TECHNICAL NOTE

CGAP

REGULATORY APPROACHES TO THE INTEREST EARNED ON E-MONEY FLOAT ACCOUNTS

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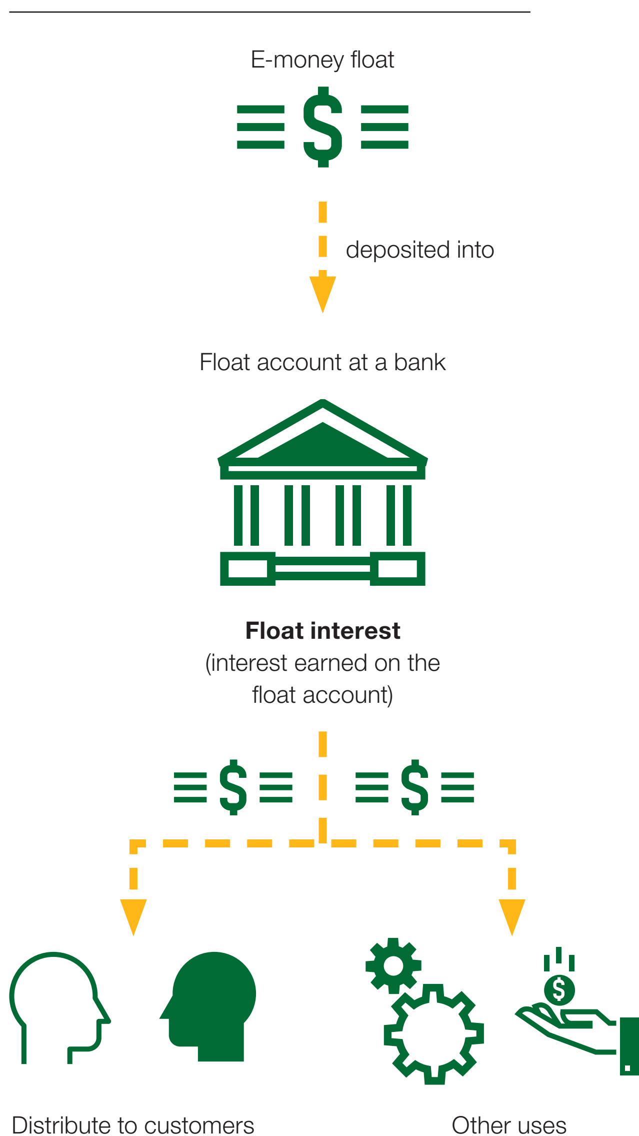
Introduction

Electronic money issuers (EMIs) are usually required by regulation to set aside an amount equivalent to the total electronic money (e-money) issued, in one or more separate accounts in banks ("float accounts").[1] Most often, float accounts earn interest ("float interest"). What happens to it? We believe that EMIs should be allowed – but not required – to distribute some or all of the float interest to their e-money customers.

Most e-money regulations prohibit EMIs from paying interest on e-money accounts in the way that bank savings accounts are remunerated.[2] The main reason is that many regulators consider "paying interest" an activity that requires a banking license. Some regulators also have concerns that paying interest on e-money accounts may lead customers to think that e-money is like a savings account.[3] As a result, many e-money regulations allow nonbanks to offer basic value storage functions linked to payments services, but include a ban on interest payments to their customers.

Yet allowing EMIs to distribute the float interest to customers is technically and legally different from paying interest on individual e-money balances.[4] *Technically,* because it does not require EMIs to guarantee a minimum rate of return on e-money accounts. The EMI simply distributes part or all of what the bank pays into the float account(s). *Legally,* because it avoids e-money accounts being characterized as savings accounts, which are not only reserved to licensed banks (and similar institutions) but could also be subject to additional legal provisions, such as indexation (typical of inflationary economies), reserve requirements, fee limitations, and rules set by deposit insurance schemes. Not all regulators agree with these arguments and quite a number continue to prohibit any type of reward on e-money accounts.

FIGURE 1. **The accrual and use of float interest**



There are several arguments in favor of distributing the float interest to customers: depending on the regulation, balances on the float account may legally belong to customers rather than the EMI, so some could argue that customers actually own the float interest; distributing the float interest may lead to higher rates of adoption

1 There are jurisdictions that permit or require part or all of the float to be invested in other low-risk assets (e.g., government securities), which can earn interest. However, the most common practice is to keep the float in bank accounts.

