitfalls of such a framework, the banking law was amended in February 2008. It gives ample regulatory and supervisory powers to the CNBV and holds banks fully responsible for the acts of their agents. In December 2008, the CNBV issued its agency regulation pursuant to which banks may hire legal entities and individuals to deliver a wide array of services, subject to an authorization

process that includes the submission of a full business plan for the agency business and the compliance with a suite of security and technological requirements set in complementary regulation applicable to electronic payments. Agency agreements cannot be subcontracted to third parties and may not have exclusivity clauses. The regulation also establishes:

1. minimum provisions to be included in agency agreements;
2. basic eligibility criteria for agents;
3. technical and operational requirements;
4. limits for agent transactions, individually and globally;
5. internal controls and reporting requirements for a bank's agency businesses;
6. the requirement that transactions be conducted on-line and in real-time (each agent must have an account with the bank for real time financial and accounting settlement);
7. different transaction thresholds depending on the level of KYC conducted;
8. valid identification authenticity procedures of both clients and agents;
9. management of agents directly by the bank or through third parties, or network managers (a pending regulation will allow MNOs to be network managers). CNBV has the prerogative to conduct onsite inspections of agents in case it deems it necessary. The bank's general manager is held responsible for complying with the agency regulations.

Lastly, the agency regulations impose a particular limitation: agents may only receive monthly deposits up to the equivalent of 50% of the bank's average monthly deposits in the last 12 months. This limit does not allow the emergence of a bank that primarily operates through agents, but so far has not proved a real obstacle for the current players.

#### **4. Philippines**

In Philippines, banks are permitted to outsource a substantial range of activities to mobile operator, Smart Communication (Smart) via a system of pre-paid accounts. Similarly, a subsidiary of a mobile operator Globe Telecom (Globe) offers virtual stored-value accounts, which enable mobile phone customers to make payments

and money transfers. Globe's subsidiary, known as G-Xchange Inc (GXI) is regulated as a remittance agent, permitting a non-bank-based model also using pre-paid accounts. As a condition of their permission to launch, Smart Money and GCash each agreed to furnish detailed operational data to Bangko Sentral ng Philipinrs (BSP).

Banks may not outsource any inherent banking functions, which effectively include all transactions related to deposit-based accounts. With this prohibition, the development of a broad range of branchless banking models in which banks use third party merchants for cash handling is unlikely to occur in the Philippines. (The Smart Money model classifies its account as a pre-paid account, rather than a deposit, and thus does not implicate the restrictions applicable to bank agents.) And although not specifically prohibited by the law, the BSP currently does not permit banks to outsource Anti-Money Laundering/Combating Financing of Terrorism (AML/CFT) functions. The BSP is currently exploring the idea of allowing such outsourcing.

## **5. South Africa**

The South African regulatory framework gives wide discretion to banks to use nonbank third parties to offer banking services beyond their traditional branch network, either as agents or through outsourcing arrangements. The Banks Act allows a bank to contract agents "to receive on [the bank's] behalf from its clients any deposits, money due to it or applications for loans or advances, or to make payments to such clients on its behalf." The only restriction is that a bank may not enter into an agency agreement until it has provisioned for the bank's organizational extensions, purchase of a business, losses (including any loss suffered from a sale of assets), and bad debts. A 2004 South African Reserve Bank (SARB) circular was issued in response to questions by banks regarding proposed outsourcing arrangements. It provides guidance for outsourcing arrangements that could (i) have a bearing on the risk profile of a bank, (ii) affect the systems and control of a bank, (iii) be classified as being of strategic

importance, or (iv) have implications for SARB and its supervisory duties. The circular does not specify which bank functions may be outsourced, but it does prohibit the outsourcing of a bank's compliance function and permits the outsourcing of the internal audit function only on a case-by-case basis. Furthermore, any outsourcing arrangement covered by the circular will be subject to SARB scrutiny. A bank is therefore left with wide discretion, provided that it:

- Enters into a detailed outsourcing agreement that is legally scrutinized by the bank
- Ensures outsourced services are performed adequately, in accordance with internal policies and standards and in accordance with the outsourcing agreement
- Ensures processes are in place to identify and deal with any weakness in a supplier's service, which may include access to the supplier by the bank's internal and external auditors as well as external agencies
- Provides SARB, when requested, with any required information on the outsourced functions or activities.

