

Economic Watch

Financial Inclusion - Peru

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Economic Analysis

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The regulatory framework for electronic money in Peru and financial inclusion

- **The regulatory framework for offering financial services via mobile devices is still recent**

Following a process of discussions beginning in 2010 with the first legislative initiatives that did not prove successful, 2012 finally saw the approval of the "Law regulating the basic characteristics of electronic money as an instrument of financial inclusion." The law is inspired in those that have already been introduced with some success in other geographical areas.

- **The law on e-money regulates the issuance of this payment method,** including reconversion into cash, transfers, payments and any transaction or operation linked to the monetary value held by the account holder. It stipulates the companies authorized to issue it and the regulatory and supervisory framework governing them.

- **It creates EEDEs as a new agent in the market**

Together with the other institutions supervised by the SBS, EEDEs may issue e-money, although this is their only function. Thus EEDEs are not permitted to grant loans and may only carry out transactions linked to their main purpose.

- **The law regulating e-money aims to generate a broad channel for accessing the financial system that brings it closer to rural or isolated areas where commercial banking has no presence,** by making secure and low-cost payments and transfers easier. The rapid spread of mobile technology across the country creates opportunities for expanding financial services, and it is in this environment that the aim is to provide wider access to the financial system.

- **The law aims to take advantage of cell-phone penetration, simplified account opening and the successful experience with banking correspondents**

The complementary nature of these developments will be key to providing greater access to the financial system for people who are still outside it.

1. A regulatory framework for the development of mobile banking

Despite the major increase in credit and the intensive growth strategies of banks in Peru over recent years, access to products in the formal financial system continues to be difficult for the rural or low-income population. Only 20% of households use the banking system, less than the figure in other countries in the region such as Brazil (56%) and Chile (42%). Mobile banking has been used basically as an additional channel to the traditional ones, allowing users to check account balances, transfer money between their own accounts, locate branches, and carry out a few other operations, rather than as a mechanism for inclusion. In this situation, mobile technology (e-money) offers the possibility to provide financial services at a lower cost than that involved in opening a branch office or another channel in places where demand does not justify the costs incurred.

The regulatory framework for offering financial services through electronic money is in its infancy in Peru. The first legislation governing its basic characteristics and use was presented in 2010¹, but was not passed by Congress. Later, in January 2013 a law was passed "governing the basic characteristics of electronic money as a tool for financial inclusion". This law mainly aims to benefit rural areas or areas that are not reached by commercial banking. It makes it easier to make payments and transfers securely and at low cost, taking advantage of the rapid spread of mobile technology in the country to generate the possibility of expanding financial services. The regulation is inspired in initiatives introduced in other countries that have been relatively successful in implementing mobile banking as a mechanism for implementing a policy of financial inclusion in areas where there is limited access to these services. Examples of this are the cases of Giros-TIGO (Paraguay), M-Pesa (Kenya), Smart Money and G-Cash (the Philippines). In these cases financial services are offered through cell phones. They are particularly linked to transactions such as remittances, payments in retail outlets, and e-transactions, with minimum information requirements and easy access for the population.

The Law on e-money approved in Peru regulates the issuance of this payment method, including reconversion into cash, transfers, payments and any transaction or operation linked to the monetary value held by the account holder. It stipulates the companies authorized to issue it and the regulatory and supervisory framework governing them. The Central Bank uses the following definitions when referring to mobile banking, e-money and electronic credit cards²:

- Mobile banking: a virtual channel through which customers can carry out transactions using cell phones.
- E-money: a value stored in electronic form in a device such as a microchip card or computer hard drive. Its value is reduced every time goods or services are purchased, or money withdrawn.
- Electronic credit cards (pre-paid cards): store monetary value that allows users to pay in entities other than the card issuer.

1: Bill No. 4168/2009PE.

2: Circular No. 046-2010 "Reportes sobre canales e instrumentos de pago distintos al dinero en efectivo" (Reports on payment channels and instruments other than cash), which aims to standardize the information requirements of the Central Bank (BCR) on the use of payment channels and instruments other than cash.

