



A Risk - Based Approach to Regulatory Policy and Mobile Financial Services

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Agenda

- ▶ Introduction – Current Regulatory Outlook
- ▶ USAID and Mobile Financial Services
- ▶ Mobile Financial Services Risk Matrix – Introduction
- ▶ Mobile Financial Services Risk Matrix – Operations
- ▶ Current Research and Relevance to USAID M-Money Initiatives
- ▶ Questions - Contact Information



Introduction: Current Regulatory Perceptions

- As mobile financial services comprise both banking and telecommunications activities, differing perspectives exist on the appropriate regulatory framework as well as the appropriate regulator(s).
- “Is the stored value money?” or “Is the stored value (and associated payment capability) a service?” Is the stored value a deposit?
- “AML and CFT procedures for m-FS providers should be designed in proportion to assessed risks. It is the duty of policy makers and regulators to determine within the different m-FS providers the higher risk areas that should be subject to enhanced procedures. Conversely, this implies also in instances where risks are low, simplified or reduced controls may be applied. (Integrity in Mobile Phone Financial Services, No. 146, World Bank, 2007)
- Results in questions for stakeholders of each country and decisions, based on a balanced risk identification and assessment, how best to harmonize the legal and regulatory environments for mobile financial services



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Mobile Financial Services (MFS) and Development Opportunities

- Within a stable policy environment, there are potentially many development opportunities:
 - Less expensive
 - ✓ remittance flows
 - ✓ payment solutions for government and others with large, disperse payrolls (e.g. agricultural outgrowers)
 - ✓ operations structures for MFIs (mobile loan payment and disbursement--though harder for group loans)
 - ✓ operations for voucher schemes
 - Lower transaction costs for general economic activity, including domestic and international small scale trade
 - Greater ability to identify and develop countermeasures for illicit and rent-seeking financial activities and increased security from getting money “off of the battlefield.”



Risk-based Focus Underpinning USAID's MFS Involvement

USAID shares with other USG entities the responsibility to ensure both national and cross-border payments systems soundness alongside the expansive growth of the use of m-money →

- Unintended benefit of increasing public involvement in the formal financial system, including expansion of savings accounts in regulated financial institutions;
- Conversion of widely distributed consumer risk into a concentrated systemic risk where the value of the funds in transit and held in trustee accounts is no longer insignificant;
- Need to balance assurance of enabling environment conducive to innovation and economic growth alongside consumer protection;
- Lack of global standards → proliferation of inconsistent operating environments for account providers and, in some cases, limitations on range of services based on non risk-based factors.



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USAID Project: Mobile Financial Services Risk Analysis

As part of G-20 Financial Inclusion Experts Group objective, USAID/EG identifies and develops the opportunities that the innovation of mobile payments presents for emerging markets. Specifically, USAID assists Central Banks and other regulators interested in the mobile ecosystem by:



- Identifying and classifying the risks associated with mobile payments by stakeholder group
- Identifying policy options and implications by risk
- Identifying market examples as a resource for regulators to consider
- MD provided technical input to project and brought in FRB/Atlanta expertise to project
- EG's two-year program partnered with experts from Booz Allen-Hamilton, in consultation with Kenya School of Monetary Studies and the Central Bank of Kenya



Initial project scope and analysis was Africa – centric

- Ongoing discussion with stakeholders indicates broad ranging applicability of the Matrix
- In many other countries, regulators balance the assurance of an enabling environment conducive to innovation and economic development against consumer protection concerns
- :
- Given the lack of a common standard for the enabling environment, different regulators have responded in different ways
- Result is a proliferation of inconsistent operating environments for account providers and limitations on the range of services provided based on factors other than the underlying risks



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The Matrix Identifies Risk Categorized by Stakeholder Group

Mobile Financial Services
Capitalizing on the Opportunity by Ensuring Sustainability



Mobile Financial Services Policy Matrix: Consumers

#	Risk	Description	Objective(s)	Policy Options	Policy Implications	International	Systemic	Operational	Reputation	Legality	Legal	MNO Model	Bank Model	Hybrid Model
L	L.1	Potential customers cannot access mobile payment services due to inability to prove their identity.	When initially registering for mobile financial services (MFS), the inability of the service provider or its agents to adequately verify the identity and personal information of applicants may block approval or access to mobile payment services.	Know Your Customer (KYC)/Customer Due Diligence (CDD) guidelines to be set commensurate with the risk of the service. Subject to regulatory approval and verification of implementation.	<p>National ID system: Authorities issue universal IDs, which are used for access to financial services</p> <p>Financial ID system: In the absence of universal ID, financial service providers (as a consortia) offer a financial ID with similar characteristics as a universal ID, but only issued to customers after meeting standard sector KYC requirements (e.g. a customer's phone # and SIM could be used as basic form of identification) Could link in with an industry ID system established for ensuring certainty of identity in credit bureaus, or with a tax ID system.</p> <p>Regulated KYC Requirements which leave implementation to institutions</p>	<ul style="list-style-type: none"> Universal ID removes potential for exclusion of those desiring service. Burden on national authorities to institute universal ID program may be unaffordable or beyond the existing infrastructure's legal, technical or political capacity to enforce. With no universal national ID, the financial sector must rely on other forms of identity, which all customers may not have access to; however, they can set risk-based tiers to ensure access. Coordination of various private actors in the financial sector could work through the bankers association and/or MFI association, possibly with leadership from the central bank. Each institution can interpret the requirements, which may allow various combinations of identification. Banks can set risk-based tiers to ensure access. Each individual bank must establish a policy that meets regulatory requirement. Reliance on existing forms of identification keeps cost low, but difference in policies across institutions creates some risk. 		X	X		X	X	X	X

