Electronic money: Secure access to the financial system?

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In 2014, just 54% of the adults in developed economies had a banking account, according to the World Bank. And that percentage is even smaller in some regions, as low as 14% in the Middle East. Given how important having access to financial services is for economic development and fighting poverty, financial inclusion has become a priority for many governments. In the digital transformation the industry is undergoing, digital financial services such as e-money can drive change.

Electronic money is a financial instrument that allows users to make payments and transfers with a smartphone or other kinds of electronic devices. Customers go to establishments that issue electronic money, where they deposit a certain amount of physical money. This turns into an equivalent amount of virtual money stored in the electronic device, which can be turned back into physical money at the customer's request. Electronic money allows unbanked people to make transactions easily, but it also entails risk for users. Several countries have implemented measures to mitigate the risk of customers losing their money if the issuer goes bankrupt (insolvency risk) o not being able to turn their virtual money back into cash (liquidity risk).

To mitigate the liquidity risk, electronic money issuers must cover 100% of the funds in safe and liquid investments. This generally means that in the case of non-banking institutions, the electronic money issuer deposits the sum of its customers' funds in one or more banks. However, this measure may not be enough to guarantee the integrity of the funds if the issuer of the electronic money goes bankrupt. To address this situation, regulators have established various mechanisms to separate the customer's funds from the issuer's assets.

But bankruptcy isn't the only risk electronic money customers face. Once the issuer deposits the funds in a banking account, the bank's own insolvency enters the equation. Protection against these types of circumstances will depend on the capital requirements imposed on the issuer and the number of banks in which the funds are deposited, given that in general the e-money accounts are not covered by the deposit guarantee system. Although the effectiveness of these measures has not been tested enough to identify an optimum solution, it is evident that effective consumer protections are vital to ensuring sustainable financial inclusion.

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