TECHNICAL NOTE

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NONBANK E-MONEY ISSUERS VS. PAYMENTS BANKS

How Do They Compare?

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CONTENTS

Introduction 1

1 Why Create Special Licensing Categories? 2

2 The EMI Licensing Category 2

3 The Payments Bank Licensing Category 4

4 Country Cases 5

4.1 India 5

4.2 Mexico 7

4.3 Nigeria 7

5 Conclusion 8

References 9

Annex: Comparative Table 10

Introduction

Creating special licensing categories to allow newcomers to specialize in niches of the financial sector is not a new regulatory approach to advancing policy goals. Examples of this include special licenses for leasing and factoring companies, microfinance banks, limited-purpose banks, and financial cooperatives—all of which exist in many countries. Typically, the objective is to address market failures, such as inefficiency, concentration, lack of innovation, and shortage of services to certain demographics or geographies, while supporting policy objectives, such as competition, inclusion, and stability.

A special licensing category for nonbank e-money issuers (EMIs) is considered a key regulatory enabler for inclusive digital financial services (Staschen and Meagher 2018). A growing body of evidence attests to the value of EMIs in fostering inclusion by providing access to transaction accounts.[1] However, not all regulators in emerging markets and developing economies (EMDEs) are open to or are able to create a special licensing category for EMIs, even if financial inclusion is a policy priority. The reasons for this range from legal challenges, to political resistance, to risk aversion. At least three EMDEs (India, Mexico, and Nigeria) have created an alternative: the payments bank license. And there is growing interest in special licensing categories among other EMDEs.

This Technical Note compares the EMI licensing category with the payments bank license. Whereas EMIs are nonbanks, a payments bank is a licensed bank that cannot provide credit services and engage in other activities that are typically permitted in a full banking license. They must dedicate their operations to payments and fund-storage services.

The EMI license has been available in many developed economies and EMDEs for many years. Payments banks, on the other hand, are fairly new to the financial sector, and they exist in just a few countries. Despite this limited experience, it is possible to identify key differences between the two licensing categories, from both the regulatory and implementation perspectives.

A key takeaway is that both licensing categories present practical and technical challenges that vary depending on the country context. Regardless of the licensing category, it is essential to adopt regulatory and supervisory frameworks that are proportionate to the limited risks inherent to the niche business of EMIs and payments banks. The experience so far indicates that it is difficult to achieve such proportionality—more so in the case of payments banks than EMIs.

For instance, it may be challenging to alter an intricate banking regulatory framework to fit the profile of payments banks. Payments banks should be exempt from certain rules designed for conventional banks, and supervisory practices need to be adapted as well.

The EMI licensing category, on the other hand, allows regulators to start from scratch and set up a new, specialized, dedicated regulatory and supervisory framework. This obviates the need to address the difficulties inherent in adapting the banking framework, and it could be a more effective and efficient use of limited resources of financial authorities. While this could explain why so many jurisdictions have opted for the EMI license category, anecdotal evidence indicates that supervisors can still face challenges when it comes to applying proportionality to the implementation of EMI regulations.

This Note analyzes the EMI and the payments bank licensing categories and describes the contexts in which the latter was created in India, Mexico, and Nigeria. The Annex provides greater detail on the licensing categories in these three countries.

1 In this paper, a transaction account, which includes e-money, is held with banks or other authorized and/or regulated payment services providers and can be used to make and receive payments and store value. It is considered an essential financial service in its own right (CPMI and World Bank 2016). The World Bank's Global Findex shows that 21 percent of adults in Sub-Saharan Africa have a mobile money account (a type of e-money), half of which do not have any other account. In 10 Sub-Saharan African countries, more adults have a mobile money account than a bank account. In Haiti, the share of adults with a mobile money account rose from 4 percent in 2014 to 14 percent in 2017 (Demirgüç-Kunt et al. 2018).

1 Why Create Special Licensing Categories?

Financial authorities give permission for financial institutions to operate by issuing licenses. The licenses should clearly describe the activities the institutions can engage in and identify which regulatory and supervisory framework will apply.[2] All licensing categories are anchored in a foundational law. For instance, banks are usually licensed based on the banking law or similar, and payments institutions are licensed based on the payments law. In some jurisdictions, issuing licenses are based on other laws, such as the central bank law.

Regulators can address the needs of new competitors and business models by creating new licensing categories with entry and ongoing requirements that vary according to different scopes of operation—the array of permitted activities—and that are proportionate to limited risks associated with these niche businesses. An adequate mix of carefully crafted licensing categories can help advance policy objectives such as competition, stability, financial inclusion, consumer protection, and integrity. Also, a "proportionate approach to licensing (e.g., less stringent licensing criteria and procedures for institutions with a low risk profile) allows authorities to allocate the level of resources appropriate for the range of activities that financial institutions are permitted to carry out and the risk posed to the financial system or depositors."[3]

Among licensing categories that include collection and storage of funds from the public, conventional banks are permitted to engage in the broadest range of activities.[4] Hence, they are a complex institutional type with risks that require stringent regulation and supervision. But not all institutions need to be so complex, and they should not face the same requirements of a full banking license. The unpacking of banking activities in different licensing categories allows for specialized ranges of permitted activities with lighter requirements. For instance, financial cooperatives in many countries fall into special licensing categories that have a lighter set of requirements compared to those of conventional banks. Other countries have created tiers within one licensing category (e.g., deposit-taking microfinance institutions), with the weight of requirements growing with the size and scope of operations.[5]

2 The EMI Licensing Category

Creating a special licensing category for EMIs is a key regulatory enabler for inclusive digital financial services (Staschen and Meagher 2018). Many EMDEs as well as advanced economies have created an EMI licensing category.[6]

Basically, the EMI license covers two common functions of conventional banks: (i) payments and (ii) value storage of funds collected from the public. The license limits EMIs to performing only services related to these two functions, namely, offering stored-value accounts called e-money accounts and payment services such as transfers, withdrawals, merchant payments, and bill payments.