Mobile Policy Matrix v2.3

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Comments

- ▶ Our team of experts, working in concert with USAID and the Kenya School of Monetary Studies, developed a comprehensive stakeholder risk framework
- ▶ The framework examines various models, including both Mobile Network Operators (MNOs) and Bank led variants
- ▶ For each risk, our analysis recommends various policy options and associated implications to help guide policymakers
- ▶ An Appendix of detailed market examples inform policymakers



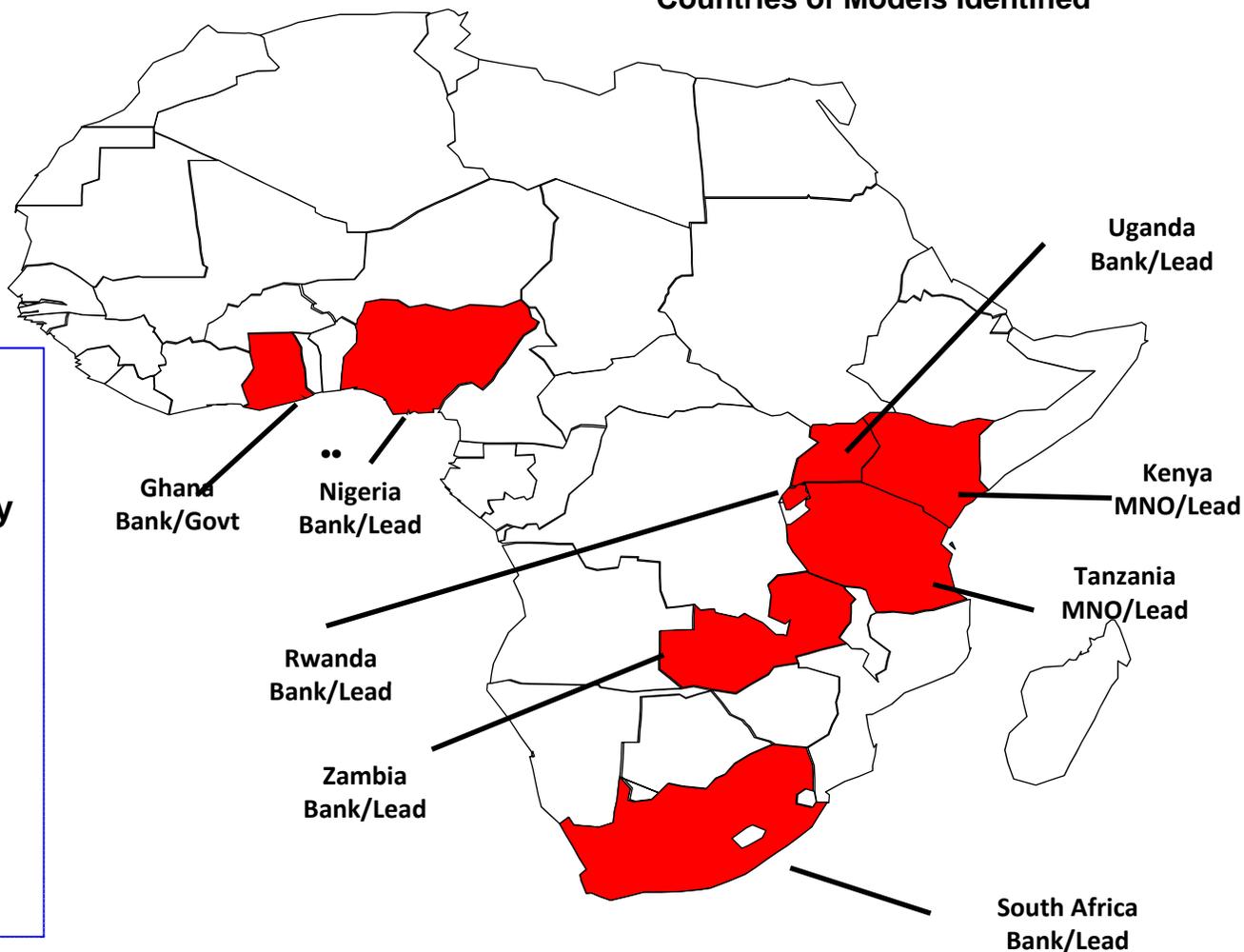
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Mobile Financial Services – Operating Models

Operating Model	Observations	Examples
Bank	Primarily an additive model linked to an existing transactional account (e.g., debit card)	
Mobile Network Operator (MNO)	A cell phone company (MNO) service extends the wireless network messaging functionality to provide payment services enabling customers to remit funds to each other that can be settled through the MNO's agent network.	
Hybrid Model	A combination of a bank, MNO or other third party that offers communications and financial transaction services that combine characteristics of both the pure bank and pure MNO models.	<p style="text-align: center;">M-KESHO</p> 

Model Identification

Countries of Models Identified



Research Observations

- Extension of credit to agents by non-bank actors to meet liquidity needs of the agents;
- Group ownership of individual accounts ;
- Issues of beneficial ownership and access to credit;
- Cross border value transfers



Mobile Financial Services – Risk Definitions

- **Systemic:** A risk that could cause collapse of, or significant damage to, the financial system or a risk which results in adverse public perception, possibly leading to lack of confidence and worse case scenario, a "run" on the system.
- **Operational:** A risk which damages the ability of one of the stakeholders to effectively operate their business or a risk which results in a direct or indirect loss from failed internal processes, people, systems or external events
- **Reputational:** A risk that damages the image of one of the stakeholders, the mobile system, the financial system, or of a specific product
- **Legal:** A risk which could result in unforeseeable lawsuits, judgment or contracts that could disrupt or affect mobile financial services (MFS) business practices
- **Liquidity:** A risk that lessens the ability of a bank or MFS provider/agent to meet cash obligations upon demand
- **International:** A systemic risk (as defined above) that could have cross-border contagion effect



