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FINANCIAL INFRASTRUCTURE SERIES
PAYMENT SYSTEMS POLICY AND RESEARCH

FROM REMITTANCES TO M-PAYMENTS

Understanding “Alternative” Means of Payment within the
Common Framework of Retail Payments System Regulation

October 2012



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FOREWORD

Retail payment systems play an important role in the smooth functioning of any economy, and thus any inefficiencies in the retail payments market can send negative effects cascading throughout the financial realm. The World Bank Global Payment Systems Survey 2010 has shown that inefficiencies persist in the payment systems of many middle-income and low-income countries, with cash continuing to be the most widely used instrument for small-value payments. A number of issues are responsible for this pattern, and the lack of a coherent, holistic strategy for the development of retail payment systems is among the most common.

The lessons learned during more than a decade of World Bank Group technical assistance, along with the research findings of other international and national agencies, have been merged into a comprehensive package for the development and reform of the national retail payments system:

1. “Developing a comprehensive national retail payments strategy” aims to provide public authorities and market participants with detailed guidance on how to develop and implement a comprehensive, strategic retail payments reform.
2. “A practical guide for retail payments stocktaking” identifies a methodology for undertaking a detailed stocktaking of a country’s retail payments landscape.
3. “From remittances to m-payments: Understanding ‘alternative’ means of payment within the common framework of retail payments system regulation” explores the development of a normative framework to underpin an efficient retail payments industry, including the so-called innovative payment mechanisms.
4. “Innovations in retail payments worldwide: A snapshot: Outcomes of the global survey on innovations in retail payments instruments and methods 2010” presents the results of the first World Bank survey among central banks that collected information on innovative retail payment products and programs.

The authors of this paper are Massimo Cirasino (Manager, Financial Infrastructure and Remittances, The World Bank) and Mariachiara Malaguti (Professor of International Law at La Cattolica University of Rome and Senior Legal Advisor, Financial Infrastructure and Remittances, The World Bank). I am grateful to other members of the team for their support.

This paper has benefited from the comments of a number of World Bank Group colleagues, national central banks and other national and international institutions, as well as private sector entities. We are grateful to those colleagues for providing their valuable insights.

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CONSIDERATIONS SURROUNDING THE PROVISION OF “ALTERNATIVE” MEANS OF PAYMENT



1. DIFFERENT INSTRUMENTS, COMMON CONCERNS

1.1 The “payments system” approach

In recent years, the payments industry has highly progressed in terms of types of instruments to execute money transfers, use of new technologies, and articulation in the offer of payment services. This has especially affected the retail sector, giving rise to various studies and evaluations of new developments from different perspectives. In particular, payments by means of mobile phones are seen as the most promising instrument, especially in countries with a high percentage of unbanked population, to widen the offerings for payment services and satisfy unaddressed needs. The fact that the device used is a mobile phone, which almost everyone possesses even among the poorest, has also led many to view this new channel as a means of defeating poverty and ensuring inclusiveness.

These important considerations, apart from either the technological or business perspectives of what is alternatively called “m-banking” or “m-payments,” are very relevant and deserve careful consideration. However, they frequently lead to approaching this phenomenon

as if it were totally new and somehow apart from the traditional ways of executing payments, which are, for the most part, led by the banking sector.

In practice, the current attention being given to m-payments is not that different from concerns that were apparent when remittance services first entered the market. Indeed, the development of non-banking networks to provide cross-border remittances has been one of the most disruptive events of recent years, creating so much change in the payments industry to lead regulators to start regarding the provision of payment services as an autonomous activity, separate (although often ancillary) to banking services. The social function of remittances, especially cross-border remittances, of facilitating repatriation of salaries of foreign workers became the major focal point of debate, especially when it was clear that in some countries revenues from these transfers would cover a high quota of domestic income. It further emerged that, from a regulatory point of view, the provision of these services requires a different focus because it is part of the retail payments industry. In practice, money remittances mean no more than money transfers, which can be domestic or cross-border, and can be indifferently executed through traditional (banking) or other channels. Such remittances might involve large or small operators, well-organized chains, or almost “informal”

traders, and finally might be cleared and settled under a wide range of methods, each entailing differently risk exposures to the parties of the transaction.

This same analytical framework and focus can be applied to m-payments: the provisioning of these payments can go from the extreme of being provided by telecommunications operators without any direct involvement of a bank, through being provided in strict cooperation with the banking sector, at least for clearing and settlement, up to situations where banks outsource such services to a telecommunications operator or even use the operator as nothing more than a communication channel, with the service fully provided by banks. Like remittance services, m-payments can be domestic or cross-border, and serve a wide range of different needs. Again, according to the different ways the service is organized, the legal schemes which are adopted, the contractual allocation of risk, and the clearing and settlement of transactions, m-payments might give rise to different risks and deserve different regulatory treatment, always against the common principles underlying the regulation of payment services in the retail market.

In fact, it should be kept in mind that most of these new means to make payments have simply linked to existing channels, interfacing with existing ATM or POS networks and working under the same patterns as cards, or mirroring schemes as that of e-money issuers, such as PayPal, by storing customers' money in some electronic device. It goes without saying that even before money remittances came to the attention of policy makers and scholars, "e-money issuers" had been the scrutiny of similar concerns, although at that time concerns were mostly related to what was perceived as the production of money, and the effects this could possibly have on monetary policy. E-money was yet an innovation in the industry leading to the potential widening of the offer, not only in terms of instruments but also (and foremost) in terms of operators.

All these progressive and interlinked developments lead to a main challenge for regulators, prior to any specific policy decision on how to treat each and any of these instruments or means, i.e., what is effectively innovative in these instruments to the point of requiring different regulatory tools, and what, on the contrary, is just a specific implementation of existing schemes already covered by the regulatory discourse on retail payments.¹ In fact, if it is undisputed that the industry has now upgraded, offering new devices and new communication technologies as well as experiencing the entry of new non-financial actors, thus modifying the shape of the market on the supply-side, this should not be taken as a need to depart from the basic principles (and the basic methods of evaluation) of regulation of the retail payments sector.

This is the more true looking at recent trends, as mobile operators not only are offering new products, but also provide platforms with multiple applications. This leads to convergence of existing products offerings into new channels and permits the offer of new products through a wide range of business models and arrangements. If any, this is a clear confirmation that payments through mobiles can only be understood within the wider picture of regulation of retail payment instruments (including both "traditional" and "alternative" products) and not by artificially focusing on the novelty of technology.