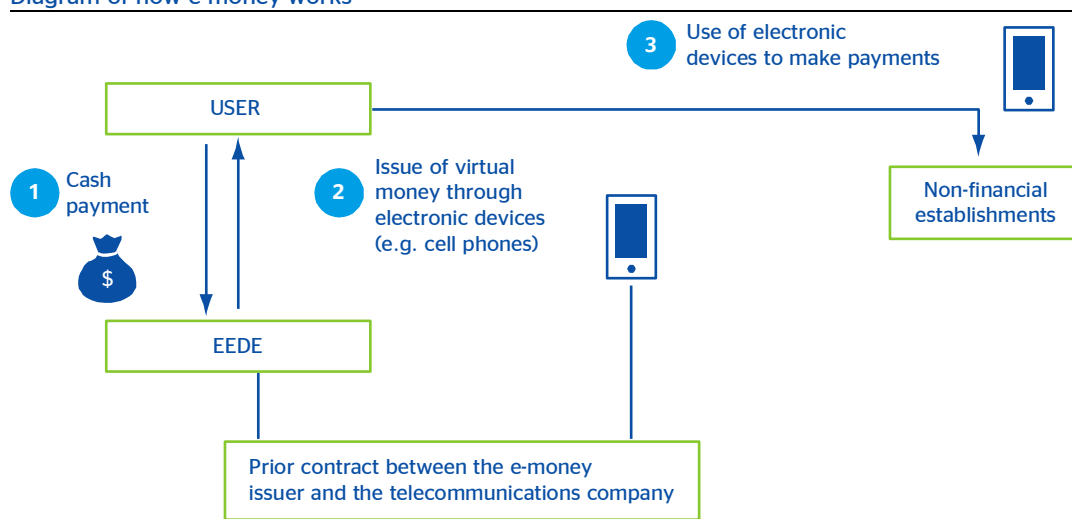
2. Electronic money: operation and characteristics

E-money is considered to be monetary value stored in electronic media such as cell phones, prepaid cards and other equipment or devices, which comply with the aims established and have technological platforms allowing transactions to be made in real time and securely.

E-money functions mainly by users having to go to a branch office or non-banking channel, where they hand over cash that is then converted into virtual money. Customers can then use this to carry out transactions over their cell phones or other devices, with the amount being charged to the converted cash balance. Underlying this is a contract between the bank or the issuer and a telecommunications company.

Chart 1

Diagram of how e-money works



Source: BBVA Research, based on the Law governing e-money

The main characteristics of e-money³ are:

- It is stored in an electronic format.
- It is accepted as a means of payment by entities or persons other than the issuer.
- It is convertible into cash up to the monetary value the holder has available.
- It is not a deposit nor does it earn interest. It is therefore not supported by the Deposit Guarantee Fund.
- A bank account is not required to use e-money.

2.1. Electronic money issuing companies (EEDEs)

The e-money law establishes that the only companies that can provide this service are those within the supervisory framework of the financial system, regulated by the Banking and Insurance Superintendency (SBS), such as banks, financial companies and savings banks. However, the law has created Electronic Money Issuing Companies (EEDEs) for the purpose of generating competition in this segment. These institutions will be supervised by the SBS and will have as their main purpose the issue of e-money (they will not issue credit and can only carry out operations linked to their main purpose). Although they can contract third parties to channel their operations, they continue to be responsible for carrying them out.

3: Established in Law No. 29985.

The issuers must set up trusts for the corresponding value and the operations must be associated with an account in which the account holder is duly identified. To create an incentive for these operations, the issuing of e-money by EEDs is free from general sales tax (IGV) for a period of three years.

The telecommunications media⁴ that are used for providing these financial services must be offered under equal conditions for all the companies that do so. The Supervisory Body for Private Investment in Telecommunications (Osiptel) is responsible for ensuring compliance in this respect. Companies in the financial system, together with telecommunications companies that provide e-money services, should jointly control the operational risks e-money users are exposed to. The financial regulator and the telecommunications regulator shall have an important role to play in minimizing these risks.

One factor to take into account in the regulations linked to e-money is minimizing the risk that it may be used for illicit activities such as money laundering or financing terrorism⁵. For this reason, a proper record of transactions made as well as full identification of e-money users (ID document, address, employment, telephone number) at financial institutions and telecommunications companies will be key.

2.2. Creation of simplified money accounts

In July 2013 the SBS pre-published⁶ additional regulations for the Law governing e-money. Worth noting here is the provision stipulating that the EEDs may offer simplified e-money accounts. These accounts would be made available for natural persons and must meet the following conditions:

- a) They can be opened by Peruvian or foreign nationals.
- b) Each transaction is subject to the limit of PEN 1000.
- c) The total balance in the e-money accounts for one account holder with the same issuer may not be more than PEN 2000.
- d) The accumulated transactions in a month per holder and issuer may not exceed PEN 4000.
- e) Simplified e-money accounts may only be opened and operated in soles and in Peru. Issuers should define procedures and measures aimed at monitoring compliance with the aforementioned limits and conditions.

