

MasterCard Perspectives on the Enabling Policy Environment for Retail Payment Systems

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1. Overview

- 1.1 The World Bank's Framework for Action to reach universal financial access by the year 2020 envisions that all adults globally have access to a transaction account or electronic instrument to store money and send and receive payments as the basic building block to manage their financial lives. The Framework relies on three key building blocks for achieving this goal: (i) an enabling policy environment; (ii) investments to ramp up payments and ICT infrastructure; and (iii) public and private sector commitments; all of which require an active collaboration across public-private sector boundaries.
- 1.2 We at MasterCard believe that the goal of Universal Financial Access by year 2020 is achievable through increased government cooperation, a focus on public-private partnerships and the continued advancement and distribution of technological solutions. As part of these efforts, we have been engaged in a constructive dialogue with various stakeholders to highlight areas of opportunities and constraints that restrict private sector's ability to drive the development and adoption of technologies and cashless innovations that foster economic empowerment, reduce poverty, and improve the quality of life for all.
- 1.3 Through this document, MasterCard is providing the PAFI Task Force with the following: (i) observations on the role of retail payment networks in meeting financial inclusion goals; (ii) challenges faced by the private sector in meeting these goals highlighted by some specific country examples; and (iii) opportunities to jointly address the impediments and realize the universal access goal.

2. Role of retail payment networks in achieving financial inclusion goals

- 2.1 The safe and efficient functioning of retail payment networks is a concern of governments, reflecting the important role such networks play in the financial system and the real economy and in driving financial inclusion. Retail payment networks generally function through the efforts of private entities that come together to collectively address recognized payment needs in a market (network operators, financial institutions, etc.). The market need for retail payment networks varies from one environment to another; however, markets in which electronic payments can flourish all share some general characteristics. Based on our experience as a global payment network, we provide some of the most important considerations for fostering an environment that is favorable for growth of retail payment networks because we believe that retail payment networks are a vital tool in the movement toward financial inclusion.
- 2.1.1 Stable and Predictable Laws and Regulations. In developing new policy in the area of electronic payments, lawmakers and regulators should carefully evaluate the full costs and benefits of proposed laws or regulations. Once a course has been chosen, the laws or regulations must be carefully drafted to be as narrow in scope as possible to minimize the risk of unintended consequences and should focus on clear, articulated goals or purposes. Authorities should also acknowledge and actively seek to address potential conflicts that may arise between their own laws and regulations and those of other jurisdictions.

Furthermore, once laws and regulations are in place, they should not be subject to frequent changes, which have the effect of adding cost to the market by requiring repeated changes to technologies, business practices, compliance policies and procedures, etc.

- 2.1.2 Transparency. Transparency regarding the policy goals for promoting competition clarifies the roles of different participants and avoids mistrust in the development and operation of the retail payments infrastructure. This is especially important if the government is also one of the payment infrastructure providers. Furthermore, because governments should evaluate costs and benefits of any new policy prior to drafting laws or regulations, they are encouraged to consult the private sector for input in advance of any new or amended laws or regulations.
- 2.1.3 Market Access, Interoperability and Level Playing Field. Policymakers should make efforts to adopt policies that promote a level playing for participants in the payments system. This issue becomes particularly relevant in instances in which a private company must compete with a payment services provider backed by a government entity. Governments should not deter private sector entrants by making it more difficult for them to justify significant investment in a financial ecosystem because they are at a disadvantage to the government backed service provider. Oftentimes, this strategy eventually turns out to be more expensive because entire payments ecosystem must be built and financed on their own, and they lose out on the opportunities to tap into the efficiencies, expertise and state-of-the-art innovations developed by the private sector. Another key aspect of market access is the need for interoperability. Policymakers need to encourage the linking of various payments networks domestically and to global infrastructure.
- 2.1.4 Competitive Environment. In fostering market access for the private sector, policymakers should encourage private sector investment, which will inevitably lead to competition and innovations. In doing so, policymakers should avoid imposing revenue or fee caps. Policymakers may have good intentions of keeping access to services or products affordable for the underserved, but imposing caps can have the effect of largely preventing services from being provided at all. It is important to recognize that the sophisticated companies seeking to serve in underserved markets understand that the market economics are quite different than when serving the more affluent, fully developed markets.
- 2.1.5 Free Flow of Data. Cross-border data flows are essential to cost-efficient retail payment networks because they facilitate essential economies of scale, promote digital collaboration to share knowledge, content and work in progress with far-flung user communities, and enable the accessing of on-demand shared networks, servers, storage, or application through clouds. All of this enhances product and service delivery through information technology. Free flows of data across borders are necessary to prevent isolating businesses and consumers, sapping productivity, reversing data-driven advances, eliminating promising new opportunities and discouraging expansions and, in effect, creating trade barriers.