Stakeholder: Risk(s)*

- Potential or existing customers cannot access mobile payment services due to inability to prove his/her identity
- Customer's identity is stolen and used to open a mobile payment account fraudulently
- Customer's account security credentials are improperly released (e.g., PIN number, biometrics, and stolen phone/SIM)
- Customer is unable to efficiently dispute a transaction or account charge
- Customer cannot access cash from mobile money account due to lack of agent availability
- Customer cannot access cash from mobile money account due to lack of system availability
- Customer loses balance due to bank/provider not maintaining a 1:1 coverage requirement in the payment account trust fund
- Beneficial owner(s) of stored value and transactional accounts (mobile money) cannot be determined by authorities in the event of illicit account activity when group accounts are used

Consumers

Merchants

Agents

Account Providers

Trust Acct Holders

Payment Systems

National Regulators

Int'l Regulatory Issues



Stakeholder: Risk(s)*

- **Merchants are unable to easily convert Mobile Money into cash, limiting their flexibility to run their business / store**
- **Merchant could be restricted by a contract with a payment provider from accepting payments for or from another account provider**

Consumers

Merchants

Agents

Account Providers

Trust Acct Holders

Payment Systems

National Regulators

Int'l Regulatory Issues



Stakeholder: Risk(s)*

- **Agent is unable to easily liquidate e-money inventory when the agency relationship is terminated**
- **Agent is robbed**
- **Agent receives cash from client but fails to provide/transfer e-money**
- **Agent experiencing customer protests due to inability to cash out for clients**
- **Agent takes in cash that proves to be counterfeit**
- **Agent pays out cash that proves to be counterfeit**

Consumers

Merchants

Agents

Account Providers

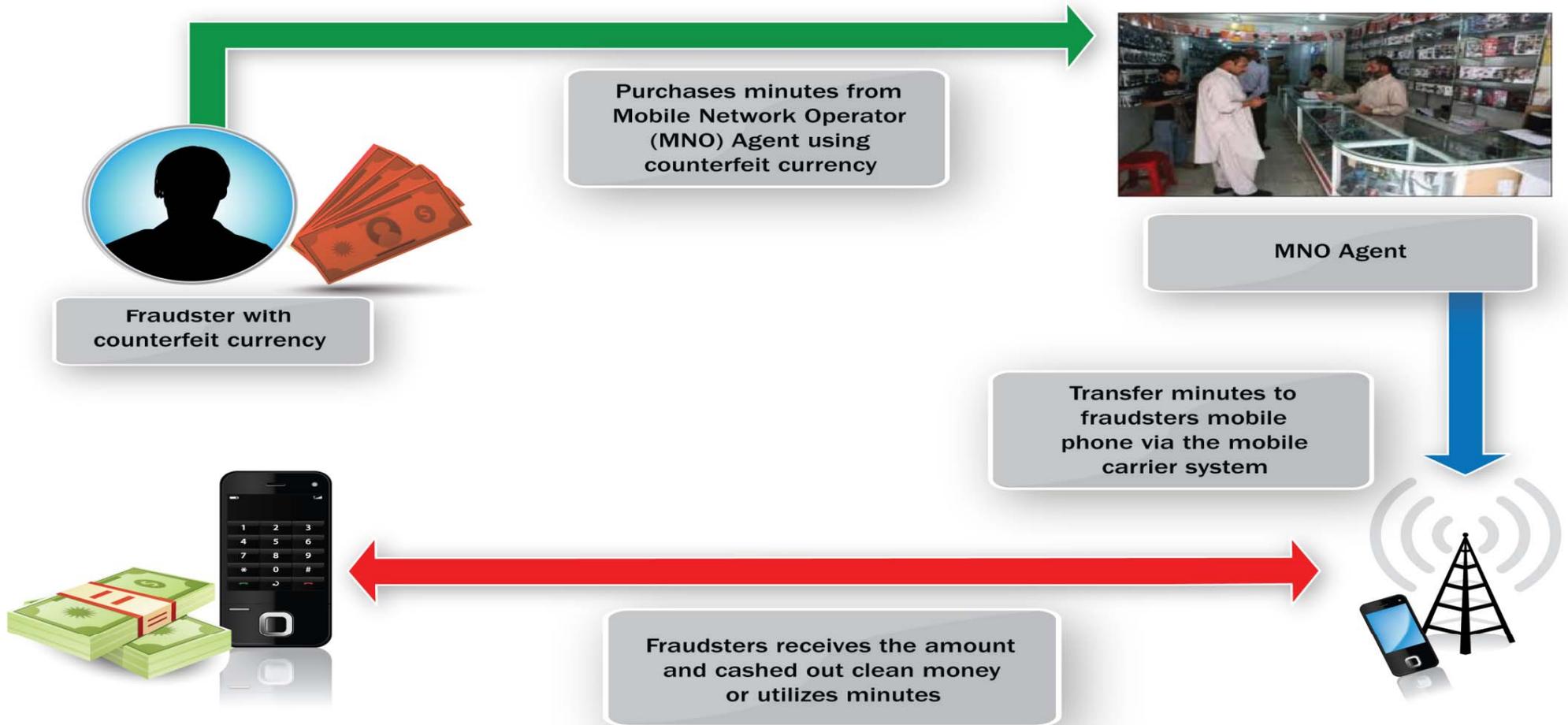
Trust Acct Holders

Payment Systems

National Regulators

Int'l Regulatory Issues

Example of laundering counterfeit currency via MFS



Stakeholder: Risk(s)*

- Provider employee manipulates agent credit allowances, agent e-money balances, or customer e-money balances for financial gain
- Provider fails to adequately select, train and supervise agents
- Provider does not meet required regulatory responsibilities in a regulated environment
- Trust fund is inadequately funded
- Agent fraud untraceable due to poor records
- System availability not be maintained by account provider
- Agents are consistently out of cash
- Agent contracted to multiple actors (i.e. cell phone provider and a bank) with different regulatory requirements (e.g. KYC) does not meet responsibilities for one or more