Identification and verification requirements applicable to the holders of these simplified accounts must include at least the full name of the holder, as shown on their ID card, Overseas National Card or Passport, with their current address as stated by the holder. In order to open e-money accounts using cell phones as electronic devices, the phone number associated to the cell phone shall also be required.

2.3. Forms of contract under the Law

Another important point in the regulations pre-published by the SBS are the forms of contract that can be used by the EEDs. The regulations stipulate that issuers of e-money may conclude contracts either in person or remotely (in the case of foreign nationals only in person), provided that the following conditions are met:

4: The telecommunications services that may participate are subject to the Single Consolidated Text of the Telecommunications Act (Supreme Decree 013-93-TCC) and the Single Consolidated Text of the General Regulations of the Telecommunications Act (Supreme Decree 020-2007-MTC).

5: Companies in the financial system and also companies constituted as EEDs fall within the scope of Law No. 28306 on money laundering. They are obliged to notify the Financial Intelligence Unit (UIF) about any suspect transactions and to comply with the preventive measures set out in these regulations.

6: A pre-published guideline is one that the SBS releases on its website so as to receive comments before being published as a regulation.

- The contract must be concluded over the phone or online.
- The issuer must have appropriate mechanisms to guarantee the security of the contract process at all its stages and to ensure that there may be proof of acceptance by the account holder.

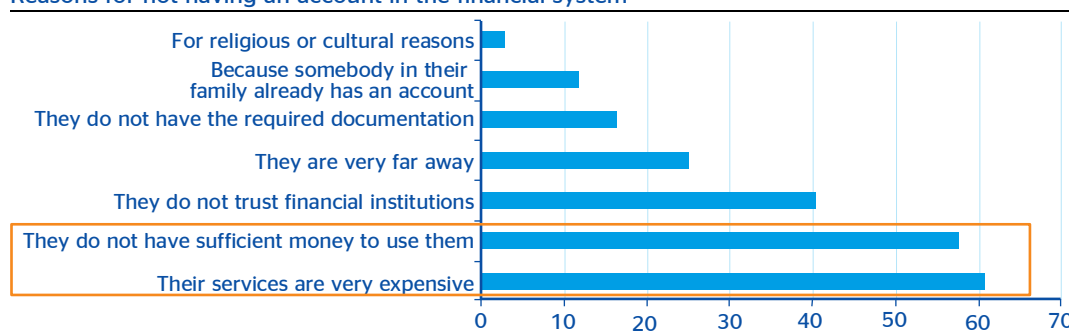
The issuer of e-money must store evidence of the contract and other documents in accordance with the provisions of the Regulation on Transparency of Information and Contracts with Users of the Financial System.

3. The challenges for the law on e-money as a basis for greater financial inclusion

Financial inclusion is an important factor for sustained and continued growth in emerging markets; without it individuals and companies trust only in their own funds to satisfy their financial needs and deal with shocks. This is inefficient. In the case of Peru, people with low incomes or who live in remote areas are those most excluded from the system. In fact, according to the Global Findex survey, among the main reasons people state for not having an account at a financial institution are the perception that services are very expensive and that they do not have enough money to use them. For low-income sectors, the financial system is not attractive, or is at least not yet seen as an attractive option.