2 Fundamentally, financial regulation and supervision need to be clear as to permissible activities and licensing criteria. For banking activities, this requirement is part of the Core Principles for Effective Banking Supervision, see BCBS (2012, p. 25–27).

3 See BCBS (2016, p. 10). In addition to specialized licensing categories, there are other approaches for proportionate licensing. For instance, regulators are increasingly using innovation facilitators such as regulatory sandboxes and innovation hubs. See Jenik, Duff, and de Montfort (2019).

4 "Conventional banks" and "full banking license" in this Note refer to the licensing category for banks that permits the broadest range of activities, including taking deposits from the general public and providing credit. These banks have different names in country regulations, such as commercial banks, multiple banks, universal banks, deposit money banks, and others. BCBS's Core Principles for Effective Banking Supervision (2012) uses the term "commercial banks".

5 BCBS (2015) describes the range of practice in the regulation and supervision of institutions relevant to financial inclusion and focuses on whether different approaches are necessary. One aspect surveyed is differentiated licensing criteria, including a graduated set of criteria.

6 EMDEs include, e.g., Afghanistan, Brazil, El Salvador, Ghana, Indonesia, Kenya, Malawi, Mexico, Myanmar, Namibia, Nigeria, Pakistan, Paraguay, Peru, the Philippines, Rwanda, Tanzania, and Uganda. Advanced economies include, e.g., Australia, Hong Kong, Singapore, and members of the European Union. EMIs may be called other names, including electronic money institution (Afghanistan), electronic money operator (Russia), store-value facilities (Australia), mobile money operator (Nigeria), mobile money service provider (Uganda), mobile financial services provider (Myanmar), mobile financial payment service provider (Malawi), and electronic payment funds institution (Mexico).

PROS

This licensing category is meant to clearly delineate the scope of EMI operations as being narrower than the more complex operations of a conventional bank. At the same time, it acknowledges that EMI operations are more complex than the more limited scope of activities of other payments services providers that do not offer value storage, such as money transfer operators, card schemes, and payment initiation services providers.

Thus, EMIs fall in a licensing category of institutions that can carry out only a specific set of relatively simple and low-risk activities. For instance, although EMIs collect funds from the public, they cannot intermediate them by offering credit, so they do not carry credit risk.[7] As a result, although EMIs, like conventional banks, are subject to licensing criteria such as minimum initial capital, fit-and-proper requirements, and governance standards, the specifics of such criteria typically amount to lighter requirements. For instance, the minimum initial capital for EMIs is usually much lower than for conventional banks. Adaptation of licensing criteria to the lower risk of EMIs varies across jurisdictions. Some licensing criteria are listed in the Annex.[8]

A separate category of regulated institution is created to reflect a specific and proportionate regulatory framework for ongoing operating requirements for EMIs, commensurate with their risks. This includes fund safeguarding rules that aim to ensure that enough funds are set aside to meet customer demands. For example, many jurisdictions require EMIs to back up the total value owed to customers with safe and liquid assets that are kept in separate accounts—that is, not comingled with other EMI assets. EMIs may also be required to hold such assets in special accounts that have protective legal features, such as trust accounts, in order to shield the assets against claims from EMI creditors other than the EMI customers.[9]

Together with the narrow range of permitted activities, these and other regulatory limitations reduce the risk of EMIs, allowing for a simpler supervisory framework than that of conventional banks.[10] At the same time, they give room for competition from new players who would otherwise shy away from a conventional banking license and all the compliance costs that come with it. As a result, the dedicated EMI framework can offer a high level of regulatory certainty for market players, which could more easily support private-sector interest and investment. A dedicated framework may also facilitate future regulatory changes needed as the EMI industry develops.

CONS

An EMI license can be issued under different laws:

- The banking law, as in Myanmar.
- The payments law, as in most jurisdictions, including in the European Union.
- Another law, for example, the fintech law in Mexico, financial inclusion laws in Colombia and El Salvador, e-money law in Peru, and the central bank law in Nigeria.

The flexibility of the parent law affects the ability to create a dedicated specialized framework. The EMI licensing category has often developed into a fully customized set of rules, but this is not always the case. In addition, the creation of an EMI licensing category may require legal reform, which can be difficult and time consuming to achieve.