2 According to the 2017 Global Financial Inclusion and Consumer Protection Survey, 13% of respondents allow EMIs to pay interest on e-money accounts (33% of low-income countries, 25% of Sub-Saharan Africa respondents); and 8% allow them to distribute the float interest to customers (all of them in Sub-Saharan Africa). It showed that 85% prohibit both.

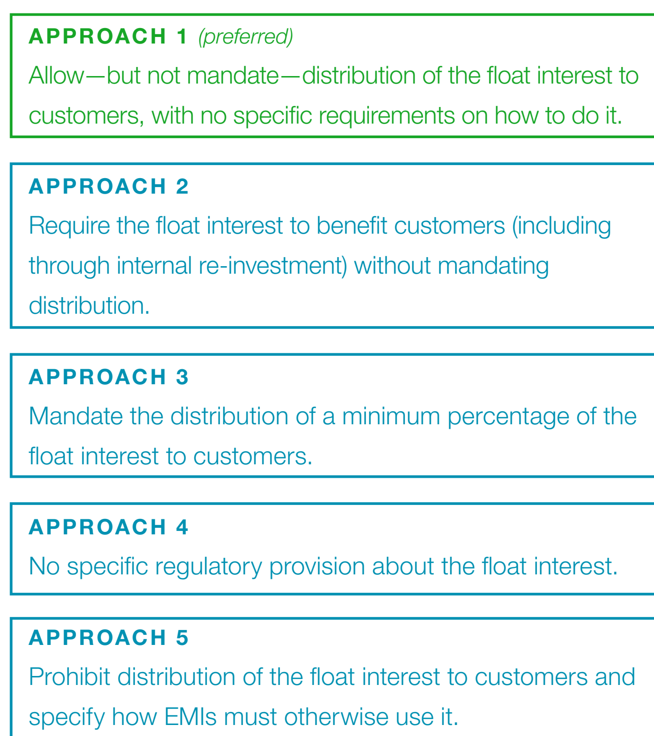
3 Tsang, Malady and Buckley (2017) presents counter arguments to these regulatory concerns.

4 Tsang, Malady and Buckley (2017) also discuss regulatory approaches to allow EMIs to actually pay interest on e-money balances (an approach adopted in Colombia), but this alternative is not addressed in this paper.

and usage; the float interest may help customers defray transaction costs[5]; and low-income customers in developing countries often have no access to interest-bearing savings accounts. Aside from the fact that not all e-money customers in developing countries are low-income, there is still – maybe surprisingly – little evidence of the impact of float interest distribution on adoption and usage patterns.[6]

This Note identifies five different approaches to the regulatory treatment of distributing float interest to e-money customers. In our preferred **Approach 1**, EMIs are allowed to distribute the float interest, but not required to do so. Given this flexibility, the distribution of float interest can become a competitive differential, because each EMI will decide whether and how to do it and some EMIs will be able to hold on to the float interest when they need it (such as in the early stage of their business). In **Approach 2**, EMIs are required to use the float interest "for the benefit of customers," which could include distribution of the float interest and/or indirect benefits. In **Approach 3**, EMIs are mandated to distribute a minimum percentage of the float interest. In **Approach 4**, the regulation does not specifically address the float interest. In **Approach 5**, EMIs are prohibited from distributing the float interest and directed on how to use it.

FIGURE 2. **Regulatory approaches to the float interest**



Regulatory approaches to the use of the float interest by EMIs

Most e-money regulations prohibit EMIs from intermediating (on-lending) the funds collected from e-money customers and require them to safeguard an equivalent amount ("the float") in liquid and low-risk assets, most often in one or more accounts at banks ("the float account(s)").[7] Banks usually pay interest on these float accounts.[8] The accrual of float interest leads to the question of how it can or should be used. There are several other questions:

1. Do EMIs need prior approval by their regulator before using the float interest in any way?
2. Are EMIs allowed, or are they required, to distribute the float interest to customers?
3. If distribution is allowed or required, what are the conditions imposed?

5 This argument is presented by Tsang, Malady and Buckley (2017).

6 In one of the studies into this subject, FinMark Trust (2016) describes how focus groups participants in Zimbabwe highlighted that mobile money do not pay interest and therefore do not cover the opportunity cost of storing their money in the account.

