



October 30, 2014
Basel, Switzerland

2nd GPFI Conference on Standard-Setting Bodies and Financial Inclusion

Session 4: Deposit insurance and digital transactional platforms – a frontier issue

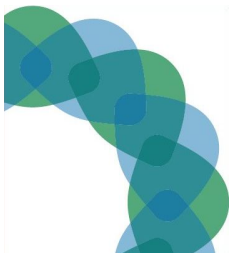
Should deposit-like stored value products be covered by deposit insurance and, if so, how?

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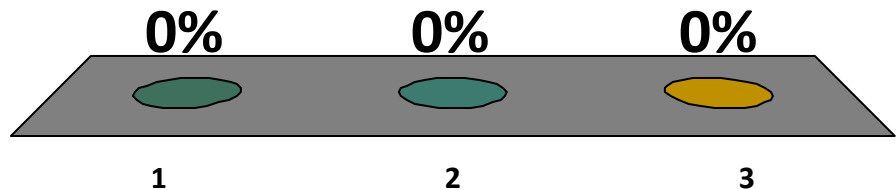
In your opinion, which functionality of a digital transactional platform is most important in considering extending deposit insurance coverage?

1. Payment and/or transfer instrument functionality
2. Value storage functionality
3. Both are equally important



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Which of the following statements regarding deposit insurance and digital transactional platforms do you agree the most with?

1. Digital transactional platform products should generally only be permitted if offered by members of deposit insurance system, to ensure customer funds are protected the same as bank deposits
2. Customer funds should be protected, regardless of provider(s) and regardless of cost implications
3. Customers should first have access to affordable digital transactional platforms, which they can use to access insured deposit accounts if they choose
4. 1 and 2, but not 3

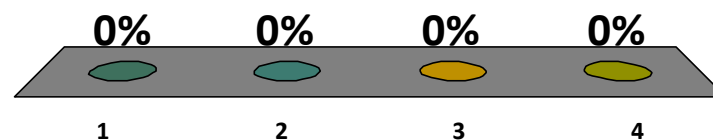


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Digital transactional platform: product, provider(s), or both?

Functionality/ product aspect

From customer's perspective

- Can be used to make payments and transfers
- Can be used to store value electronically

Provider(s) aspect

*From regulator's/
deposit insurer's perspective*

- Combination of bank and non-bank providers likely
- Many examples where 2 or more separate legal entities responsible for:
 - Holding (having custody of) customers' funds
 - Managing records of individual customers' account balances



Deposit insurance and digital transactional platforms: Why should we care?

- From a product perspective, digital transactional platforms combine functionality of payment instrument with that of current account – and latter triggers question of deposit insurance
- Importance of deposit insurance for digital transactional platforms:
 - ***Systemic perspective***: market for the products/functionality is growing rapidly in multiple countries, and number of poor and low-income customers who could lose all they have if one or more providers of a digital transactional platform fails may become systemically important in some markets
 - ***Inclusion perspective***: digital transactional platforms hold great potential for expansion of financial inclusion (though in some cases product uptake is moving slower than expected, perhaps in part due to lack of consumer confidence)



What do we know about the issue(s)?

- Reasonable policy makers can differ as to which product aspect (payment instrument or stored value) is more important when considering deposit insurance treatment
- Products offered via digital transactional platforms may or may not be deemed “**deposits**” subject to deposit insurance coverage, and providers may or may not be eligible “**members**” of deposit insurance systems, depending on notional model of digital transactional platform, and structure and features of deposit insurance system (though change is possible)
- To date, little research or analysis has been done (and IADI survey touched on it inconclusively)
- Yet countries are moving ahead with one position or another



Core deposit insurance issues to bear in mind

- Deposit insurance systems seek to shift financial burden of protecting smaller, retail depositors from government to financial providers
- There is cost/access tradeoff at margins, regardless of notional model of digital transactional platform or structure and features of deposit insurance system
- Other issues beyond cost may justify extending (or trying to extend) coverage – e.g., increased consumer trust that might result, limiting systemic consequences of failure of provider, minimized disruption to payment systems



Core deposit insurance issues to bear in mind

- **Membership** – *will determine whether provider involved in digital transactional platform is member, or eligible to become member, of deposit insurance system*
- **Coverage** – *will determine whether product is covered (i.e. qualifies as “insured deposit” and in what amount)*
- **Sources and uses of funds** – *will influence what providers pay as premium for insured deposits (and likelihood of passing costs along to customers, reducing uptake)*
- **Public awareness** – *will determine what customers understand about what is covered, in what amount – and importantly what is not covered at all*
- **Reimbursing depositors** – *will determine whether system functions to promptly refund customers from provider failure*



Key aspects of digital transactional platforms ...