Furthermore, as nonbanks, the funds EMIs collect from customers are often ineligible for deposit insurance coverage (Izaguirre, Dias, and Kerse 2019). However, some countries have extended such coverage to the float backing the funds collected by EMIs. Examples of this can be found in Jamaica, Kenya, Nigeria, Rwanda, and the United States. EMIs may also be prohibited from distributing interest to their clients, such as in the European Union, Brazil, Paraguay, and Peru, However, distribution of interest is permitted or required in some countries, such as Bangladesh, Ghana, Myanmar, and Tanzania.

7 Although they are not able to lend or offer other financial services, EMIs are usually allowed to partner with lenders, insurers, and other financial institutions to distribute their services. This presents new business and revenue opportunities for EMIs.

8 Staschen and Meagher (2018) delve into the main aspects of an EMI licensing category.

9 Kerse and Staschen (2018) detail the rules for EMIs to safeguard customer funds.

10 Dias and Staschen (2018) provide guidance on key areas of EMI supervision.

Strict fund safeguarding rules are a cornerstone of EMI regulations and are intended to provide a high level of ongoing protection to EMI customers. However, not all EMI frameworks provide such protection. For instance, when the safeguarded funds can be invested in risky assets, customer funds may be at risk.[11] Moreover, some regulations do not require the use of special accounts with protective features such as trusts, leaving the funds potentially unprotected from claims by EMI creditors. Even when such special accounts are required, there could be legal and operational challenges to their effective use (Izaguirre, Dias, and Kerse 2019).

Another risk is the imposition of excessive requirements on EMIs. In many cases, this is because of the lack of detailed subordinate regulation and a tendency to apply standards designed for conventional banks to EMIs. Anecdotal evidence indicates that authorities in some EMDEs have imposed disproportional requirements on EMIs either during licensing or through the course of supervision. These may include the establishment of board committees and other governance and organizational structures that are required for conventional banks. The risk is accentuated when the staff assigned to EMI licensing and supervision do not have deep knowledge about the EMI business, supervisory experience, or internal support to adapt specific regulatory requirements. Finally, as a relatively new type of regulated institution globally, EMIs typically lack an internationally accepted framework for their recovery and resolution.

3 The Payments Bank Licensing Category

A special licensing framework for payments banks exists in at least three EMDEs: India, Mexico (referred to as payment niche banks), and Nigeria (referred to as payment services banks). In all three countries, payments banks are banks licensed under the banking law,[12] but they cannot engage in the full range of banking activities. They must specialize in basic deposits and payments services, which makes their business very similar to the EMI business, except that they are licensed as banks.[13] In that sense, this regime does not create a new type of regulated entity, but a type of limited-purpose bank. There are five payments banks in India (of which one is under liquidation), one in Mexico, and none yet in Nigeria, as the first approvals-in-principle were awarded only in September 2019 (Proshare 2019).

PROS

Sometimes, creating an EMI licensing category is not feasible because of limitations in the existing legal system. Some banking laws have encompassing definitions of “banking business”, “deposit taking”, or “deposit”. This makes it nearly impossible for nonbanks to collect redeemable funds from the public, even if they are not intermediating the funds through lending. In some cases, reform of the banking law would be required. In other cases, reform of the banking law may not be needed because the definitions are more flexible, but regulators or politicians—or both—may not want nonbanks to collect and store client funds and may oppose the EMI licensing category. The payments bank license can be a solution in any of these cases.

The accounts of payments bank customers are classified as bank deposits under banking law, rather than e-money accounts. As such, they are likely to be covered under the deposit insurance system (if there is one). Another potential advantage is that as banks, payments banks may have access to central bank services, such as settlement accounts and liquidity facilities, and the interbank markets that help them to manage liquidity needs. They may also be included in the recovery and resolution frameworks created for conventional banks.

11 E.g., in the West Africa Economic and Monetary Union, EMIs can invest part of their e-money liabilities in corporate securities.

12 Banking Regulation Act, 1949, in India; Credit Institutions Law, 1990, in Mexico; Banks and Other Financial Institutions Act, 1991, in Nigeria.

13 “Digital banks” is a term that may be confused with “payments banks” as defined in this paper. However, the two have little in common. Digital banks are usually fully fledged banks licensed under the banking law that focus on digital financial services and channels by leveraging technology. They may be called online banks, virtual banks, smart banks, digital-only banks, and challenger banks. In most countries, digital banks do not require a special license category (exceptions include Hong Kong and Singapore).

Like EMIs, payments banks are prohibited from lending.[14] However, while most regulations prohibit EMIs from paying interest on e-money accounts, payments banks can offer interest-bearing accounts, which might help them attract customers.

CONS

The payments bank license also has disadvantages. The main challenge seems to be adapting banking regulations and supervisory practices to the risk profile of payments banks, including setting specialized licensing criteria and ongoing operating requirements. The existing bank regulations may automatically apply unless there is an explicit exemption, even though they may be too burdensome for the limited scope of payments banks. Full customization is necessary but depending on the level of detail included in the banking law, it may require changing the banking law itself.

Even if a legal reform is not needed and proportional requirements could be specified on the level of subordinate regulation, the bank regulator or supervisor may be unwilling or unable to adapt the regulations and the supervisory approach—payments banks are still banks, after all. As in the case of EMIs, a lack of technical knowledge about the payments bank business or a lack of internal support for customizing requirements may be the cause of a disproportional approach.

Also, it can be challenging to craft a proportionate specialized framework for payments banks out of existing banking regulations. Regulation and supervision designed for banks can form undue obstacles for payments banks, particularly for newcomers.