1.2 Categorization of m-payments schemes

A number of publications have described new-born countries' experiences in payments, with a special focus on m-payments as potentially the best suited method to increase access to finance; it is therefore un-

¹ This is also the exercise undertaken in the recent contribution of M. Klein and C. Mayer, "Mobile Banking and Financial Inclusion. The Regulatory Lessons", World Bank Policy Research Working Paper 5664, May 2011. The focus of these authors is on different issues than those addressed in this paper.

necessary to repeat this work.² However, a timely legal and regulatory analysis of each of them should be made in accordance with the pertinent domestic legal and regulatory framework. If, for the sake of further considerations, we can operate a sort of abstract categorization (although some models have clearly prevailed in the market and some are the combination of more than one), we can identify the following:

- Under some contractual schemes, banks provide access to current accounts by way of mobile phones (or similar devices) in the same way as by Internet, payment cards, or ATMs (or a combination). Services may include execution of payments towards third parties accounts. Aside from the bare case when telecom networks have no other involvement than providing a means of communication, it is possible that the bank would outsource part of the operational activities to execute the transfers to the mobile operator. In this case the bank keeps control over the service, to the point that it can be said that the bank, and the bank only, is the relevant service provider.³ In this case, outsourcing might still imply a number of risks that need to be assessed and consistently controlled, but the structure of the service does not strongly differ from execution of payments by other “traditional” means, since no accounts other than the existing bank accounts are open, nor does the mobile operator possess any funds.

² See among the many T. Lyman, M. Pickens and D. Porteous, “Regulating Transformational Branchless Banking: Mobile Phones and Other Technology to Increase Access to Finance”, CGAP Focus Note No 43 of January 2008; I. Mas and K. Kumar, “Banking on Mobiles: Why, How, for Whom?” CGAP Focus Note No 48 of June 2008; F. Eijkman, J. Kendall and I. Mas, “Bridging the Cash: the Retail End of M-PESA”, Journal of Saving and Development 2010. Regulatory considerations are included, in addition to some of the contributions already mentioned, in D. Dias and K. McKee, “Protecting Branchless Banking Consumers: Policy Objectives and Regulatory Options”, CGAP Focus Note 64, 2010 and in P. Makin, “Regulatory Issues around Mobile Banking”, OECD 2009.

³ For example, many operational services associated with payment cards and ATMs are also outsourced to specialized operators.

- In other cases, the bank outsources a wider range of services to the mobile operator; customers of mobile operators are required to open accounts at the bank to be allowed to execute transfers by mobile phone. The mobile operator acts as an agent of the bank when facilitating the opening of such accounts by collecting relevant information and documentation and directly deals with the customer (who is originally its own customer). These new accounts, although being a new kind of account that often imposes thresholds in terms of operations to be transacted or funds to be deposited, are in fact opened at the bank and should in principle benefit of any existing legal protection for deposits. The accounts are in the name of the customer and establish a relationship between the bank and the customer, who also becomes a client of the bank. This is true even though the mobile operator acts as an intermediary between the bank and the customer, and is the only entity that deals directly with the customer. This scheme is more complex and permits a much more active role by the mobile operator. However, the latter does not perform any clearing or settlement activity, nor does it possess any of the customer’s funds, since all transactions occur at the bank level. The general structure may be further enriched by a system of agents permitting withdrawal and deposit of money, but the bank requires such agents to open an account with the bank and formally becomes an agent of the bank, even though, again, the mobile operator is the only entity in direct contact with the customer. In this case, the service provider is the bank, although the outsourcing of such a relevant part of the activities and the establishment of an agent network requires a risk assessment and consequent monitoring.
- In countries where the execution of payments is not considered as an exclusive banking activity,

the mobile operator might itself offer its customers the service of executing payments using the same mechanisms that the client is used to for buying airtime. One way to clear such transactions could be for the mobile operator to open a pooling account with a bank where it deposits the money received by its customers to execute payments. In this case the mobile operator does possess customers' funds, executes the clearing and manages the pooling account under some legal scheme such as trust. When the country does not recognize legal schemes such as that of a trust, the account is opened in the operator's name under some other fiduciary mechanism, although in several cases the domestic legal system (especially in civil law countries) is not equipped to fully regulate fiduciary relationships and the account is plainly open under the operator's own name. Under this structure, the service provider is the mobile operator, which has a link with one or more banks or other financial institutions to ensure clearing and settlement of transactions. The bank might still undertake a more active role if it accepts to insure or guarantee customers or otherwise participate in the contractual relationship between the operator and the client (becoming, therefore, a three-party contract), especially in cases where the domestic legal framework does not sufficiently protect customers under a fiduciary relationship between the customer and the mobile operator as the holder of pooling accounts. Agents can also be appointed under this scheme: in this case, these shall, in principle, be agents of the mobile operator as service provider.

- Finally, the mobile operator may directly charge clients' money into the mobile or in some software, without opening any account at a bank, neither on the name of the customer(s) nor on its own name, but virtually opening an account

at its own "premises." In this case, the banking sector is potentially excluded, although the mobile operator still needs to access the payments system for final settlement. Under these circumstances, some additional regulatory concerns might arise from the fact that such issuance is considered the production of money. In this specific case, the service provider also clears and settles operations. These considerations have caused a number of countries either to prohibit this activity on the part of non-banks, or to strictly regulate it, to the point that this situation is rarely reproduced in reality.

1.3 The main emerging features

This attempt of categorization, which – as mentioned above – does not intend to represent any concrete existing scheme but is instead a tentative generalization coming from a number of varying experiences,⁴ should help in identifying some of the relevant features of m-payments that apply to regulatory issues that surround such payments. Moreover, identifying such features further helps in identifying similarities with other "alternative" means of payment to confirm the correctness of a general evaluation under common principles and reconnect them to the traditional discourse on regulation of retail payments. This document has a particular focus on similarities with remittances and, where relevant, with use of stored-value cards (i.e., e-money), as these instruments are primarily associated with the entry into the payments market of non-financial institutions, although it does not mean

⁴ In several concrete cases some of these schemes are mixed and different channels provided.

to underscore the wider array of business schemes, arrangements and satisfaction of market needs that m-payments may offer.⁵

1.3.1. Relevance of account holding

From the previous brief description it clearly appears that the real issue when a service provider happens to be a mobile operator, is how the money received for the transfer is treated: does the mobile operator open accounts in the name and behalf of the client(s) or does it keep accounts in its own name (pooling the money received). Issues of segregation or other forms of protection of customers' accounts arise, as well as the parallel risk that any situation of insolvency of the service provider could affect the users.