Consumers

Merchants

Agents

Account Providers

Trust Acct Holders

Payment Systems

National Regulators

Int'l Regulatory Issues

Stakeholder: Risk(s)*

- The reputation of the financial institution which holds the trust account for the mobile financial account provider is damaged due to their mismanagement of the trust account
- The reputation of the financial institution which holds the trust account for the mobile financial account provider is damaged due to its association with an account provider whose payment system is poorly run

Consumers

Merchants

Agents

Account Providers

Trust Acct Holders

National Regulators

Payment Systems

Int'l Considerations



Stakeholder: Risk(s)*

- Commerce across providers unavailable due to lack of a switch (clearing and settlement system)

Consumers

Merchants

Agents

Account Providers

Trust Acct Holders

Payment Systems

National Regulators

Int'l Regulatory Issues

Stakeholder: Risk(s)*

- Illicit financial activities enabled by weak KYC/CDD requirements/enforcement
- Identification of illicit financial activities hampered by insufficient reporting requirements
- Illicit financial activities facilitated by unlicensed/ unmonitored agent network.
- Inadequate transaction records impair investigation of fraud or criminal activity
- National regulators and/or law enforcement authorities unable to effectively investigate fraud or criminal activity due to lack of operational support systems and human capacity
- National regulators and/or law enforcement authorities unable to effectively investigate fraud or criminal activity due to lack of authority.
- Ability to track/investigate illicit transactions made difficult by the number of financial intermediaries (e.g. agents, super agents, acct providers, banks managing trust accts) and potential lack of transparency between these parties may exacerbate challenges for regulators
- Account provider suspends operations or collapses, disrupting service
- Financial terrorists' target payment network to destabilize financial system

Consumers

Merchants

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Payment Systems

National Regulators

Int'l Regulatory Issues



Stakeholder: Risk(s)*

- Heightened difficulty tracking and prosecuting illicit cross-border transactions given the new payment capability with a nascent regulatory framework and enforcement mechanisms
- Cross-border payments through a mobile financial service could be seen as bypassing a country's foreign exchange restrictions

Consumers

Merchants

Agents

Account Providers

Trust Acct Holder

Payment Systems

National Regulators

Int'l Regulatory Issues

Policy Options and Implications Categorized by Stakeholder

Mobile Financial Services Policy Matrix: Consumers

#	Risk	Description	Objective(s)	Policy Options	Policy Implications	Informational	Systemic	Operational	Reputation	Liquidity	Legal	FX/NO Model	Bank Model	Hybrid Model
L	L1	Potential customers cannot access mobile payment services due to inability to prove his/her identity.	When initially registering for mobile financial services (MFS), the inhibitor of the service provider or its agents to adequately verify the identity and personal information of applicants may block approval or access to mobile payment services.	Know Your Customer (KYC)/Customer Due Diligence (CDD) guidelines to be set commensurate with the risk of the service. Subject to regulatory approval and verification of implementation.	<ul style="list-style-type: none"> National ID system: Authorities issue universal IDs, which are used for access to financial services Financial ID system: In the absence of universal ID, financial service providers (as a consortium) offer a financial ID with similar characteristics as a universal ID, but only issued to customers after meeting standard sector KYC requirements (e.g. a customer's phone # and SIM could be used as basic form of identification) Could link in with an industry ID system established for ensuring certainty of identity in credit bureau, or with a tax ID system. Relaxed KYC Requirements which leave implementation to institutions 	<ul style="list-style-type: none"> Universal ID removes potential for exclusion of those desiring service. Burden on national authorities to institute universal ID program may be unaffordable or beyond the existing infrastructure's legal, technical or political capacity to enforce. With no universal national ID, the financial sector must rely on other forms of identity, which all customers may not have access to; however, they can set risk-based tiers to ensure access. Coordination of various private actors in the financial sector could work through the bankers association and/or MFI association, possibly with leadership from the central bank. Each institution can interpret the requirements, which may allow various combinations of identification. Banks can set risk-based tiers to ensure access. Each individual bank must establish a policy that meets regulatory requirement. Reliance on existing forms of identification leaves cost low, but difference in policies across institutions creates some risk. 		X	X		X	X	X	X