In terms of recovery and resolution, it is not yet clear whether conventional bank frameworks would be appropriate for payments banks. Given the much lower level of complexity of payments banks, customized frameworks may still be needed. The liquidation of Aditya Birla Idea Payments Bank will be the first case of liquidating a payments bank and will provide some early insights (Economic Times 2019).

Another potential issue concerns fund safeguarding requirements. These are typical of EMI regulations, and in principle, they should apply to payments banks. However, payments banks may not be subject to the full array of fund safeguarding rules. For instance, the regulation may not impose restrictions on how payments banks handle the funds owed to customers (other than the prohibition to lend them out). Without such rules, payments banks may comingle customer funds with their own or invest the funds in risky or illiquid assets. The fact that payments banks may have access to bank deposit insurance coverage does not eliminate the need for fund safeguarding rules because these measures serve different purposes.

4 Country Cases

So far, India, Mexico, and Nigeria are the only EMDEs that have a payments bank licensing category, as it is defined in this Note. Mexico and Nigeria also have an EMI licensing category, while India has a licensing category for an institution similar to EMIs, but subject to more restrictions. The different country contexts are summarized below. Greater detail on the regulatory requirements for each country is in the Annex.

4.1 INDIA

In 2009, the Reserve Bank of India (RBI) created, under the Payment Systems Act, a special licensing category similar to EMIs, called Prepaid Payment Instrument (PPI) issuer. The intent was to make room for nonbanks to conduct e-money business. Due to restrictive definitions in (or interpretations of) the banking law, the regulation does not allow nonbank PPI issuers to operate “open system PPIs.” This means that their customers cannot cash out funds from PPI accounts. Only banks can operate open system PPIs that offer cash withdrawals. This restriction, alongside a monthly deposit limit of US$700 (INR 50,000), prohibition of interest payment, constantly shifting customer due diligence (CDD) rules, and a recent increase of the minimum capital (defined as net worth)

14 Like EMIs, payments banks may distribute credit and other services (e.g., insurance) on behalf of another financial services provider.

for existing and new nonbank PPI issuers, has challenged their viability.[15]

In 2014, RBI created a special licensing category for payments banks under the Banking Regulation Act. This is in response to a strategic review of the banking sector that highlighted the need for niche banking and pointed to differentiated licensing as a desirable step.[16] Payments banks are similar to EMIs in the activities they undertake, except that they are banks. As banks, they can offer interest-bearing current/savings accounts that may be covered by deposit insurance. Unlike customers of PPI issuers, customers of payments banks can cash out their funds, but their accounts are subject to a maximum balance of US$1,400 (INR 100,000).[17] When compared to nonbank PPI issuers, payments banks are subject to stricter rules, such as:

- Capital requirements (higher minimum initial capital and a capital adequacy ratio of 15 percent).[18]
- A leverage ratio of 3 percent.
- A cash reserve ratio for outside demand and time liabilities.
- A statutory liquidity ratio of 75 percent on demand deposit liabilities.
- Minimum board structure.
- A minimum of 25 percent of physical access points in rural areas.

Despite the limited scope of permitted activities, payments banks are subject to most of the existing banking regulations, while benefiting from a minimum initial capital five times lower than that for conventional banks (RBI 2013b, p. 76).[19] RBI had expected that nonbank PPI issuers would apply for payments banks licenses (Paytm, the largest payments bank, is a converted PPI issuer). Nonbank PPI issuers used to lack access to the national payments system, but have since been allowed to connect to the Unified Payments Interface (UPI).[20] This has made the upgrade of nonbank PPI issuers to payments banks, with their heavier regulatory costs, less attractive. Also, payments banks have faced strict RBI measures.[21]

The uncertainty around the legality of using Aadhaar, the government-issued ID, for CDD purposes has also affected PPI issuers and payments banks. A September 2018 Supreme Court verdict had created some ambiguity about the private sector's use of Aadhaar for CDD. This led institutions to shift from digital CDD procedures to costly manual procedures. After a period of uncertainty, the Aadhaar and Other Laws (Amendment) Act, 2019, was passed by Parliament in July 2019 to allow the use of Aadhaar for customer authentication (although customers cannot be compelled to use their Aadhaar for this purpose).[22]

Payments banks and PPI issuers have also struggled to provide value in India's specific context. The massive account opening effort led by the government through Pradhan Mantri Jan Dhan Yojana (known as PMJDY) since 2014 has resulted in nearly all households in the country having access to an account. These accounts are mostly provided by government banks, leading to fewer opportunities for others to serve unbanked customers. However, payments banks and nonbank PPI issuers might still have a comparative advantage

15 In late 2017, RBI increased the minimum required net worth of nonbank PPI issuers from INR 10 million (US$140,000) to INR 150 million (US$2.1 million). Compliance was required within three years from licensing for nonbank PPI issuers licensed after the issuance of the new regulation or by 2020 for nonbank PPI issuers already operating when the new regulation was issued. PPI issuers were first allowed to follow simplified CDD procedures, but in late 2017 they were required to reregister all clients using full CDD procedures.