3. Impediments to Financial Inclusion

3.1 There are numerous challenges to advancing financial inclusion, ranging from overcoming basic economic hurdles to changing long-rooted cultural and behavioral attitudes and approaches to financial services. Additionally, businesses that could be in a position to promote financial inclusion are experiencing negative public policy trends. A growing number of governments are creating barriers to modern business practices by drafting new laws and regulations that limit the ability for private sector entities to enter or compete effectively in markets—especially in emerging markets. We discuss some of the most concerning issues.

3.1.1 Localization Requirements and National Monopolies. Some countries impose restrictions that require local processing of all electronic payment transactions. Localization restrictions can force the building or replication of costly infrastructure domestically as a means of maintaining operational control and data within a country. Others force the use of a local provider. Some of these countries require a global payment network, such as MasterCard, to contract with a local, government-owned entity to process all of its domestic payment card transactions. Even worse, some countries have created, or are in the process of creating, monopolistic national suppliers for the processing of domestic transactions, which has the effect of precluding the supply of services by global networks. In our experience, domestic infrastructures often insufficiently address the demands of today's electronic payments ecosystem. Localization restrictions may therefore prevent global payments networks like MasterCard from offering value-added services, which can force local merchants and consumers to use riskier, less efficient and less convenient forms of payment, such as cash. Also, by forcing electronic payments networks to replicate infrastructure in-country, countries drive up merchant costs and product prices. In the process the desired purpose of the restrictions—data security—could be undercut, as the valuable security expertise and insights used to spot fraudulent activity and safeguard transactions processed at global and regional operations centers could be difficult to reproduce as effectively in many smaller, isolated locations. Forced localization could also prevent interoperability among networks of many nations and cause further fragmentation throughout the global payments system.

3.1.2 Pricing Restrictions and Acceptance Economics. Some countries have introduced restrictions on pricing or other economic terms in an effort to keep financial products and services affordable. Policymakers' intentions may be admirable, but these policies deter private sector entities from establishing themselves within the respective countries because they know that they may not receive adequate returns on their investments. India, for example, instituted a forced reduction of the merchant discount rate in an effort to promote acceptance among merchants. However, there has been no evidence to indicate that this has been the case and, to the contrary, there are strong indicators to support the argument that the reduction has worked against its intended goal by damaging the delicate economic balance of costs and values received.

3.1.3 Know-Your-Customer Regulations. Standard setting bodies have generally recommended that governments employ the principle of proportionality in devising know-your-customer regulations to combat money laundering and terrorist financing.

This so-called “risk-based approach” states that where there are higher risks, countries should require financial institutions to take enhanced measures to manage and mitigate risks. Correspondingly, where the risks are lower, countries can move away from a “one size fits all” solution and tailor their regulations to specific risks. For example, financial institutions would be permitted to apply simplified know-your-customer standards to underserved individuals who may have access to small amounts of funds and thus pose lower overall risks. The failure to implement a risk-based approach may create disproportionate and unnecessary requirements that may hinder access to appropriate services for underserved groups. In the same light, governments should also consider allowing financial institutions to rely on alternate means to obtain identification from certain individuals. Given recent technological advancements, new forms of identification, such as biometric techniques, may be more widely available and easily accessible to the underserved population. Given the length of time it takes to implement globally accepted KYC standards, it may be suggested that countries adopt an incremental approach where the focus is on promoting electronic payments (over cash) as electronic payment transactions are traceable and verifiable. This will help expand access and mitigate risks before KYC protocols are perfected.

- 3.1.4 Agent Banking. A significant challenge for many countries is geography. Individuals may be excluded from the payments system and may have a lack of knowledge about payment options because they are forced to use cash as a result of an inability to access ATMs, merchants, or bank branches. Reaching these individuals through traditional means may be expensive and impractical. One way for these countries to overcome this challenge is to rely on new innovations that let non-banks reach out to new segments of the retail payment market or meet a new need in an established market. The industry has seen the tremendous proliferation of prepaid products in recent years as well as growth in mobile technology that have both provided an entry into the financial system for those who previously had no access to traditional banking services. These technologies rely on third parties, however, in many aspects of their offerings, whether it be retailers that sell, or permit the reloading of, prepaid cards or a non-bank payment service that accepts funds into an account on behalf of an individual who can make payments from that account. Many countries, however, have bank licensing and regulatory regimes in place that are based on the traditional, yet somewhat antiquated, principle that banks provide all financial services. Without modifying the existing framework, third-party agents will be prohibited from providing these necessary services and products.