Chart 2

Reasons for not having an account in the financial system



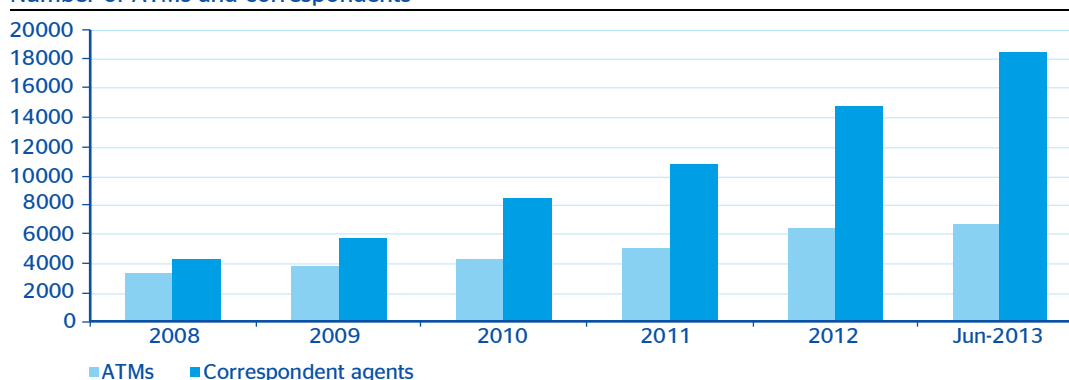
Source: Global Findex

Given these problems, cheaper channels such as e-money via ordinary cell phones, as well as a publicity campaign highlighting the benefits of bank use, would be essential for increasing inclusion levels. The level of cell-phone penetration across the country (75% of households⁷), provides an enormous potential for increasing banking penetration through existing platforms that are well-known to users. The same is true with ATMs and banking correspondents, whose expansion, particularly in rural areas, will allow e-money to reach areas where there are no other kinds of banking services, and allow money to be paid into and out of accounts. This would provide an opportunity for expanding EEDE networks without major infrastructure costs. In the last three years, the number of banking correspondents has more than doubled (from 8,543 in 2010 to 18,552 in June 2013), with 92% of these channels located outside Lima.

7: According to the National Household Survey (ENAH 2011), 75% of households say they have a cell phone.

Chart 3

Number of ATMs and correspondents



Source: SBS

The implementation of regulations governing e-money is an important step forward in its use with respect to financial inclusion. The legislation aims to take advantage of both the high penetration rate of cell phones in the country and the major expansion of channels as banking correspondents (through the outsourcing of the services provided by the EDEs). However, these elements still have to be fully integrated. The links between cell phones and bank accounts (the bank-phone company link) and options for physical access (correspondents, ATMs that allow cash-in/cash-out services with longer hours and greater geographical coverage, will be key for the success of e-money as a mechanism for inclusion. To achieve this integration it will be important to take into account all the actors involved in the service, provide incentives to non-financial institutions that act as correspondents (that can provide the e-money top-up service) and develop appropriate awareness campaigns, particularly at the deployment stage.

Another important element for the development of this service is the existence of simplified accounts, which are already included under the law. These require a minimum of documentation, formal requirements and registration time, and can break down entry barriers for the less formal segment of the economy. Such accounts would allow people with low incomes to enter the system through a sustainable but cheap and easily accessed product. The existence of these accounts does not mean the balance between the registration information needed and formal requirements should be disregarded; transactions must be correctly registered and users fully identified.

In line with the above, a financial inclusion strategy could allow access to account services for low-income segments, with a limited range of products that allow the use of financial services and reduce the transaction costs of intermediation, fundamentally through payment services / use of cash. These could then allow access to more complex products.

4. Conclusions

- The recently approved legislation governing e-money raises some interesting prospects for the development of the sector. It aims to increase the levels of financial inclusion, particularly in segments of the population with problems in accessing the financial system (people without education, with low incomes or living in rural areas).
- The legislation establishes that only companies in the financial system, supervised by the Banking and Insurance Superintendency (SBS) may issue e-money. However, to increase the levels of competition it has created Electronic Money Issuing Companies (EEDs), specialized in this operation and supervised by the SBS.
- Although the regulations in Peru have only recently been implemented, the measures introduced so far appear to point in the right direction in terms of creating incentives or access to financial services, particularly in remote areas or for people with low incomes. Measures such as allowing the EEDs to outsource some operations, for example by using correspondents, creating simplified accounts for natural persons, or the use of remote channels for e-money contracts, all help increase coverage using existing platforms, reducing paperwork and waiting times and simplifying formal requirements. The important part of these elements, and a challenge that is still pending resolution, is to organize them in such a way that the advantages presented in this market are used to increase the levels of financial inclusion.

Measures of this kind and the relatively flexible legal framework for the use of e-money that takes advantage of the extensive presence of cell phones are positive steps forward. However, it is not enough to have technological platforms that allow the implementation of these measures; adequate controls and identification of customers and operations also have to be in place to prevent fraud or illegal actions such as money laundering or terrorist financing.

References

Circular SBS No. B-2147-2005: "Establecen disposiciones para la apertura, conversión, traslado o cierre de oficinas, uso de locales compartidos y uso de cajeros automáticos y corresponsales" (Establish provisions for the opening, conversion, move or closure of branches, use of shared premises and use of ATMs and banking correspondents).

Law No. 26702 "General Law on the Financial and Insurance System and Organic Law on the Banking, Insurance and AFP Superintendency."

Law No. 29985 (2012) "Law governing the basic characteristics of electronic money as a tool for financial inclusion."

Draft Bill No. 4168/2009 PE (2009) governing the basic characteristics of electronic money as a tool for financial inclusion.

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