16 The review is reflected in RBI (2013a and 2013b), which examined the issues relevant to a ubiquitous payments network and universal access to savings. In a 2014 speech, India's Finance Minister noted that "differentiated banks serving niche interests, local area banks, payment banks etc. are contemplated to meet credit and remittance needs of small businesses, unorganized sector, low income households, farmers and migrant work force" (Jaitley 2014).

17 Some payments banks have worked around this limit by partnering with conventional banks to make automatic transfers of the excess amounts to fixed-term deposits with the partner bank.

18 The minimum paid-up equity capital for payments banks is INR 1 billion (US$14 million).

19 The minimum paid-up capital for conventional banks is INR 5 billion (US$70 million).

20 For details on UPI, see Cook and Raman (2019).

21 E.g., in August 2018, RBI prohibited Paytm from enrolling new customers due to weaknesses in CDD controls and data security, it required Paytm's CEO to step down for not having a banking background, and it required the company's head office to split from that of its parent company. Previously, RBI had temporarily prohibited two other payments banks, Airtel and Fino, to acquire new customers because of compliance issues related to CDD rules.

22 The Aadhaar and Other Laws (Amendment) Act, 2019, https://uidai.gov.in/images/news/Amendment_Act_2019.pdf.

over conventional banks in serving more remote and poorer segments of the population.

Also, big tech companies (Google, Amazon, Facebook/ Whatsapp) have entered the India market, bringing competition but avoiding the regulatory costs (since they partner with licensed conventional banks). In this context, and considering the regulatory burden imposed on them, PPI issuers and payments banks do not have a clear future. Out of the 11 payments bank licenses issued, only five were operating as of July 2019. One of the five closed down by October 2019 (Moneylife 2019), while two have announced reaching profitability. RBI has retracted its policy of not allowing payments banks to apply for a license to be a small finance bank, which is permitted to lend (RBI 2019). This shift has been interpreted as an attempt to boost payments bank profitability (Gopakumar 2019).

4.2 MEXICO

Since 2009, Mexico has passed reforms to increase competition and promote financial inclusion. From the start, it recognized the potential role of EMIs. Despite this, an early attempt to create a licensing category for EMIs was strongly opposed by a range of stakeholders who followed a strict interpretation of the banking law. Also, some feared that the financial sector would become as concentrated as the telecom sector if mobile network operators (MNOs) were allowed to own EMIs.

For these reasons, a reform of the banking law in 2012 introduced a new category of "niche banks," including payments niche banks, instead of a special licensing category for EMIs. Some expected payments niche banks to be as successful as EMIs had been in some other countries, but the expectation has not been met. There is only one payments niche bank in Mexico, and it does not provide services to retail customers. A major reason this model failed is because prudential regulation was not adapted to account for the limited scope of activities, which resulted in excessive regulatory costs.[23] For instance, payments niche banks have been subject to the same capital adequacy requirements applied to conventional banks, as well as to the same reporting requirements.

Low uptake of these banks and limited progress in financial inclusion prompted Mexican authorities to finally create a licensing category for EMIs in the 2018 fintech law.[24] Unlike most EMI frameworks, the newly created *instituciones de fondos de pago electrónico* (IFPEs [Spanish for "electronic payments funds institutions") can receive cash deposits only if the banking authority gives them a separate authorization. Given this and other strict rules embedded in the fintech law and implementing regulation, it remains to be seen whether IFPEs will be able to advance financial inclusion.

4.3 NIGERIA

In Nigeria, a licensing category for an EMI, referred to as mobile money operator (MMO), was created in 2009. While the regulation generally follows the international practice for EMIs' permitted activities and requirements, it does not permit MNOs to own MMOs. Although 15 nonbanks hold an MMO license Nigeria has fallen behind in expanding financial inclusion.[25] One reason for the slow progress may be the absence of MNOs in the market. In countries such as Ghana, Kenya, Rwanda, and Tanzania, MNOs leverage their extensive agent networks to support their EMI businesses. To correct this, the Central Bank of Nigeria created an additional licensing category for payment services banks in October 2018.

A payment services bank is similar to an MMO, except that, because it is a bank, funds collected from customers are classified as bank deposits and covered by deposit insurance. Nigeria's payment services bank regulations are very similar to those in India. The minimum initial capital is high at US$13.5 million (NGN 5 billion) compared to that of MMOs at US$5.5 million (NGN 2 billion). The high minimums together with other requirements impose high costs, which limit new entrants to large players such as MNOs.[26] As opposed to the MMO license,

23 Discussions with industry experts. See also Skelton (2013).

24 Only 36.9 percent of Mexican adults had an account in 2017 (Demirgüç-Kunt et al. 2018).

25 In 2017, 39.7 percent of adults had an account whereas, in 2014, 44.4 percent had an account (Demirgüç-Kunt et al. 2018).