4. Where We Should Be Heading

- 4.1 Over two billion people lack access to savings accounts, credit, insurance and other formal financial services. They do not have secure places to save money, reliable ways to transfer it, or safe ways to transport it. Further, eighty-five percent of the world’s retail transactions are still conducted in cash and check, increasing both costs and risk to an economy and its participants.
- 4.2 MasterCard believes that growing the use of electronic payments will ultimately have a significant positive effect on local economies, because a strong payment system enables both economic advancement and financial inclusion. We encourage a cooperative and

constructive dialogue with governments to explain how we can help them to achieve their socioeconomic objectives. We share several underlying goals with governments in the provision of electronic payments and promotion of financial inclusion:

- 4.2.1 Decreasing reliance on cash transactions, and avoiding the attendant high handling and management costs, as well as non-traceability of cash transactions;
 - 4.2.2 Enabling payment system interoperability;
 - 4.2.3 Developing innovations that meet evolving consumer needs while improving efficiency, security and reliability;
 - 4.2.4 Fostering consumer confidence in payment systems;
 - 4.2.5 Strengthening system stability and integrity;
 - 4.2.6 Ensuring network reliability and security;
 - 4.2.7 Maintaining costs at a level that permits access by underserved individuals; and
 - 4.2.8 Ensuring data privacy.
- 4.3 The model employed by the global payment networks – which makes use of economies of scale and cross-border information flows – provides the best method for us to help achieve these aims. We reiterate our position that growth can occur most effectively and efficiently in countries that have stable laws and transparent legislative and rulemaking processes, that promote a level playing field and a competitive environment for private industry, and that permit the free flow of data to further innovations and allow businesses to take advantage of economies of scale. It is also essential for governments to move away from the many impediments that can stunt the growth of payment systems.
- 4.4 Beyond expanding our network for individuals to access financial services, MasterCard as an organization is committed to financial inclusion in other ways. In those jurisdictions in which we have been able to grow, we have a record of successful cooperation with local authorities. Our strategy for financial inclusion includes financial education, philanthropy, and academic research.
- 4.4.1 Financial Education. We believe it is necessary to complement the traditional approach of educating consumers on budgeting and savings with education to help people understand how they can empower and enable their lives by entering the financial mainstream and using electronic payments to their advantage. *Master Your Card* and *Master Your Card Oportunidad* are two such programs that are active across North America, Latin America, and Europe. From assisting consumer and social advocacy groups to increase financial literacy, to helping small business associations teach members how to negotiate the best terms for processing electronic payments, to providing assistance to governments transitioning to electronic payments and disbursements, MasterCard's commitment to financial education is critical to advancing financial inclusion.

- 4.4.2 Philanthropy. We invest in programs and initiatives that provide entrepreneurship, education, and economic empowerment as on-ramps to financial inclusion and economic development. We focus on programs that assist women and youth, two groups that comprise a disproportionate share of the world's poor and financially excluded. For example, we have partnered with Child & Youth Finance International to promote the economic and social livelihood of children and youth around the world by enabling financial inclusion and education programs. Together, we have joined forces to develop guidelines for responsible financial products for children and youth that build on the Children's Rights and Business Principles adopted by UNICEF. Among our other numerous joint efforts around the globe, we have provided e-voucher programs in Lebanon to deliver food assistance to Syrian refugees and to provide rural farmers in remote parts of Colombia with vital information regarding agriculture, weather, and pricing via mobile phones.
- 4.4.3 Academic Research. MasterCard engages academic thought leaders and institutions from around the world and publishes the findings in an open-source environment as catalysts for change. Our efforts target the advancement of research and inquiry into sustainable and equitable economic growth and financial inclusion. Recent publications of ours have focused on these and related topics.
- 4.5 MasterCard believes that broad based financial inclusion is achievable through increased government cooperation, a focus on public-private partnerships and the continued advancement and distribution of technological solutions. Where given the opportunity, we will work together with policymakers, corporations, governments, non-governmental organizations, and academics to drive the development and adoption of technologies and cashless innovations that foster economic empowerment, reduce poverty, and improve the quality of life for all.