Mobile Policy Matrix v2.2

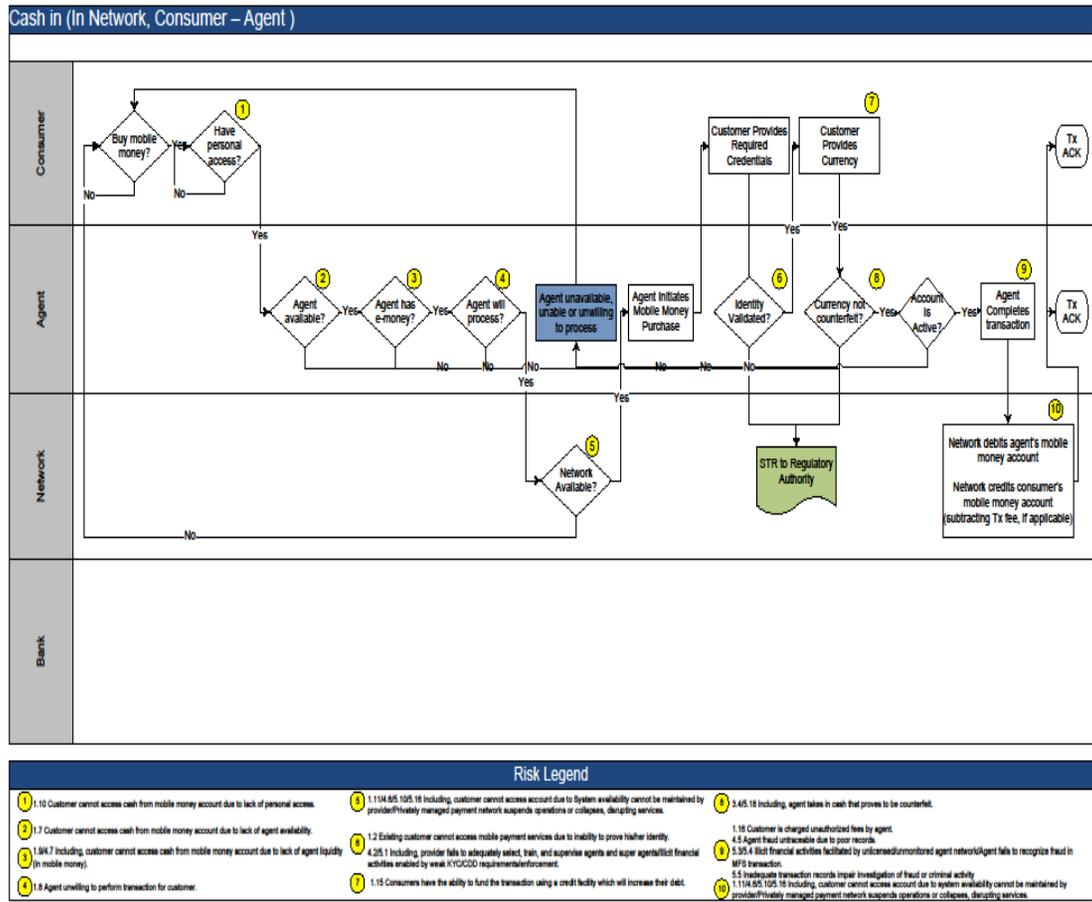
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Comments

- ▶ For each risk, our analysis recommends various policy options and associated implications to help guide policymakers
- ▶ Policy Options typically range from oversight or intervention at the National Regulator level – to graded action by the mid-tier of the mobile financial services ecosystem, usually the account provider- to no action or allowing a laissez faire mobile financial services environment



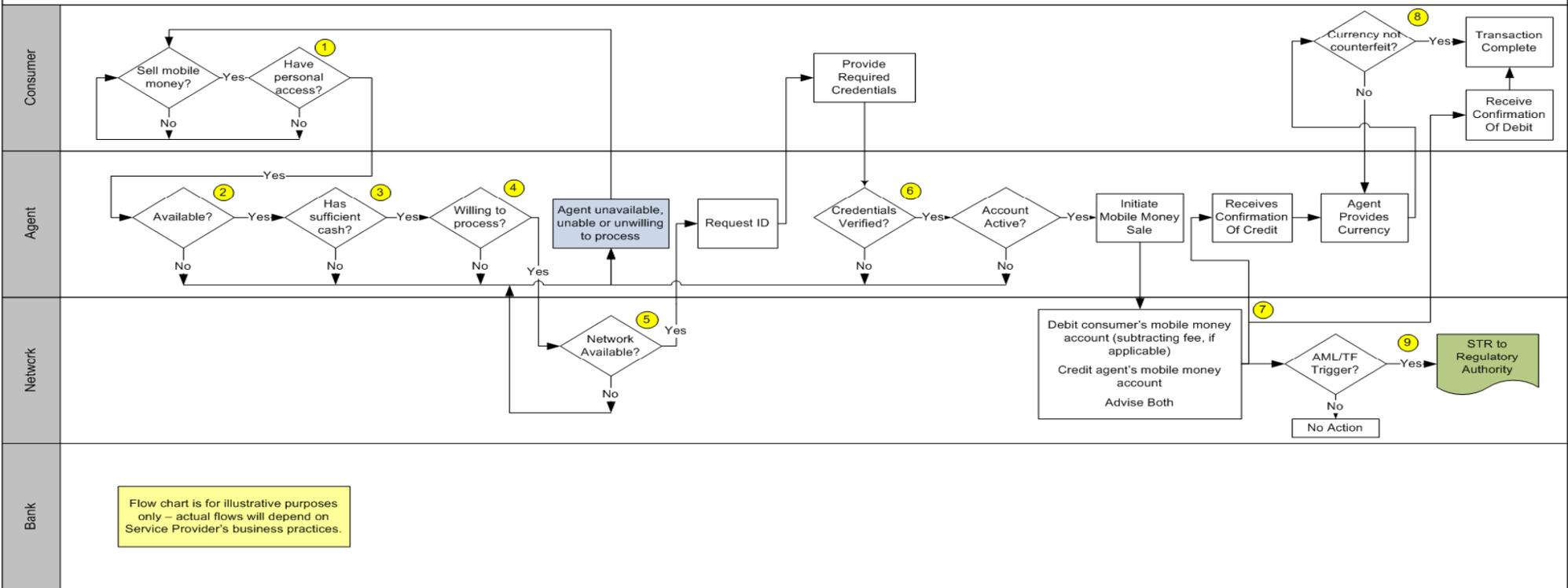
Representative Payment Transaction Flows Integrate Risk Analysis