26 Other requirements may include, e.g., a minimum of 25 percent of touch points in rural areas, a required cash reserve, risk-weighted capital adequacy ratio, and a minimum of 75 percent of customer liabilities invested in government bonds.

this one allows MNOs to enter the e-money business. These two licensing categories for MMOs and payment services banks mean that they provide the same type of service. This may lead to regulation and supervision issues regarding level playing fields. It remains to be seen how payment services banks will affect the financial inclusion landscape in Nigeria, as the Central Bank has to date only issued three approvals-in-principle and none of the providers has fully launched its operations.[27]

5 Conclusion

Creating special licensing categories for newcomers to pursue a limited set of regulated activities in the financial sector is one strategy to advance policy goals, such as financial inclusion, competition, and efficiency. More specifically, a licensing category for EMIs is a key regulatory enabler for inclusive digital financial services. The EMI licensing category allows for the creation of a fully tailored regulatory and supervisory framework that is aligned with the risks of the EMI business. As such, it imposes proportional regulatory costs and provides a high level of certainty for EMIs. There is also significant global experience with EMI regulation. Potential weaknesses are that it may require legal reforms, prohibit payment of interest to e-money customers, face resistance from stakeholders, and exclude the funds collected by EMIs from deposit insurance coverage.

India, Mexico, and Nigeria have an additional licensing category called the payments bank license. In these cases, the permitted activities of payments banks are similar to those of EMIs. Like the EMI license, the payments bank license presents inherent advantages and disadvantages.

The main advantage of payments banks is that they are allowed to provide interest-bearing current and savings accounts that are likely to be covered by deposit insurance. However, as banks, payments banks are immediately subject to the full range of banking regulations and supervisory practices that apply to conventional banks unless regulators tailor regulation and supervision to their specific risk profile. The experience with payments banks is still limited, and the country contexts in which they have been created are unique and do not allow for drawing general conclusions at this point.

The central takeaway from the experience so far is that, regardless of the licensing category chosen, regulators and supervisors may find it difficult to break free from the conventional bank mindset. They will need to implement fully tailored regulatory frameworks and supervisory practices that are commensurate to the specific risk profile of EMIs or payments banks. Requiring EMIs and payments banks to comply with regulation intended for conventional banks leads to unduly high compliance costs that could prevent either type of institution from helping regulators achieve their stated policy goals. Balancing financial stability, inclusion, integrity, and other policy objectives remains a significant challenge. Overcoming this challenge must be a central concern when creating new licensing categories.

27 The approval in principle is the first stage of the licensing process, after which the applicant must set up the business and, within six months, apply for a full license to start commercial operations.

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Annex: Comparative Table

Key regulatory provisions in India, Mexico, and Nigeria				
Regulatory provision	**Countries**	**EMIs (or similar)** *India: Nonbank PPI Issuer in Semi-Closed System* *Mexico: Electronic Payment Funds Institution (IFPE)* *Nigeria: Nonbank Mobile Money Operator*	**Payments banks** *India: Payments Bank* *Mexico: Payments Niche Bank* *Nigeria: Payment Services Bank*	**Conventional banks**
Foundation law	India	Payment and Settlement Systems Act, 2007	Banking Regulation Act (BRA), 1949	BRA, 1949
	Mexico	Financial Technology Institutions Law, 2018 (Fintech Law)	Credit Institutions Law (CIL), as per 2012 reform, Art. 10, 19, 46	CIL, 2012
	Nigeria	Central Bank of Nigeria Act, 2007	Banks and Other Financial Institutions (BOFIA) Act, 1991	BOFI Act, 1991
Implementing regulation	India	PPI Master Direction 2017 (Master Direction DPSS.CO.PD.No.1164/02.14.006/2017–18)	Guidelines for Licensing of "Payments Banks," Nov. 2014	Various
	Mexico	Various regulations implementing the Fintech Law, issued by the Bank of Mexico or by the Banking and Securities Commission in March 2019 (some aspects, such as capital adequacy, are still pending regulation)	General Provisions Applicable to Credit Institutions (Circular Única de Bancos)	
	Nigeria	Guidelines on Mobile Money Services in Nigeria, 2009	Guidelines for Licensing and Regulation of Payment Services Banks in Nigeria, October 2018	
Minimum initial capital	India	INR 150 million (US$2.1 million) to be complied with within 3 years for institutions licensed after October 2017, or by 2020 for institutions already in operation in October 2017	INR 1 billion (US$14 million)	INR 5 billion (US$67 million)
	Mexico[A]	UDI 500,000 (US$166,836) UDI 700,000 (US$233,570) if authorized to operate with virtual assets or act as a clearinghouse (although operation with virtual assets is currently prohibited as per a Banco de Mexico regulation)	UDI 36 million (US$12 million)	UDI 54 million (US$18 million) to UDI 90 (US$30 million) depending on the range of permitted activities
	Nigeria	NGN 2 billion (US$5.5 million)	NGN 5 billion (US$13.9 million)	NGN 25 billion (US$69.4 million) for national commercial bank NGN 50 billion (US$138.8 million) for international commercial bank
Capital adequacy ratio	India	No capital adequacy ratio is imposed	Risk-weighted capital adequacy ratio of 15% Tier I capital must be at least 7.5% Leverage ratio of 3% (i.e., capital plus reserves equivalent to at least 3% of outside liabilities)	Risk-weighted capital adequacy ratio of 9% (+ 2.5% conservation buffer)
	Mexico	Customized capital adequacy ratio to be defined in upcoming regulation (to be based on one of more of the following: average e-money issued, or number and value of transactions and/or deposits)	Risk-weighted capital adequacy ratio as applicable to conventional banks	Risk-weighted capital adequacy ratio of 10.5%
	Nigeria	No capital adequacy ratio is imposed	Risk-weighted capital adequacy ratio of 10% "Capital measurement approach" as applicable to conventional banks Capital measurement approach for credit risk shall be applicable as prescribed for conventional banks, or as prescribed by the central bank	Risk-weighted capital adequacy ratio of 10% (15% for internationally active banks)