... of relevance for deposit insurance purposes:

- **Who holds/has custody of customers' funds and how do they hold them?** *(E.g., currently banks typically hold funds for MNO e-money issuers, but many variations on nature of custodial accounts used)*
- **Who accounts for/manages individual digital account balances and what is their relationship to holder/custodian?** *(E.g., lots of outsourcing of account management across different models, and often manager = MNO)*



Three approaches to deposit insurance for digital transactional platforms (though there may be more – frontier issue)

- **Direct coverage:** *regulation is adjusted as needed to bring digital transactional platforms within deposit insurance coverage*
- **“Pass-through” or indirect coverage:** *customer funds held in pooled custodial account are insured, and insurance is “passed through” to individual account balances managed by third party (such as MNO e-money issuer or issuer of reloadable prepaid cards)*
- **Exclusion from deposit insurance:** *conscious policy decision is taken to exclude products offered via digital transactional platforms from deposit insurance coverage*



Direct coverage

- Single entity may be both product provider and deposit insurance system member
- Product must qualify as insured deposit
- Adequate prudential regulation, supervision and resolution framework for provider must be in place
- What issues or complications are introduced if third party (e.g., MNO) accounts for /manages customers individual account balances?





Mexico – Direct coverage

Direct coverage – Mexico

| Notional model | Who holds customers' funds? | Who accounts for/ manages customers' funds? | Who pays premium for digital transactional platform? | Implications for customers |
|--|--|--|---|---|
| Bank providing basic account via mobile or POS | <ul style="list-style-type: none"> – Bank (deposit insurance system member) | <ul style="list-style-type: none"> – Bank (deposit insurance system member) | <ul style="list-style-type: none"> – Bank (deposit insurance system member) – Any change if non-bank accounts or manages? | <ul style="list-style-type: none"> – Potential higher cost of product – Product is insured – Account management issues if 3rd party account manager fails |
| Niche bank providing accounts via mobile or POS | <ul style="list-style-type: none"> – Bank (deposit insurance system member) | <ul style="list-style-type: none"> – Bank (deposit insurance system member) – Non-bank | <ul style="list-style-type: none"> – Bank (deposit insurance system member) – Any change if non-bank accounts or manages? | <ul style="list-style-type: none"> – Potential higher cost of product – Product is insured – Account management issues if 3rd party account manager fails |



“Pass-through” or indirect coverage

- Holder/custodian of customers’ funds must qualify for membership in deposit insurance system
- Provider or manager of individual customer accounts is not required to become member
- Pooled account in which customer funds are held must qualify as “insured deposit” and individual customer accounts must be eligible for “pass-through” treatment
- Manager of individual customer accounts and custodian holding customer funds must be able to account close to real-time and to reconcile records





Kenya – Pass-through coverage (planned)

“Pass-through” or indirect coverage – Kenya (planned)

| Notional model | Who holds customers' funds? | Who accounts for/ manages customers' funds? | Who pays premium for digital transactional platform? | Implications for customers |
|---------------------------|--|---|---|--|
| MNO e-money issuer | <ul style="list-style-type: none"> – Bank (deposit insurance system member) | <ul style="list-style-type: none"> – Trustee | <ul style="list-style-type: none"> – Bank – MNO e-money issuer <i>does not</i> pay premium | <ul style="list-style-type: none"> – Potential higher cost of product – Product is insured if custodian of customer funds fails – Failure of issuer /manager of customer accounts doesn't trigger coverage (but account data could be lost) |



Exclusion from deposit insurance

- Inclusion tradeoffs associated with extension of deposit insurance to products offered via digital transactional platforms could be significant
- Significant practical feasibility challenges may not justify coverage (e.g., political economy considerations render regulation change unrealistic)
- Digital transactional platforms must be excluded from definition of insured deposit
- Increased efforts appropriate to raise consumer awareness of coverage exclusion of products offered via digital transactional platforms



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The Philippines – Coverage exclusion

Exclusion from deposit insurance – The Philippines

| Notional model | Who holds customers' funds? | Who accounts for/ manages customers' funds? | Who pays premium for digital transactional platform? | Implications for customers |
|---|--|--|--|---|
| Bank providing basic account via mobile or POS | <ul style="list-style-type: none"> – Bank (deposit insurance system member) | <ul style="list-style-type: none"> – Bank – E-money network service provider | <ul style="list-style-type: none"> – None | <ul style="list-style-type: none"> – No additional cost of product – Product is not insured |
| MNO e-money issuer providing accounts via mobile | <ul style="list-style-type: none"> – Bank (deposit insurance system member) | <ul style="list-style-type: none"> – Non-bank e-money issuer | <ul style="list-style-type: none"> – None | <ul style="list-style-type: none"> – No additional cost of product – Product is not insured |



Key takeaways (1 of 2)

- No prescribed definition of “insured deposit” in draft revised Core Principles for Effective Deposit Insurance Systems
- No “one-size-fits-all” approach to extending deposit insurance to digital transactional platforms, but three approaches have emerged: ***direct coverage, pass-through*** or indirect coverage, and ***exclusion from coverage***
- Country specifics such as notional models of digital transactional platform and key features of deposit insurance scheme are important dimensions to consider
- *Necessarily* a cost/access tradeoff if deposit insurance system is effective at shifting burden of depositor protection from government to providers



Key takeaways (2 of 2)

- Cost to providers likely to be passed on to customers (limiting access)
- Feasibility and cost implications should be thoroughly assessed when evaluating whether to attempt extending deposit insurance to digital transactional platforms
- Regardless of decision, ***public awareness*** is critical for consumers to understand differences in protection depending on product or provider of digital transactional platform
- Further research useful to measure issues such as cost, funding, and consumer confidence implications of extending or excluding deposit insurance coverage to digital transactional platforms





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