- Comments**
- ▶ We conducted transaction flow mapping, highlighting where risks occur and how these differ depending on the service model
 - ▶ Flow charts are representative, since each account provider will have its own business model
 - ▶ Options found for each risk are not necessarily mutually exclusive, since more than one policy option may be appropriate

Cash Out – In Network, Consumer – MNO Agent

Cash Out (In Network, Consumer – Agent)

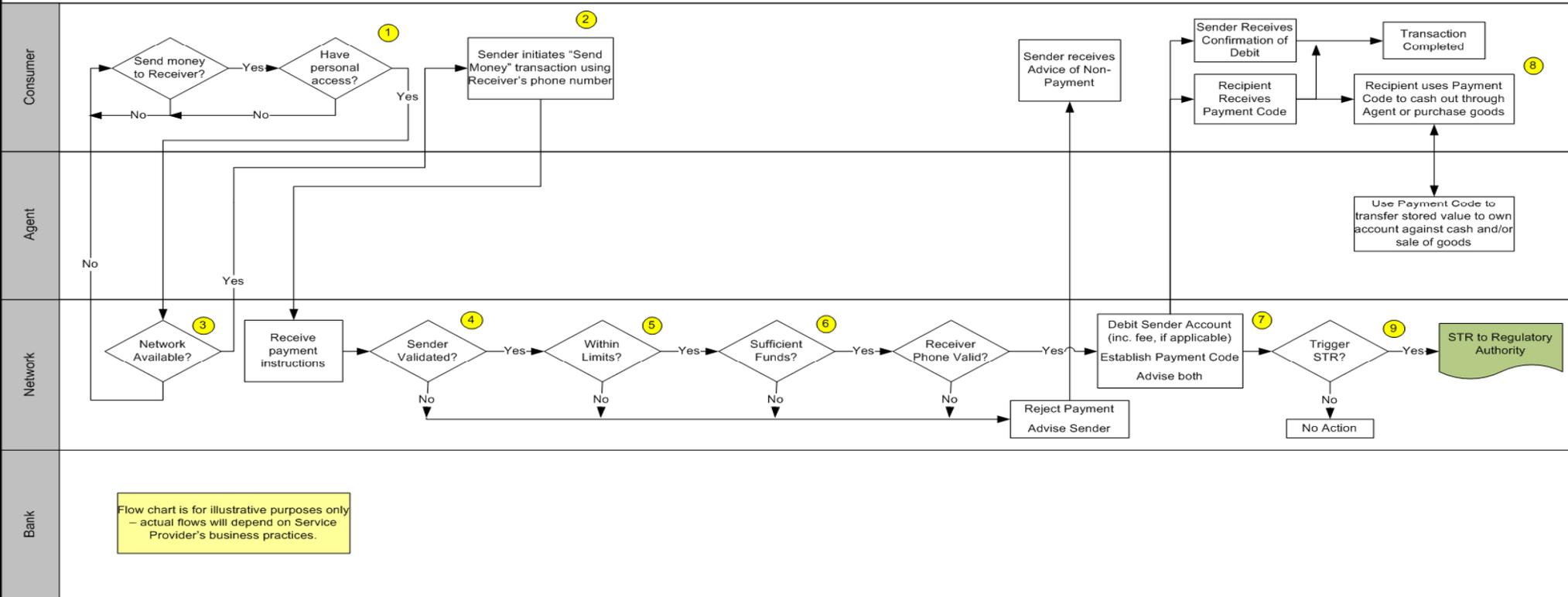


Risk Legend

- | | | |
|--|---|--|
| <p>1 1.10 Customer cannot access cash from mobile money account due to lack of personal access.</p> <p>2 1.7 Customer cannot access cash from mobile money account due to lack of agent availability.</p> <p>3 1.9/4.4/4.7/5.2/5.3 Including, customer cannot access cash from mobile money account due to lack of agent liquidity (in mobile money).
3.3/3.4 Including, agent is robbed.
3.7 Provision of credit to agents by non-bank actors.</p> | <p>4 1.8 Agent unwilling to perform transaction for customer.
2.1 Merchants unable to easily convert mobile money into cash, limiting their flexibility to run their bus.
4.2 Provider fails to adequately train and supervise agents and super agents.</p> <p>5 1.11/4.6/7.9/7.15/7.16 Including, customer cannot access account due to System availability cannot be maintained by provider/Private managed payment network suspends operations or collapses, disrupting services.</p> <p>6 1.2 Existing customer cannot access mobile payment services due to inability to prove his/her identity.
1.3 Customer's identity is stolen and used to conduct fraudulent transactions
4.2/4.3/7.1/7.3 Including, provider fails to adequately select, train, and supervise agents and super agents/Illicit financial activities enabled by weak KYC/CDD requirements/enforcement</p> | <p>7 1.4 Customer's account credentials are improperly released.
1.13/1.14/1.15/1.16 Including, customer loses balance due to failure of a bank holding trust fund, or a similar situation where trust fund is compromised.
1.6/1.19 Including, customer is charged unauthorized fee by agent
4.5/7.2/7.4/7.5/7.6/7.8/8.1 Including, inadequate transaction records impair investigation of fraud or criminal activity.</p> <p>8 3.6/7.18 Agent pays out cash that proves to be counterfeit.</p> <p>9 7.2/7.4/7.5/7.6/7.8/8.1 Including, inadequate transaction records impair investigation of fraud or criminal activity.</p> |
|--|---|--|