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Permitted activities	India	Issue reloadable and nonreloadable PPI to facilitate the purchase of goods and services, including financial services, remittance facilities, at establishments that have a contract with the issuer, and agents Cash withdrawals prohibited Interest payment prohibited PPI as paper vouchers prohibited Cross-border transactions prohibited, except inward remittances, up to INR 50,000, for know-your-customer compliant reloadable PPIs	Accept demand deposits (current and savings) from individuals and small businesses Provide payments and remittance services Issue ATM/debit cards Offer cash withdrawals Issue PPIs Internet banking Function as agents of another bank Accept/send remittances (as channels for banks) Accept/send remittances subject to prior authorization Nonrisk sharing distribution of financial products such as insurance and mutual funds subject to prior authorization Offer utility bill payments Participate in the payment and settlement system Access the interbank uncollateralized call money market and collateralized repo and collateralized borrowing and lending obligations (CBLO) markets Lending prohibited
	Mexico	Issue one or more accounts per client, in domestic currency; foreign currency subject to special authorization Transfers among clients Interoperable transfers, including payments Cash withdrawals Issue payment instruments linked to the accounts Remittances Interest payment prohibited	Accept demand deposits; Issue payment instruments—credit cards not permitted; Lending prohibited
	Nigeria	Accept deposits originating from bank accounts, cards, and directly into stored-value accounts issued by the EMI Provide payments services, based on bank accounts, cards, prepaid accounts	Accept deposits from individuals and small businesses Carry out payments and remittances Sell foreign currency from inbound remittances to authorized exchange dealers Issue debit and prepaid cards Operate electronic wallet Render financial advisory services Invest in government securities (FGN and CBN) Partner with card scheme operators Deploy ATMs, POS, agents, agent networks, and other channels Access interbank market and central bank liquidity facilities (collateralized repo window) Prohibited: lending, acceptance of closed scheme electronic value (e.g., airtime), acceptance of foreign currency deposits, deal in foreign exchange market, insurance underwriting

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Selected licensing criteria (in addition to minimum initial capital)	India	Eligible promoters: conventional banks and nonbank entities Nonbanks must be registered under the companies Act, 1956 Nonbanks with foreign investors allowed Licensing procedure established in the Payment and Settlement Systems Regulations, 2008 Certificate from Chartered Accountant must be submitted during licensing, as per the audited balance sheet Fit-and-proper requirements apply with regard to the directors of the nonbank promoter RBI may consider aspects such as customer service, efficiency, technical and related requirements, safety, and security in making the licensing decision Approval in principle is issued with validity of 6 months for PPI issuer to start operations PPI issuer must submit a System Audit Report within 6 months to get a final approval by RBI Certificate of Authorization is valid for 5 years	Separate legal entity, registered as a public limited company Eligible promoters: PPI issuers, other entities and individuals, nonbank finance companies, corporate business correspondents, MNOs, supermarkets, companies, real-sector cooperatives owned and controlled by residents, public-sector entities, joint ventures with conventional banks up to the shareholding limit imposed on them Initially, no shareholding diversification applies. But promoters should hold at least 40% of paid-up equity for the first 5 years Shareholder diversification and public listing required within 3 years of reaching net worth of INR 5 billion Foreign shareholding subject to various limits Fit-and-proper requirements apply on promoters Shareholder's voting rights capped at 10% (can be raised by RBI) Detailed business plan and technology plan Board with majority of independent directors Licensing applications subject to the evaluation by an External Advisory Committee, which submits its recommendation to RBI
	Mexico	Eligible promoters: domestic and foreign individuals and corporates. Credit institutions can be shareholders up to 50% of the capital Quarterly and annual disclosure of financial statements, on the EMI's website EMI's name must contain "Electronic Payment Funds Institution", which is restricted to EMIs that have obtained a license to operate as such Credit institutions that are shareholders cannot advertise the EMI's products EMI license is issued by the Banking and Securities Commission (CNBV) with agreement of an Inter-institutional Committee comprised of six members, including two representatives of each financial authority (CNBV, Ministry of Finance, and the Bank of Mexico)	Same requirements as applicable to conventional banks, including permission for domestic or foreign promoters (individual or corporate)
	Nigeria	Eligible promoters: conventional banks and other corporate organizations, except telecommunication companies	Eligible promoters: banking agents, MNOs, retail chains, postal services, MMOs, fintech companies, financial holding companies, others may be considered. Switching companies are not eligible Foreign institutional investors allowed Use of word that links payments bank to parent company prohibited Detailed business plan and technology plan Board must have 5–7 members, 2 of which must be independent Fit-and-proper requirements apply to shareholders, director, and managers An approval-in-principle is issued with 6-month validity A prelicensing inspection is undertaken before final approval