When transfers are executed only on existing or specifically opened bank accounts in the name of the customer, such transfers would benefit from domestic legislation on protection of deposits and of the existing supervisory mechanisms of banking institutions. At the other extreme of possible scenarios, i.e., when these amount to production of e-money, the issuer may be subject to specific capital requirements and operational restrictions. Instead, when the service provider opens pooling accounts or even accounts in its own name without making any fiduciary link explicit, requirements to guarantee traceability of funds by each client and the solvability of the service provider are necessary.

These assessments, at least in terms of general parameters, align with those applied to remittance services: the major difference between m-payments and remit-

tances is that remittances neither require nor depend on a stable relationship between the user and the provider of the service (although this may have a factual relevance). The user just walks into the store, deposits cash and orders the transfer of money to a third person, who also does not need to have any stable relationship with the service provider (or its disbursing agents). However, the service provider still possesses the customer's funds and deposits those funds somewhere in order to be able to execute the transaction, these types of transactions can range from full management of bank accounts open in the name of the remittance provider for the benefit of execution of customers' transfers up to the production of e-money.⁶

As a remark, the use of deposits and store value thus makes a difference in terms of risk and regulatory concerns in respect of the provision of payment services as the pure intermediation in the transfer of money.

1.3.2. Access to clearing and settlement

These schemes also relate to the clearing and settlement of m-payments and remittances. Apart from the relationship between the service provider and the user, clearing and settlement schemes used by these operators may widely vary, but always within the known, "traditional" patterns of intrabank or interbank clearing and settlement. Risks and remedies, in this case, have been widely studied by regulators and there is the benefit of long experience with these well-understood methods. In this context, the essential difference would indeed not be between alternative and traditional instruments, but between domestic and cross-border transfers, since dealing with foreign currency and cross-border settlement presents peculiarities that

⁵ See in particular the following documents being published by the World Bank in the context of the "Retail Package" public consultation: "Developing a Comprehensive National Retail Payments Strategy", "A Practical Guide for Retail Payments Stocktaking", and "Innovations in Retail Payments Worldwide: A Snapshot. Outcomes of the Global Survey on Innovations in Retail Payments Instruments and Methods 2010". See also CPPS, 2012, "Innovations in Retail Payments", Report of the Working Group on Innovations in Retail Payments, available at www.bis.org.

⁶ The situations do not apply to remittances services provided directly by banks or through credit card networks, since these are to "traditional" means of transfer.

do not emerge in domestic situations. This same concept is also true for the now long tradition of regulatory analysis of cross-border transfers.

What can only be different in terms of clearing and settlement is the potential immediacy of m-payments, which would in theory imply real time settlement for retail payments like these. However, this issue should not be misinterpreted: the fact that the payment might be immediate to the benefit of the receiver does not automatically imply that this should also be immediately settled in the interbank network: banks can provide credit to their customers or the service provider to permit daily settlement of these transactions.

Indeed, the major issue is access to clearing and settlement by non-financial service providers, where the issue of potential transfer of risk from the mobile operator to the system arises. This issue is far from new, and has led to prolonged discussions on differentiation between direct and indirect participation in a payments system, collateralization, and access to central bank money.⁷

Incidentally, access to clearing and settlement also calls for the issue of interoperability: in the same way that non-financial service providers would need ready access to clearing and settlement systems in order to be able to provide their services, they may be equally required to ensure interoperability to permit a full use of their networks by users. This issue still creates a lively debate, which however is by no means unknown to the general regulatory discussion on payment systems and follows analogous patterns.

⁷ See for example, The World Bank, "Balancing Co-operation and Competition in Retail Payment Systems." Study coordinated by Mario Guadamillas, Financial Infrastructure Series, 2009.

1.3.3. The role of agents

In order to operate efficiently, both m-payments and remittances need an articulated network of agents (merchants, post offices, and the like), as an alternative, or more often in addition, to bank-owned branches. Together with the nature and kind of accounts to be opened to perform the service, this need seems to be the most evident structural characteristic of both instruments. Indeed, since a fully cashless system would not be realistic at the present time, people need access to a wide number of locations where they can either deposit cash in order to have it transferred by mobile phone or a remittance network, or withdraw it once received, as well as simply deposit and withdraw money for their own needs.

One of the major elements of innovation in these channels as opposed to the traditional banking sector is the use of existing merchants or other services (such as post offices) that people already know and trust to complete the chain of operations needed to execute the service. Since these actors are not part of the banking sector (i.e., they are not branches subject to the existing regulation on bank branches and derive benefit from no specific protection), this structure does bear relevance from a regulatory point of view since it adds a number of complexities to the scheme, both to remittances as well as to m-payments.⁸

One of the major new complexities seems to be the liquidity risk connected to the service. The agents must indeed always have sufficient cash on hand to permit withdrawals, and when the customer requires transfer of money directly to or from the account of the

⁸ This issue is not totally new to the banking sector. For further references on this see I. Mas and H. Siedek, "Banking through Networks of Retail Agents", CGAP Focus Note No 47 of May 2008; and M. Klein and C. Mayer, "Mobile Banking and Financial Inclusion. The Regulatory Lessons", World Bank Policy Research Working Paper 5664, May 2011. The Brazilian experience on banking correspondents is of extreme interest to this end.

agent (only for the purpose of executing the transfer), the latter needs to ensure adequate coverage of funds. Segregation of accounts for the purposes of the service in respect to the agent's own account is also an issue.

The issue of liquidity is also linked to security concerns, since granting availability of cash at the premises of these agents also means granting security against robbery or other crimes. Finally, these agents must be trusted by people using their services and consequently need to be screened and duly trained. It must also be remembered that anti-money laundering (AML) requirements may be imposed on agents because of their direct contact with the final customer, which in some cases also includes the possibility of opening accounts for those customers. In such cases, additional requirements are often imposed. Taken together, these issues amount to protection of users of the service—the customer—and observance of some minimum standards of service.