P2P In Network to Out-of-Network Consumer - No Acct

P2P (In Network Consumer to Out-of-Network Consumer – No Account)



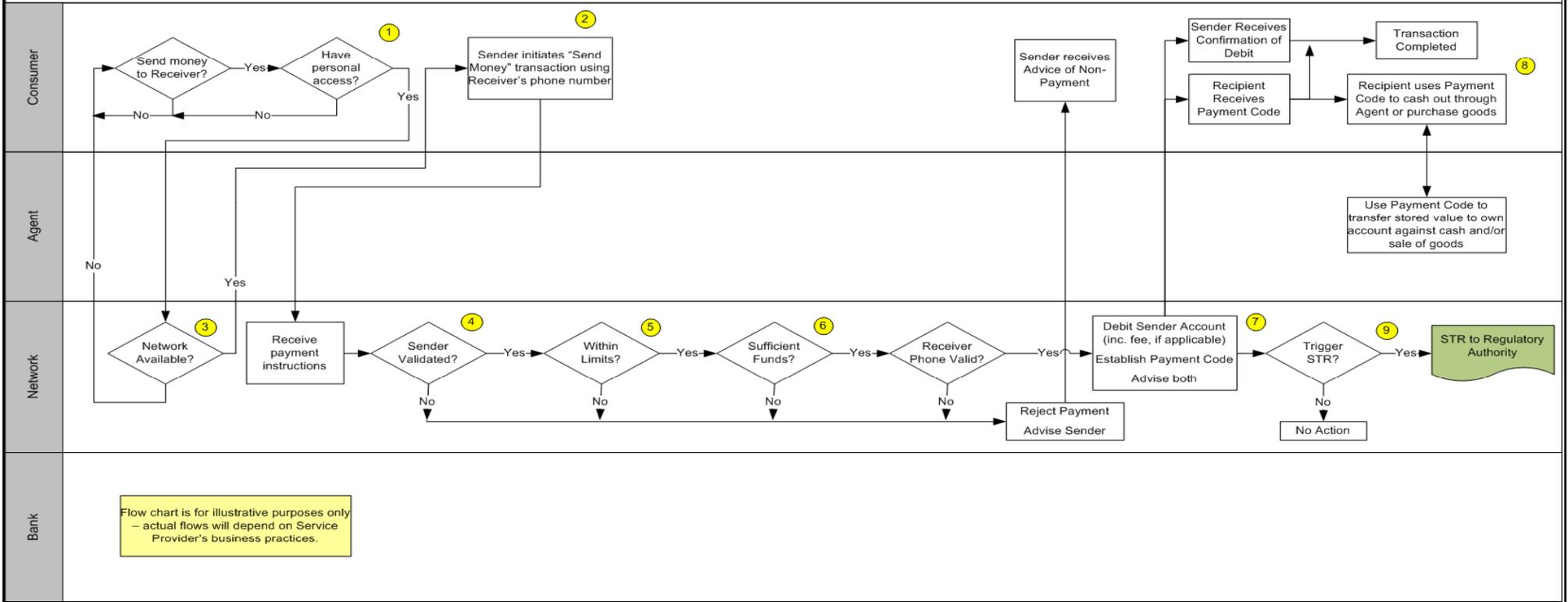
Risk Legend

- 1. 1.10 Customer cannot access cash from mobile money due to lack of personal access.
- 2. 8.2 Small-scale traders face a theft risk due to their 'cash & carry' business.
- 3. 1.11/4.8/7.9/7.15/7.16 Including, customer cannot access account due to personal access issues/ System availability cannot be maintained by provider/Private managed payment network suspends operations or collapses, disrupting services.
- 4. 1.4 Customer's account credentials are released improperly
- 5. 7.14 Illicit actors conduct high volume transactions using multiple accounts, bypassing monitoring systems before regulators can step in.
- 6. 1.13/ 1.14/1.15/1.16 Including, customer loses balance due to failure of a bank holding trust fund, or a similar situation where trust fund is compromised.
- 7. 7.2/7.4/7.5/7.6/7.8/8.1 Including, inadequate transaction records impair investigation of fraud or criminal activity. 5.19 Including, currency redenominated while in transit. 1.8/1.19 Government decides to tax transactions to raise funds increasing the marginal cost. 7.2/7.4/7.5/7.6/7.8/8.1 Including, inadequate transaction records impair investigation of fraud or criminal activity. 7.19 Currency redenominated while in transit.
- 8. 1.7 Customer cannot access mobile money account due to lack of agent availability 1.9/4.4/4.7/5.2/5.3 Customer cannot access cash from mobile money account due to lack of agent liquidity. 3.7 Provision of credit to agents by non-bank actors 3.3/3.4 Including, agent is robbed. 1.8/4.2 Including, agent unwilling to perform transaction for customer. 4.2/4.3/7.1/7.3 Including, provider fails to adequately select, train, and supervise agents and super agents/Illicit financial activities enabled by weak KYC/CDD requirements/enforcement. 3.6/7.18 Agent pays out cash that proves to be counterfeit.
- 9. 7.2/7.4/7.5/7.6/7.8/8.1 Including, inadequate transaction records impair investigation of fraud or criminal activity.