In addition, bank management is required to advise SARB of any proposed outsourcing arrangements prior to finalization of such arrangements and to provide SARB with copies of the minutes of the board risk subcommittee meeting at which the proposed agreements were considered.

The wide discretion accorded to banks in their use of agents has enabled banks to provide banking services outside traditional bank branches. However, requiring agents to perform in accordance with the internal policies and standards of the bank may result in the exclusion of smaller establishments that are more likely to be located in low income areas but, unlike larger retailers, do not have the resources to satisfy the bank's internal control and audit standards.

\* Consulting Group to Assist the Poor ([www.cgap.org](http://www.cgap.org)); # Guidelines issued by the Central Bank of Kenya

**Extracts of the Report of the committee on financial inclusion, January 2008  
(Chairman: Dr. C. Rangarajan)**

**Business Correspondents**

**4.55** With increasing competition, banks are getting to be quite wary of the reducing margins available to them on financial intermediation. Banks are, therefore, hesitant to opt for increasing their physical presence in upcountry/ remote locations entailing considerable capital/ operating costs. Under the present dispensation, small value clients (depositors) in remote locations get very little preference in accessing financial services. It is, therefore, imperative to have in place an arrangement which can cater to a large number of clients having irregular and low value transactions ensuring at the same time full protection of the interests of depositors. Such an arrangement is possible only by having a BC touchpoint in each of the 6 lakh plus villages serving as a customer interface at the front-end and backed by appropriate technology for its integration with the mainframe banking at the bank level. Keeping this in view, the following **recommendations** for the BC Model are made :

**4.56** In addition to the institutions presently allowed by RBI to function as BCs, individuals like locally settled retired Government servants like postmasters, school teachers, ex-servicemen and ex-bank staff whose relationship with the banking system, through a pension account, has already been established, may be permitted to act as BCs.

**4.57** Further, MF-NBFCs may be allowed to act as limited BCs of banks for only providing savings and remittance services.

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**Micro Finance Institutions**

**8.07** There is a need to recognize a separate category of Microfinance - Non Banking Finance Companies (MF-NBFCs), without any relaxation on start-up

capital and subject to the regulatory prescriptions applicable for NBFCs. Such MF-NBFCs could be defined as companies that provide thrift, credit, micro-insurance, remittances and other financial services up to a specified amount to poor in rural, semi-urban and urban areas.

**8.07** MF-NBFCs operate in a limited geographical area and have local feel. To enable the poor to have access to savings services, MF-NBFCs may be recognized as Business Correspondents of banks only for providing savings and remittance services.

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**RBI Guidelines on Business Correspondents (BCs)**

List of Circulars issued by the RBI to Scheduled Commercial Banks (including RRBs) on use of BCs:

1. DBOD.No. BL.BC. 58/22.01.001/2005-06 dated January 25, 2006
2. DBOD.No. BL.BC. 72/22.01.009/2005-06 dated March 22, 2006
3. DBOD.No.BP.40/21.04.158/2006-07 dated November 3, 2006
4. DBOD.No. BL.BC.74/22.01.009/2007-08 dated April 24, 2008
5. DBOD. No. BL.BC.35/22.01.009/2008-09 dated August 27, 2008
6. DBOD.No.BL.BC.36/22.01.009/2008-09 dated August 27, 2008
7. DBOD.No. BL.BC.129/22.01.009/2008-09 dated April 24, 2009
8. DBOD. No. BL.BC.63/22.01.009/2009-10 dated November 30, 2009
9. DBOD. No. BL.BC.99/22.01.009/2009-10 dated April 26, 2010

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