One final focal point for both the public and the private sector is competition within the market, specifically related to distribution agreements and exclusivity. This issue would perfectly apply also to networks of agents as those described for m-payments under exactly the same parameters of access to the market, as well as – when relevant – exclusivity agreements with banks or other financial institutions.

1.4 Drawing some parallels (also a matter of definitions)

As mentioned, if something new can be identified in these “alternative” means of payment, it is that non-financial operators have entered the market and provided fierce competition to the banking sector. Regulation—which had traditionally focused on the banking sector under the assumption that payment services could only be an ancillary activity to the man-

agement of bank accounts—proved to be inadequate when non-bank operators entered the market. These newcomers were, on the one hand penalized because of existing restrictions (including the aforementioned limitations of a lack of direct access to clearing and settlement), and on the other hand benefitted by the possibility of operating without such stringent prudential requirements as the ones applied to banks. The combination has been in some circumstances highly detrimental to final users who both pay the cost of oligopolies generated by the often-imposed cooperation between banks and “new” services providers and bear the risk, in the case of remittances, of numerous small operators turning to the black market to avoid burdensome regulations. Indeed, the industry's inability (at least at first) to conceive of these operators as providers of payment services of the same kind as banks, although under different business schemes, has led to dangerous misconceptions, which do not individually benefit either the “traditional” operators or the “new entrants,” but above all seriously damage final users, who lack adequate protection and pay the price of closed markets.

There are a basic few questions: a) which provider of the service bears the primary responsibility for the service, independent from any form of cooperation or outsourcing it may engage with other operators; b) where are the funds deposited/stored and are those funds that belong to final users adequately protected; c) does the storing of money outside of the banking channel amount to production of money, and what regulatory concerns does this lead to; and d) how do non-financial agent networks affect the provision of payment services, including security concerns. All these issues can be reconnected one way or another to existing regulatory parameters.

This exercise should clarify the confusion surrounding definitions of specific instruments: m-banking as opposed to m-payments should in principle reflect

whether the service is directly provided by a bank or by a non-financial institution (where this is of relevance), as stored-value devices should have the same meaning as pre-paid instruments or e-wallets, to represent the “storage” of money for some length of time previous to the effective execution of the transaction outside of the banking sector (the only entity in principle permitted to take deposits and open credit lines). Finally, “remit-tances” should specifically refer to all those transfers of money executed without the user accessing an account (which also pertains to stored-value instruments). These definitions express legal or regulatory concepts (or define regulatory or legal consequences) but cannot exactly represent any individual scheme as such.

SECTION II

TOWARDS COMMON PRINCIPLES



2. WHAT DOES THE EU PAYMENT SERVICES DIRECTIVE TEACH?

2.1 Common treatment of payment services

The 2007 Payment Services Directive (PSD)⁹ has been an important normative attempt to consistently regulate payment services within a common set of principles, with, in fact, a special focus on retail payments. Indeed, under this legal framework “payment services” encompass cash deposits and withdrawals into/from an account and the management of such account, execution of payment transactions from a payment account with or without coverage by a credit line, issuing and/or acquiring of payment instruments, and money remittances. The Directive also explicitly includes “*execution of payment transactions where the consent of the payer to execute a payment transaction is given by means of any telecommunication, digital or IT device and the payment is made to the telecommunication, IT system or network operator.*”¹⁰ However, as mobile and other innovative payments were still in their infancy at the time of the adoption of the law, the European

Commission just recently consulted on a Green Paper “Towards an integrated European market for card, internet and mobile payments”, on the need for further actions.¹¹ In spite of these undisputed shortcomings, the PSD is an interesting instrument to take into consideration for the purposes of this paper, in the impossibility to give account of the many solutions offered by domestic regulators.

For the purposes of this analysis it is first relevant that when referring to a “payment account” the Directive does not refer to bank accounts, but to an account “*held in the name of one or more payment service users which is used for the execution of payment transactions*” (Article 4.14). As a consequence, any entity authorized to provide payment services under the PSD can offer accounts for the purposes of executing payment transactions. This includes non-banks.

Secondly, payment services can also be provided without the opening of a payment account. Indeed, what distinguishes the provision of “money remittances” from other kinds of payment services under the PSD is the lack of such account: “*money remittance*’ means a payment service where funds are received from a payer, without any payment accounts being created in the

⁹ Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC, O.J. L 319 of 5 December 2007, p. 1.

¹⁰ Article 4.3 of the PSD and Annex.

¹¹ Any changes needed, including on the Payment Services Directive, shall be announced soon.

name of the payer or the payee, for the sole purpose of transferring a corresponding amount to a payee or to another payment service provider acting on behalf of the payee, and/or where such funds are received on behalf of and made available to the payee” (Article 4.13).¹²

Thus, all payment services are in principle regulated alike, either when provided by means of a payment account or without one, and irrespective of the channel used, either “traditional” or “technologically innovative,” with or without the “interposition” of a communication network directly interfacing with the customer.

In addition, the PSD tolerates a privileged treatment for operators having a turnover under certain amounts, irrespective of the kind of payment services provided or the channels employed. This is different from what occurs in a number of countries outside the European Union where a distinction is made according to the kind of instrument. Under the PSD the only thing that counts is whether the operator can be considered a “small business.” In that case, a registration mechanism is accepted instead of the general instrument of issuance of a license (Article 26).

An additional specification is made when the activity of the telecommunication, IT, or network operators goes beyond a mere payment transaction as it facilitates the purchase of digital goods or services (such as ring tones, music, or digital newspapers): in this case, the European legislator traces a boundary between situations where the operator itself is involved in produc-

ing such goods or services by adding value to them in the form of access, distribution or search facilities, on the one side, and situations where the operator is just an intermediary between the supplier and the buyer of goods or services produced by third parties, on the other. Whereas in this latter case the operator only provides a payment service, in the first case its activity is considered to be more complex and consequently is excluded from the scope of the Directive (Article 3.1(l)).¹³ The exact scope of this exception, excluding certain services from the Directive seems to raise complex issues of interpretation, notably in the new environment of mobile payments.

