



## NOTE FROM IMTFI

### Mobile money regulation: A story arc of best practices and emerging realizations

Formal mobile money services – the use of mobile phones as a channel for money transfer and savings – have only been around for a very short while, beginning with the launch in the Philippines of Smart Money in 2003 and Globe G-CASH in 2004. Informal mobile money services, however, have existed since 2000 when people could purchase prepaid airtime and either transfer it from one account to another or resell prepaid airtime codes on the black market. If the airtime could be cashed out, person-to-person airtime transfer served as a form of remittance. Even if it could not be formally cashed out, it could still be resold to another person.

Today, the intensity of interest in mobile and the growing regulatory conversation about balancing the benefits with the potential risks is still somewhat outsized relative to the actual scale of the industry. Outside of a few limited geographies – notably Kenya, the Philippines, and to a lesser but growing extent elsewhere in East Africa – mobile money serves a limited client base, and achieving scale appears always to be “just over the horizon.” Safaricom Kenya’s M-PESA, the subject of much interest, hope, and

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scrutiny, dates back only to 2007. With 12 million clients, it is by far the biggest success story in this space, with the runners-up Smart Money and G-cash reaching 8 million and 1 million clients respectively. There are currently about 130 live deployments of such services, ranging from banking-on-phone via mobile browser interface to airtime-based remittance transfer. Much has been made of the distinction between “carrier-led” and “bank-led” models. The former seems to offer more nimble and rapidly scalable products, especially for the poor and underbanked, while the latter is tied to existing bank services and products. As others have noted, however, the distinction is overdrawn, and there is always a bank somewhere in the background of any mobile money service, even if it is limited to serving as the holder of the float.

As someone who has been researching mobile money globally since 2007, and in



particular client and regulator perspectives on mobile money, I have watched the unfolding story arc of mobile money regulation with keen interest. Mobile money regulation has proceeded in a manner relatively unique to global governance: rather than being dictated from the traditional centers of financial regulatory authority and expertise<sup>i</sup>, mobile money regulation is emerging from a unique South-South conversation and knowledge transfer. Witnessing the development of mobile money services in their countries, regulators in Kenya, South Africa, the Philippines, India, and other countries have come up with innovative solutions to protect consumers and facilitate this new business model. These solutions have included allowing for non-bank electronic money issuance and proportionate due diligence. They have done so because of their commitment to financial inclusion goals.

Granted, there are several confounding factors. Market participants are responding to market signals and seeking profit, but many businesses are also pursuing a double- or triple-bottom line, seeking to advance social development and sustainability goals. These businesses can see a potential for return in promoting financial inclusion simply by bringing more people as clients into their systems. Regulators are responding to market participants, sometimes in collaboration and sometimes in competition or even direct conflict. Many regulators, major multilateral organizations, and aid agencies, ranging from the G20 to the Department for International Development (DFID), have also signed on to financial inclusion goals and have promoted this agenda.

These two factors – South-South knowledge transfer on complex financial and technological regulation and a commitment to

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<sup>i</sup> The traditional centers of financial regulatory authority and expertise include: the OECD and Bank for International Settlements on banking, the Financial Action Task Force and Financial Stability Forum on financial integrity and anti-money laundering, or, especially for Commonwealth countries, the UK Financial Services Authority.

financial inclusion goals – make this emerging domain of regulation distinct from others. There seems to have been three developments in mobile money regulation, and we are in the middle of a fourth. The three developments are not necessarily sequential: they take place in different countries at different times, and not all have been implemented everywhere. But together they create the regulatory environment for mobile money.

### **Developments in the regulatory environment**

The first development is the establishment of proportionate due diligence for client identity requirements. Know Your Customer (KYC) and Customer Due Diligence (CDD) processes are not only important for financial system integrity, anti-money laundering, or countering the financing of terrorism. They are also important because the lack of identity documents is often one of the most powerful barriers to financial inclusion. Furthermore, the northern states that have dominated multilateral forums like the OECD have historically used lack of adequate KYC/CDD in shaming exercises and so-called blacklists against less powerful countries with less regulatory capacity. Developing world countries are thus hit with an extra disadvantage of wanting to achieve financial inclusion goals without ending up on blacklists. South Africa led the way by permitting proportionate due diligence, tiered to transaction and e-purse limits.

The second development is the authorization of non-bank entities either to accept deposits or to issue electronic money. Defining e-money as value backed in a one-to-one ratio by the issuer's liquid assets and forbidding intermediation of e-money float creates a system for facilitating transfer and payment distinct from the banking sector. This enables non-bank entities like telecommunications companies to start offering rudimentary financial services.



But how should operators handle the float in the system? If structured as a pooled trust account, the funds would be safer than they would be if they were used for operations or intermediated for profit. But mobile money accounts, basically tokens representing portions of the pooled trust, have resembled prepaid accounts in other, developed world card systems. This raises a question of whether a second-class banking system has been created that does not offer its clients interest, a key benefit of intermediation. This is the third development: the realization that, by not eroding entirely the boundary between e-money and deposit taking, regulators have inadvertently given license to an alternative payment system, one that rides the rails of the telecommunications networks rather than the traditional wire and card payment systems.

Given that this alternate payment system was a prepaid system and now involves card networks and private network rules, we start to see the sheer complexity that various stakeholders in mobile money are only now beginning to grapple with. Mobile network operators and banks, heretofore dancing only with each other (sometimes disharmoniously), now have to contend with card networks, database companies, airtime distributors, along with the traditional wire services like Western Union. For example, earlier this year in June 2011, Visa acquired Monitise and Fundamo. And regulators are just now clueing in to things like cross-boundary airtime topup services, which have the potential to offer a truly transnational remittance service riding a whole separate set of rails from the traditional payments systems.

Outside of the payments industry, people often forget that the means of value transfer is central to economic transactions large and small in the global economy. Who outside of payments experts even pretends to be aware of, much less understand, the Automated Clearing House (ACH) system for automatic electronic deposit and bill pay in the United States? But the evolution of mobile money has led regulators and industry professionals

to turn once more back to the original infrastructural questions that animated mobile money in the first place: do mobile telecommunications networks represent a new set of rails for payments? What else can ride those rails? Attention has turned back to the specific channels used by mobile money services – USSD, SMS, and so on – as ever more channels come to light (one to watch: airtime topup) and traditional payments service providers like the card networks reassert themselves.

And finally, the fourth (still unfolding) development has to do with the regulation of payments. In the United States and Europe, payments have come under renewed regulatory scrutiny because of consumer protection related criticisms and concern that interchange fees are too high. And in the mobile money space, one hears more and more frequently that “no one wants to be a dumb pipe.” By this, people mean that no player wants to operate a system of channels through which data or value is transmitted without getting a piece of the fee revenue pie. This leads some regulators to ask the question of whether payments are a public good. While it may sound like an argument stopper, the question of public goods and public infrastructure is high on the agendas of developed and developing world countries in the wake of the global financial crisis and the attempt to create new infrastructures to kick-start employment, drive growth, and create new innovations. It is a good time to remember that banking infrastructure in the developed world proceeded in large measure due to public support, as did the Internet (which was built upon basic US government funded research). M-PESA owes some of its success to initial public investments from DFID and the Kenyan government through Telkom Kenya.

This story is unfinished and likely to remain open-ended. But mobile money has come a long way in a very short span of time. It has productively reenergized fundamental questions about the nature of value and value transfer in democratic and open societies.

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### **Feature photograph**

A woman displays money and her mobile phone at a Hawala market in Afghanistan. Photo credit: Institute for Money, Technology and Financial Inclusion.

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