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Limits on the accounts provided by the special licensing category	India	Maximum INR 50,000 (US$700) in deposits per month in any situation, and two levels of limits apply according to the "KYC compliance" level. a. **Minimum detail on holder:** INR 10,000 (US$144) in monthly deposits, maximum balance, and maximum debit. INR 100,000 (US$1,400) deposits per year. No transfers allowed. These PPIs must be converted into "KYC compliant" within 12 months of issuance. b. **KYC-compliant:** INR 100,000 (US$1,400) maximum balance. Transfer allowed "back to source," holder's own bank account, or preregistered beneficiaries (up to INR 100,000 or US$1,400) or other cases up to INR 10,000 (US$140).	INR 100,000 (US$1,400) balance per customer; may be raised by RBI based on the payments bank performance
	Mexico	a. **Level 1:** UDI 1,000 (US$333) balance, UDI 750 (US$250) monthly deposits, UDI 1,500 (US$500) daily cash withdrawals, UDI 10,000 (US$3,338) monthly cash deposits b. **Level 2:** UDI 3,000 (US$1,000) monthly deposits, UDI 1,500 (US$500) daily cash withdrawals, UDI 10,000 (US$3,338) monthly cash deposits c. **Level 3:** no balance limit, UDI 10,000 (US$3,338) monthly cash deposits, UDI 1,500 (US$500) daily cash withdrawals	Tiered account system for conventional banks applies. a. **Level 1:** UDI 1,000 (US$333) balance, UDI 750 (US$250) monthly deposits. No transfer allowed. b. **Level 2:** UDI 3,000 (US$1,000) monthly deposits, plus UDI 6,000 (US$2,000) in government programs c. **Level 3:** UDI 10,000 (US$3,338) monthly transactions d. **Level 4:** no limits
	Nigeria	3-Tier account system applies (same for conventional banks) a. **Level 1:** NGN 50,000 (US$139) daily deposit, NGN 300,000 balance (US$833) b. **Level 2:** NGN 200,000 (US$555) daily deposit, 500,000 balance (US$1,387) c. **Level 3:** NGN 5 million (US$13,880) daily deposit, no balance limit	3-Tier account system applies (same for conventional banks): a. **Level 1:** NGN 50,000 (US$139) daily deposit, NGN 300,000 (US$833) balance b. **Level 2:** NGN 200,000 (US$555) daily deposit, NGN 500,000 (US$1,387) balance c. **Level 3:** NGN 5 million (US$13,880) daily deposit, no balance limit
Fund safeguarding requirements	India	Back 100% of PPI obligations with a noninterest-bearing escrow account with only one bank, on behalf of the customers, based on a service level agreement between bank and PPI issuer. At least daily reconciliation with PPI obligations. **Exception:** "core portion" (defined in regulation) may be transferred to interest-bearing account linked to the escrow account for PPI issuers operating for at least a year No comingling of funds originating from any other activity that the issuer may be undertaking	At least 75% of the demand deposit liabilities in government bonds with maturity up to 1 year Up to 25% of demand deposit liabilities in current and time/fixed deposits PPI balances can be flexibly invested between government bonds and bank deposits
	Mexico	100% of e-money issued backed by demand deposits (separate from other funds) at banks or invested in bonds of the federal government or the central bank, through daily repurchase agreements	No fund safeguarding requirements imposed
	Nigeria	100% of the e-money issued backed by settlement accounts at banks (nominee accounts on behalf of EMI customers), separate from the EMI's other funds, noninterest bearing and not subject to bank fees. At least one daily reconciliation.	Minimum of 75% of the demand deposit liabilities in CBN securities, T-Bills, and other short-term government instruments. Remaining balance shall remain in bank deposits.

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Other liquidity requirements	India	None.	Cash Reserve Ratio and Statutory Liquidity Ratio applicable to conventional banks apply on the overall outside demand and time liabilities, including PPI balances
	Mexico	None.	Liquidity requirements for conventional banks apply
	Nigeria	None.	Statutory reserve requirement for conventional banks applies Cash reserve requirement to be prescribed by CBN
Other selected requirements or provisions	India	Phased interoperability: among PPI issuers, between PPI wallets and bank accounts, followed by interoperability of card-based PPI	Other banking prudential regulations for conventional banks apply except with regard to loans and advances portfolio Prohibition of setting up subsidiaries to undertake nonbanking financial services Requirement of at least 25% of physical access points (e.g., agents) in rural centers apply. Controlling offices for clusters of access points required. Corporate governance regulations for conventional banks apply Payments banks come under the RBI Banking Ombudsman Scheme, 2006
	Mexico	Governance structure requirements flexible according to size and complexity Obliged to set up APIs for open banking	Other banking prudential regulations apply
	Nigeria	Technology requirements, transaction security standards, switching and settlement standards, consumer protection, and business continuity planning standards apply as per the mobile money regulation. Risk management standards apply as per the mobile money regulation.	Requirement of at least 25% of service touch points in rural areas and unbanked locations Coordinating centers in clusters of outlets required Parent company prohibited from discriminating against other Payment Services Banks Prohibition of setting up subsidiaries Limits to investment in fixed assets may be prescribed Other banking prudential regulations apply Corporate governance standards for conventional banks apply Dealings with infrastructure providers and intragroup transactions must be at arm's length

A UDI (Unidades de Inversión) is a reference factor used in Mexican regulations. The value of UDI, in Mexican pesos, is published daily by the central bank.

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