When technical service providers are involved, which provide technical services to payment service providers so that these can provide payment services to their users, their technical activity is also not covered by the law, even if they would be telecommunication, IT or network operators (Article 3(j): this latter case is outside the scope of the PSD because this activity does not amount to a payment service. Indeed, they themselves are at no point in possession of the funds to be transferred and do not enter in relationship with the users directly.

2.2 Institutions providing payment services

Once the PSD has fully defined what a payment service is and what appear to be its main characters, the PSD lists which institutions can provide such services: banks (credit institutions according to Community

¹²Whereas (7) of the PSD interestingly states: “Money remittance is a simple payment service that is usually based on cash provided by a payer to a payment service provider, which remits the corresponding amount, for example via communication network, to a payee or to another payment service provider acting on behalf of the payee. In some Member States supermarkets, merchants and other retailers provide to the public a corresponding service enabling the payment of utility and other regular household bills. Those bill-paying services should be treated as money remittance as defined in this Directive, unless the competent authorities consider the activity to fall under another payment service listed in the Annex.”

¹³“The content of these goods or services may be produced either by a third party or by the operator, who may add intrinsic value to them in the form of access, distribution or search facilities. In the latter case, where the goods or services are distributed by one of those operators, or, for technical reasons, by a third party, and where they can be used only through digital devices, such as mobile phones or computers, that legal framework should not apply as the activity of the operator goes beyond a mere payment transaction. However, it is appropriate for that legal framework to apply to cases where the operator acts only as an intermediary who simply arranges for payment to be made to a third-party supplier” (whereas 6).

language) as regulated by European directives; e-money institutions, also regulated by European directives; and “Payment Institutions,” which represent a new category established in the PSD itself:¹⁴ any entity which is not a credit institution or an e-money institution, willing to provide payment services need to be licensed according to the PSD, under a number of capital and liquidity requirements, as well as the respect of some conditions (Articles from 5 to 19).¹⁵

Telecommunication, IT, or network operators providing payment services can thus be licensed as a Payment Institution, in the same way a remittances provider can. If payment accounts are opened at other than a bank premises (i.e., accounts held in the name of one or more payment service users), these should have the sole purpose of permitting the execution of payment transactions, and should not be considered by any means to be deposits.¹⁶ This would be possible without leading to production of money—that is to say without the need to get a license as an e-money institution under the recently adopted Directive 2009/110, modifying the previous Directive 2000/46 also as far as the very definition of e-money institution is concerned.¹⁷

The exact boundary between a payment institution and an e-money institution is one of the most intriguing

and complex issues of interpretation of recent EU regulation, and examining that boundary is outside the scope of the present analysis. However, it is interesting to note that, while Directive 2000/46 basically mirrored the regulation of credit institutions in terms of prudential requirements, e-money institutions are currently treated less strict than credit institutions but stricter than payment institutions, in view of the higher risks involved in issuing money compared to providing payment services. On other requirements, however, the rules applicable to e-money institutions follow closely the rules set out in the PSD, since the European legislator recognized that the two kinds of institutions to a certain extent perform similar services, and that the only evident reason to justify a different treatment for e-money institutions is the fact that by issuing value, they are meant to produce money and as a consequence monetary policy is relevant to them.

In addition, Directive 2009/110 defines e-money as pre-paid stored value in exchange for funds and regards these as general-purpose instruments (not limited to closed networks). The directive applies to money stored either on a payment device in the holder possession, or stored remotely at a server and managed by the holder through a specific account for electronic money.¹⁸ Putting aside the almost insoluble issue of differentiation between a payment institution opening a payment account on the name of a customer and providing custody services (which is permitted under Article 16 of the PSD, together with the concession of credit, although to a very limited extent) and an electronic money institution storing, by definition, value on a device or in an account, it is evident that the intent

¹⁴ In fact, Article 1 also includes post office giro institutions which are entitled under national law to provide payment services, the European Central Bank and national central banks and domestic public authorities, in these two later cases when they do not perform their public activities.

¹⁵ See how “payment service providers” are defined under the 2007 WB-CPSS General Principles: “Payment service providers” include both (i) entities that take deposits and allow transfers of funds to be made from those deposits (i.e. most banks and many non-bank deposit takers) and (ii) non-deposit-takers that transfer funds. The latter, in turn, can include (a) money transfer operators (where the service is based on “pay now” – for example, by cash or bank transfer from the payer to the money transfer operator), (b) those providing “prepaid” transfers (e.g. traveller’s cheques or prepaid cards) or (c) those providing transfers on the basis of “pay later” (e.g. credit cards).”

¹⁶ See Article 16 of the PSD.

¹⁷ Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and Prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC, OJ L 267 of 10 October 2009, p. 7.

¹⁸ Article 2.2: “electronic money” means electronically, including magnetically, stored monetary value as represented by a claim on the issuer which is issued on receipt of funds for the purpose of making payment transactions as defined in point 5 of Article 4 of Directive 2007/64/EC, and which is accepted by a natural or legal person other than the electronic money issuer”. See also whereas (6) to (8).

of European legislator is to conceptually separate between the production of money and execution of payment services.

Indeed, whereas (10) of Directive 2009/110 states: *“It is recognised that electronic money institutions distribute electronic money, including by selling or reselling electronic money products to the public, providing a means of distributing electronic money to customers, or of redeeming electronic money on the request of customers or of topping up customers’ electronic money products, through natural or legal persons on their behalf, according to the requirements of their respective business models. While electronic money institutions should not be permitted to issue electronic money through agents, they should none the less be permitted to provide the payment services listed in the Annex to Directive 2007/64/EC through agents, where the conditions in Article 17 of that Directive are met”*.

2.3 Behavioral and structural requirements

In addition to initial and on-going capital requirements, payment service providers must comply with a number of requirements and conditions. First, they may obtain a license only if they are able to provide a valid business plan, satisfactory governance arrangements, and internal control mechanisms (Article 5), as well as mechanisms to safeguard funds received by the payment service users at least when the payment institution also engages in other business activities (Article 9).¹⁹

Moreover, the PSD specifically regulates the use of agents, branches, and entities to which activities are

outsourced (Article 17). On the one side, transparency criteria are established to ensure full information to payment services users on the role and qualities of the agent they interact with; on the other side, full responsibility is allocated to the service provider for any action performed on its behalf by the entity to which the activity has been outsourced. For the sake of transparency and general monitoring by competent authorities, the latter must be informed of the identity and qualities of agents and keep a registry with updated information of each network.