P2P (In Network Consumer to Out-of-Network Consumer–No Acct)

P2P (In Network Consumer to Out-of-Network Consumer – No Account)



Risk Legend

- 1. 1.10 Customer cannot access cash from mobile money due to lack of personal access.
- 2. 8.2 Small-scale traders face a theft risk due to their 'cash & carry' business.
- 3. 1.11/4.6/7.9/7.15/7.16 Including, customer cannot access account due to personal access issues/ System availability cannot be maintained by provider/Private managed payment network suspends operations or collapses, disrupting services.
- 4. 1.4 Customer's account credentials are released improperly
- 5. 7.14 Illicit actors conduct high volume transactions using multiple accounts, bypassing monitoring systems before regulators can step in.
- 6. 1.13/ 1.14/1.15/1.16 Including, customer loses balance due to failure of a bank holding trust fund, or a similar situation where trust fund is compromised.
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- 8. 1.7 Customer cannot access mobile money account due to lack of agent availability 1.9/4.4/4.7/5.2/5.3 Customer cannot access cash from mobile money account due to lack of agent liquidity. 3.7 Provision of credit to agents by non-bank actors 3.3/3.4 Including, agent is robbed. 1.8/4.2 Including, agent unwilling to perform transaction for customer. 4.2/4.3/7.1/7.3 Including, provider fails to adequately select, train, and supervise agents and super agents/illicit financial activities enabled by weak KYC/CDD requirements/enforcement. 3.6/7.18 Agent pays out cash that proves to be counterfeit.
- 9. 7.2/7.4/7.5/7.6/7.8/8.1 Including, inadequate transaction records impair investigation of fraud or criminal activity.

Appendix – Policy Table Expands Matrix Implications

7.6. Risk (National Regulators):

“National regulators and/or law enforcement authorities unable to effectively investigate fraud or criminal activity due to lack of authority.”

Description:

In many country contexts, the regulatory framework for mobile payment service provision has not been established. Thus, it is unclear whether the financial regulators have the authority to oversee the payment network, or if it is the responsibility of the telecommunications regulators, or if anyone has the requisite authority.

Policy Table:

Options	Implications
1. Empower through law/regulation either the financial regulator or telecommunications regulator as the sole regulatory authority over mobile payment system.	<ul style="list-style-type: none"> • Sole authority limits confusion regarding investigative authority. • However, different issues may require different subject matter expertise which may not be resident in the sole regulator. • Capacity/Budget of sole regulator may need to be adjusted to accommodate increased responsibility.
2. Harmonize enforcement and penalty authority framework across Communications and Financial Services regulatory authorities.	<ul style="list-style-type: none"> • Harmonization process defines which regulator is responsible for which tasks, mitigating risks of issues “falling between the cracks” or of overlapping or contradictory activities. • However, emerging risks may create confusion regarding responsibility. • Authorities may lack capacity to implement across institutional silos.
3. No Formal System (Ad hoc – on a case-by-case basis as determined).	<ul style="list-style-type: none"> • Lack of defined responsibility regarding specific risks will create confusion and uncovered areas, creating risk for the financial sector.



Appendix – Policy Narratives Expand Matrix Options

Policy Narrative: *FATF Recommendations 29-31* address adequate powers, adequate resources and effective mechanisms regarding human capacity of both appropriate authorities to monitor and mitigate illicit financial activity:

- **Recommendation 29:** Compliance by financial institutions - Supervisors should be “authorised to compel production of any information from financial institutions that is relevant to monitoring such compliance, and to impose adequate administrative sanctions for failure to comply with such requirements.”
- **Recommendation 30:** Countries, as well, should both provide their competent authorities involved in Anti Money Laundering (AML) and Combating the Financing of Terrorism (CFT) with sufficient “financial, human, and technical resources”
- **Recommendation 31:** Countries should ensure that “policy makers, the FIU, law enforcement and supervisors” can effectively and efficiently develop and implement AML and CFT policies



Appendix – Market Examples of MFS Implementation

Market Examples

- **Malawi:** The Malawi FIU was established under the Money Laundering, Proceeds of Serious Crime and Terrorist Financing Act, Number 11 of 2006 and became operational in July 2007. The FIU is an autonomous national body which reports directly to the Malawi Minister of Finance. Under the auspices of the Act, the FIU is responsible for identifying the proceeds of serious crime and combating money laundering and terrorist financing activities...
- **India:** The law governing AML/CFT issues was promulgated in 2002 under the Prevention of Money Launder Act and applies to banks and financial institutions. ...The Financial Intelligence Unit of India (FIU-IND) was established by the government in 2004 as the central agency responsible for receiving, processing, analyzing, and disseminating information relating to suspicious financial transactions.
- **Pakistan:** The Pakistan Telecommunications Authority (PTA), as the telecommunications regulator, requires notification prior to the introduction of m-banking services as with any value-added service launch. ...In November 2009, the “Ordinance to Provide for the Prevention of Money Laundering (AML Ordinance) established a Financial Monitoring Unit (FMU) to receive and analyze reports of suspicious transactions, assist in investigations, and exercise general AML responsibility. Strategic oversight and administration of the FMU was established by the AML Ordinance with creation of the National Executive Committee, which publishes an annual AML strategy.



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Current Research & Relevance to USAID Programming

- “Creating A Living Document” out of the risk matrix
- Cloud computing risk research: Service Level Agreements
- Developing industry MFS norms, standards, guidelines
- Internal controls & risk mitigation: Cloud computing, stress tests
- Consumer Financial Protection initiatives
- Policy papers, collaboration and subject matter expertise



Current Research & Relevance to USAID Programming

How will USAID partner effectively with State (Citibank, Cisco), partner country regulators (Haiti, DRC), and US regulatory authorities (FRB, FDIC, Treasury, OCC, CFPB) to take advantage of these opportunities together?





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Thank You

MATRIX:

<http://bizclir.com/galleries/publications/Mobile%20Financial%20Services%20Risk%20Matrix%20July%202010.pdf>

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