The payment institution is obliged to undertake full responsibility for the actions of the entities to which a service has been outsourced and have mechanisms and controls to ensure that the entities perform adequately. Outsourcing is not permitted when such outsourcing would materially impair the quality of “important operational functions,”²⁰ such as the payment institution’s internal controls and the ability of the competent authorities to monitor the payment institution’s compliance with the obligations laid down by the Directive.

The PSD then contains two full Titles that regulate behavior requirements of payment services providers toward users, including transparency of terms and conditions, charges for information, maximum execution times, authorization and withdrawal of consent, limits in the use of the payment instrument, and mechanisms to ensure refund and liability, as well as allocation of burden of proof (Titles III and IV).

Finally, it regulates access to payment systems by service providers, in order to guarantee that any operator satisfying reasonable criteria of solvability can access the inter-bank network of services to efficiently

¹⁹ According to Article 9 of the PSD, users’ funds must not be commingled at any time with the funds of any other user, or be otherwise insulated against the claims of other creditors of the payment institution, or be covered by an insurance policy or other comparable guarantee, payable in the event that the payment institution is unable to meet its financial obligations.

²⁰ Article 17.7, third subparagraph: *“... an operational function shall be regarded as important if a defect or failure in its performance would materially impair the continuing compliance of a payment institution with the requirements of its authorization requested under this Title or its other obligations under this Directive, or its financial performance, or the soundness or the continuity of its payment services”*.

and safely execute payments (Article 28). It reiterates what European case law has established under competition principles, i.e., that rules on access to payment systems must be objective, non-discriminatory, and proportionate. Furthermore, it further limits payment systems autonomy to fix access rules involving service providers to the extent that payment system operators do not inhibit access more than is necessary to safeguard against specific risks, such as settlement, operational and business risk, and to protect the financial and operational stability of the payments system. In summary, protection from risk is the only justifiable reason for imposing access restrictions to payment systems (to clearing and settlement infrastructure) to the extent that payment service providers are concerned. Finally, restrictions on payment service providers or payment services users cannot be imposed if such restrictions limit effective participation into other payment systems, if they discriminate between authorized (or registered) service providers, and if they are based on the institutional status of the participant.²¹

2.4 Consequences on supervision and oversight

Central banks have traditionally focused their attention on wholesale systems, since these have been the most relevant in terms of the stability of the markets, and have developed over the years a number of principles and standards for overseeing such systems. More recently they have started to focus as well on retail payment systems, where individual transactions are normally of low value, but the systems might involve a very large number of transactions. In so doing, central banks have begun to consider issues such as consumer protection, transparency and cost-effectiveness, and market competition. Oversight tools, including out-of-

court complaint and redress procedures for the settlement of disputes, have consequently improved. These have varied, naturally, with differing scope and shape according to domestic legislation and competencies, and have been assigned to the central bank itself and to other relevant bodies, such as the Ombudsman or the antitrust authority.

The PSD has offered a new challenge for the regulation of payments: it no longer focuses only on systems (or possibly instruments), but rather on activities, and has a well defined system of controls. Service providers must be licensed, which may take place only after the fulfillment of capital requirements, which are a typical prudential tool. Yet, capital requirements, in both cases of Payment Institutions and Electronic Money Institutions, are paralleled by on-going own funds requirements, to be calculated according to alternative methods, reducing the role of capital in favor of continuing means to satisfy obligations. In addition, a license is subject to proof of compliance with managerial standards and to conditions on business schemes and structures. These requirements are clearly a combination of what traditionally pertains to supervision and what traditionally pertains to oversight, however, the whole structure of monitoring by way of concession of a license and possibly its withdrawal in case the future behavior of the service provider no longer satisfies the original conditions, resembles a kind of continuous monitoring based on constant dialogue with the authority, that characterizes oversight.

Although capital requirements are compulsory, it would seem that the monitoring contemplated in the PSD is more focused on activities. And absolutely, it is based on risk assessment that it is typical of oversight. Note that oversight in the case of retail services can also comprise customer protection, competition within the market, and risk management (as the 2007 WB-CPSS General Principles further discussed clearly show). In conclusion, the PSD has, for the first time,

²¹ Payment systems designated under Directive 98/26/EC on settlement finality are excluded from the scope of this Article.

combined the tools of supervision and those of oversight in an attempt to offer a consistent framework for regulating the payments market as a whole.

3. THE GENERAL PRINCIPLES FOR INTERNATIONAL REMITTANCES AS A BENCHMARK

3.1 The 2007 WB-CPSS General Principles

At the beginning of 2007, the World Bank (WB) and the Committee on Payment and Settlement Systems (CPSS) completed a global regulatory study of (international) remittance services and adopted some general principles.²² These encompass transparency and consumer protection, governance and risk management, the role of payment system infrastructure, legal and regulatory environment, and market structure and competition.²³

The main justifications for these principles rely on the fact that (international) remittances not only are retail services, but especially address a poor and financially unsophisticated population, so that transparency and consumer protection require special care; additionally the infrastructure to support such services needs to be adjusted in order to properly address the specific needs of users, requiring—as explained previously—a wide articulation of partners, from financial institutions up to a network of agents, which can affect the safety and efficiency of the provision of the service. Although remittances do not likely involve systemic risk (in the light of the small amounts usually transacted), the complex business scheme usually imple-

mented to widely offer such service must be adequately managed and each part to the business scheme must be sound and not compromise the overall trust in the network and service (reputational risk also being of high relevance).

Such articulation needs adequate legal and regulatory treatment: legal, since allocation of risks and responsibilities need to be correctly identifiable and legal schemes must be fully enforceable; regulatory, since over- or under-regulation of the sector, as well as a discriminatory regulation among remittances providers or against other payment services providers might negatively affect the correct expansion of remittance services and impair the satisfaction of an existing market need.

Finally, the efficiency of remittance services depends on there being a competitive business environment. In the light of the high heterogeneity of operators present in the market, such environment needs to be fostered and appropriate access to payment infrastructures be ensured.

These general principles have been selected to guarantee markets for remittances that are contestable, transparent, accessible and sound (point 6). Indeed, they arise from a concrete analysis of the various patterns of the service and the identification of its inherent features: remittance services can be more or less complex; yet, in all cases some kind of network, i.e., “connected access points” seems to be necessary. These also need to be linked by common procedures to enable messaging and settlement. Leaving aside what is called “unilateral service” (i.e., remittances provided by global banks by way of their branches), others, including small providers, may either use “franchised services,” which are provided by large global money transfers operators, or build up an autonomous contractual network, defined as “negotiated service” (point 10). This addresses one of the point of the Report, which states

²² WB-CPSS “General Principles for International Remittance Services”, BIS, January 2007.

²³ The General Principles have been endorsed as the main tool to achieve ambitious objectives of cost reduction for the provision of remittance services by the G8 and the G20. See also the work of the Global Remittances Working Group, chaired by the World Bank at <http://go.worldbank.org/SS0MQSBFM0>

that such networks could be ultimately considered as “remittance systems,” where a system is defined as an organized whole made up of diverse but interrelated and interdependent parts (point 29). In addition, the capturing and disbursing processes involve the transfer of information as well as funds, whereas the processing of the transaction requires messaging and settlement. A variety of arrangements can be undertaken to execute this phase; however, in many cases remittances are not settled individually. Liquidity arrangements can be agreed upon.

A concrete analysis of markets for remittances has shown shortcomings justifying the adoption of the WB-CPSS General Principles. However, it is the general characteristics of such service that justifies why the General Principles are formulated the way they are; in the same vein, m-payments also need a network. Although the method of connection is the mobile network itself, various access points are indeed necessary, which leads to the establishment of an articulated network of agents and the provision of various alternative channels. Moreover, especially in the light of the device used (apart from the implication of various “physical access points”), users—who as in the case of remittances might easily be financially unsophisticated people—need to be protected from misuse and risk, as well as provided with all relevant information.

To the same extent, the establishment of such an articulated network and the possible use of various channels require adequate governance, including clear delineation of roles and responsibilities, as well as forms of control by the partner better equipped for this purpose, for each branch of the service and of the functioning of communication networks.

3.2 Relationship between the service provider and the user

The relationship of both remittance service providers and of m-payments service providers with the user deserves special care. Know-your-customer and anti-money laundering requirements need to be satisfied, although international principles recognize that under some circumstances less stringent parameters can be applied, in both cases due to the low individual value of the transactions executed through such channels, rather than because of the structure of the service. In the case of m-payments, moreover, a continuous relationship does exist with the user, since this is a client of the mobile operator, and some sort of control can consequently be operated through this existing relationship.

Special requirements might also be needed for transparency of conditions and prices, where it yet seems that conditions could be imposed in parallel to those usually established by authorities in charge of consumer protection in general. It appears clear that in regard to remittances, the small individual values transacted could not be charged at a fee that in percentage terms would strongly affect the final cost of the transaction. Moreover, the pricing mechanisms should not inhibit the use of the service. In this respect, domestic authorities in charge, respectively, of telecommunication and financial services might need to cooperate, since transparency and other conditions’ requirements should be applied consistently in the general context of communication services provided by the mobile operator.

Remittances users should also receive reasonable protection from operational failures and criminal abuse. Especially for m-payments, verification mechanisms should be ensured to avoid situations of erroneously entering numbers and codes and mismatching, loss of the device, or mischarging of fees.

3.3 Infrastructure

Both for remittances and m-payment services, infrastructures are of the essence. In addition, in both cases, such infrastructure strongly departs from the traditional organization of financial services, since non-financial entities are involved. These entities most often provide other services of a non-financial nature; are of small dimension, and are not organized under corporate structures but provide services as individuals. In addition, in order to offer the service to a wide audience, numerous entities need to be involved, often with non-homogeneous characters. All of this requires both care in the agent-user relationship and adequate management and control by the service provider.

As for the “internal” network, security and efficiency of the communications network is also of the essence, especially for m-payments where the character of (potential) immediacy bears a substantial relevance. Shortcomings, breakdowns, and other failures can seriously jeopardize the service and lead to the risk of losing track of transactions unless adequate recovery mechanisms are put in place.

In addition, in both clearing and settlement of transactions require regulation by competent authorities. Here the business models chosen are of relevance, since these influence (in fact, determine) the legal allocation of risk and qualify the exact involvement of the banking sector. In the specific case of m-banking—as previously discussed—the issue of holding of accounts and protection of users’ funds is of the utmost relevance in the evaluation of the risks involved in the business model chosen.

3.4 Governance and risk management

As a direct consequence of the shared features of e-payments and m-money governance and risk management are of extreme importance in both cases, and probably of particular relevance in instruments that depend on and arise from the use of technology. However, the reputational risk in the provision of these services inherently bears a significant role: these services are characterized by a large number of users entering into low-value transactions, requiring a wide diffusion among the population. For m-payments, this risk is connected to the quality of the general communication services provided by the operator, since the user will be directed towards a specific operator not only because of its performances as a payment services provider but also as a communication services provider.

Governance and risk management should therefore be carefully considered for m-payments, since shortcomings in the provision of payment services could indeed also affect the main services provided by the operator (as well as vice-versa). The speed of transfers usually entails a heavy reliance on technology. As a result, the governance of entities in charge of ensuring technological and operational efficiency would deserve special care.

Finally, the close link needed between the banking sector and the telecommunication network in order to provide the service requires coordination and clear allocation of tasks and consequent individual responsibilities. Both for remittances and m-payments, when the banking sector is involved, clear dependencies of the agency networks from one or the other entity should be clearly defined and the respective governance tools established, in order to ensure that any form of outsourcing or use of other third parties does not compromise the sound provision of the service.

SECTION III

A SINGLE REGULATORY FRAMEWORK



4. “ALTERNATIVE” MEANS OF PAYMENT AS PART OF THE RETAIL PAYMENTS SYSTEM

All previous considerations confirm not only that there are very good reasons to consider remittances and m-payments services, if not under the same set of principles then at least under the same set of general parameters (these being the two major types of payment services directly involving non-financial institutions), but also that these need to be primarily taken into consideration under the wider approach of regulation of retail payments and evaluated for their inclusion into this business sector. Incidentally, this approach would inevitably lead to apply the same (risk-based) analysis also to “traditional” financial institutions when providing payment services.

4.1 Risk-based assumptions

Remittance services and m-payments (as well as prepaid cards) are both components of the (retail) payments system and should consequently be taken into consideration under this approach for the kind of risks they raise.

Abandoning a pure institutional approach, regulation should be based on kinds of services provided and, most relevant, on the business scheme adopted. As already mentioned several times, it is indeed the business scheme which will determine who the authority will consider the service provider, which will therefore bear the main responsibility for the provision of the service. To this extent, it appears that what counts is not, as is often stated, which operator interacts with the final user, but rather which of them possesses and manages the users’ funds in order to execute the transaction, since this seems to be the very essence of the service and the main source of risk.

However, both outsourcing and agency schemes may generate additional risks that need to be identified and evaluated. Although the service provider must be held responsible for the acts of its agents and of those operators it outsourced part of its activities to, the regulator must be in a position to clearly identify these additional sources of risk and have the power to intervene directly in how the arrangement between the entities should be shaped and with what conditions they must comply in order to be allowed to perform the service.

The general criteria should however be that of risk: individual sources of risk need to be identified and regulated accordingly, also considering that under certain circumstances it is not the single element in isolation

that produces risk, but the combination of (often interdependent) factors. In addition, if transactions are of low value and consequently do not bear risk by themselves, their potential large number and frequency may indeed require overall control.

4.2 Efficiency

As part of the retail payment system, remittance services and m-payments services should contribute to the overall effort to enhance the efficiency of the sector. This means that one of the objectives of regulation should be to ensure that the benefits on any improvement in the retail payment space accrue to the end-users and the economy in general, without creating un-justifiable rents in some part of the value chain.

The relationship with the final user and its protection is of course of the essence. However, the payments infrastructure is equally relevant for the proper operation of the payments industry, and of main concern in particular for central banks.

In the first place, being part of the payments system also means being able to take part in such infrastructure—providing of course that there is compliance with the same requirements imposed upon all other operators. Access to systems may be limited for a number of valid reasons; however, such restrictions must be transparent, proportionate, and non-discriminatory. Since the main reason for limiting access relies on risk, an adequate protection from risk according to the services provided as described in the previous chapter should reduce the urgency (although not the general necessity) of access restrictions to clearing and settlement.

In the second place, and somehow in parallel, in order to guarantee efficiency and full profit by end-users, networks and system must ensure interoperability. Indeed, one of the major desirable features of payment

infrastructures should be to permit final users to benefit from it irrespective of either the institution used as an intermediary or the chosen instrument of payment.

All of this relates to market structure and its contestability, in a balance of considerations between competition and need for cooperation within the private sector.

4.3 Competition and market contestability

Different regulatory treatment might lead to distortions on competition: regulatory constraints should be proportionate to effective risks and public policy needs to ensure a level playing field for retail payment services in general. In the same vein, regulation should be non-discriminatory, avoiding either favoring or ignoring certain categories of service providers over others. Regulation should also remove business practices when they hamper competition severely.

Indeed, if the assumption is correct that new entrants in the market improve both the range of services and their quality, in order to make this assumption concretely true and allow the final users to fully benefit of such improvements, regulation must not lead to discrimination or favor the creation of dominant positions. In particular, since retail payments are of low value, costs are a most relevant issue for their efficiency. Both discriminatory regulation and restrictive business practices do influence costs and consequently strongly impair potential benefits by customers.

To this end, regulation must both be oriented by risk and try to regulate entities proportionate to the scope and dimension of their activities, and be adequate to cope with possible restrictive business practices. The regulatory approach should be technology-neutral and only focus on the financial element of the service.

In pursuit of this goal, central banks, as the primary regulatory body in charge of monitoring, need to coordinate not only with antitrust authorities, but also with telecommunication authorities, since the inherent involvement of telecom networks requires careful evaluation, such that their presence does not add operational risk to the provision of the service.

4.4 Consumer protection

Retail payments raise the additional issue of consumer protection. Independently from the kind of commercial relationship between the service provider and the user of the service, either durable or occasional, rules on transparency and protection of customers must be implemented.

In addition to regulatory policy focusing on the structure of the market and its infrastructure, the described payment instruments require adequate protection of users. In particular, in addition to transparency requirements, know-your-customer guidelines, and observance of AML regulation, the protection of users' funds and their traceability are a must, as well as protection from any risk arising from the use of electronic means and the intermediation of non-financial agents.

Indeed, once service providers are duly regulated under a risk-based approach and a playing field is ensured in the market to guarantee competition and competitiveness, all other needs for protection can be addressed under a general understanding of consumer protection and an adequate consideration of the role of agents.

4.5 Empowering the Overseer(s)

The establishment of an effective oversight function on payment systems and services is instrumental to foster the adoption of electronic payments, including mobile money.

The adoption of a functional approach in the provision of payment services requires a parallel empowerment of one or more authorities able to regulate and oversee the market. This is particularly important as, in some countries, the prevalence of an institutional approach in financial regulation²⁴ might leave some services or their providers outside the realm of financial authorities. This circumstance might have led some authorities to adopt a conservative approach and simply prevent some institutions from offering certain services rather than exposing the financial system to risks that were considered difficult to manage in that particular legal and regulatory framework. In this regard, proper payment system oversight should be seen as an enabler of innovation in the retail sector.

Overseeing a payment system means ensuring that the infrastructural components and the markets for the provision of payment services:

1. Work smoothly, efficiently and fairly for all participants and users.
2. Minimize and control the risk of transmitting shocks through the economy via the reverberation across the payment system of failures by individual participants to settle obligations.
3. Pursue the level of technological and institutional development necessary to satisfy the payment needs of a growing and open economy.

²⁴ Institutional approach in this context refers to regulating the institutions that perform a certain economic activity rather than the activity itself.

The role of primary payment system overseer in particular on retail payments is typically played by the central bank. Appropriate cooperative arrangements need to be in place with other relevant authorities (e.g., banking and financial supervisors, anti-trust authorities, Ministries of finance and the economy, etc.) and with the market itself.²⁵

²⁵ See B. Bossone and M. Cirasino, "The Oversight of the Payment Systems: A Framework for the Development and Governance of Payment Systems in Emerging Economies", July 2001, The World Bank and CEMLA. The PSDG is preparing a paper on the practical challenges economies encounter in establishing the payment system oversight function. The paper is expected to be released in early 2013.