7 Rules on fund safeguarding are detailed in Staschen and Meagher (2018) and Kerse and Staschen (2018). Some jurisdictions require EMIs to maintain the float in trust accounts at banks, so that customers' ownership over the float is legally recognized. In countries where trust accounts do not exist (civil law countries), fiduciary or similar accounts may or may not provide similar protections. Greenacre and Buckley (2014) and Ramos et al (2015) discuss these accounts in detail.

8 There is only anecdotal evidence about banks not paying interest on float accounts, due to, for instance, laws or regulations prohibiting payment of interest on trust and similar accounts. GSMA's Mobile Money Regulatory Index 2019 shows that in around 90% of the assessed countries, float accounts are permitted to earn interest. However, at least one country, Guyana, prohibits banks from paying interest on float accounts (Bank of Guyana, Article 23/7 of the Regulations made under the National Payments System Act (Act No. 13 of 2018), 2019). Almazán and Vonthron (2014) notes that some EMIs forego the interest as a compensation to the banks holding the float accounts.

- What percentage of the float interest can/should be distributed?
- Can/should all EMIs distribute the same percentage of the float interest?
- How frequently can/should the float interest be distributed?
- Does the regulator impose common formulas for the calculation of the amount each customer gets?
- What information shall be disclosed to customers about the distribution? When? How?
- Can part of the float interest be used to cover fees/charges related to the management of float accounts?

These issues are addressed to varying degrees in e-money regulations. In its Policy Model for E-Money, the Alliance for Financial Inclusion (AFI) has called for regulators to provide guidance on how EMIs may use the float interest.[9] Actual regulations vary widely. We observe five different approaches affecting the use of the float interest.

APPROACH 1

Explicitly allow – but not mandate – distribution of the float interest, with no specific requirements on how to distribute it

Example: Brazil

In this approach, the regulation explicitly allows for the distribution of the float interest to e-money customers. However, EMIs are not required to do so, and the regulation does not impose specific requirements on how or when this distribution should happen. This way, float interest distribution can become a competitive differential and be offered as a reward to customers. This could potentially encourage EMIs to negotiate better return rates with the banks holding the float accounts. Also, the float interest could help nascent EMIs survive the hard first years of operation. After these initial years, EMIs could choose to distribute some or all of the float interest to keep current customers and attract new ones. However, under this approach, EMIs may choose to not distribute any of the float interest to customers.

In Brazil, EMIs can use the float interest as they please, including re-investing it internally or distributing it to customers, entirely or partially. There are no specific requirements on how the distribution should happen. To this date, EMIs in Brazil are not distributing the float interest to their customers.

APPROACH 2

Require that the float interest benefit customers without mandating distribution

Examples: Myanmar, Tanzania, Zambia

In this approach, the regulation does not require the distribution of float interest to customers but requires EMIs to use it "for the benefit of customers," which can include distribution. The regulation in Myanmar, for example, requires that the float interest benefits customers, subject to the approval by the Central Bank of Myanmar. In Zambia, the regulation lists the acceptable uses for the float interest, including distribution to customers. Similarly, a circular issued in 2014 by the Bank of Tanzania requires EMIs to use the float interest to benefit e-money customers, which includes customer care, customer education campaigns or distribution to customers, subject to prior approval by the Bank of Tanzania (which has rejected uses with self-promotion elements).[10] Since 2014, EMIs in Tanzania have distributed the float interest to customers (including agents, who hold much of the float in the system) on a quarterly basis (McKay 2016). Tigo Pesa and Airtel Money distribute the float interest in proportion to customers' balances and transaction volumes.[11] No formula is imposed by the Bank of Tanzania.

This approach gives somewhat less flexibility to EMIs compared to Approach 1 and does not allow EMIs to use this extra source of cash as they please. It also implies a

9 AFI (2019).

10 McKay (2016) and di Castri and Gidvani (2014).

11 "Tigo Pesa customers pocket TZS 5.48 bn in quarterly profit share" https://www.tigo.co.tz/news/tigo-pesa-customers-pocket-5-48bn-in-quarterly-profit-share and "Airtel to distribute 2.6 billion in interest disbursement to loyal Airtel money customers" http://ardenkitomaritz.blogspot.com/2020/03/airtel-to-26-billion-in-interest.html.

greater compliance burden for EMIs and more effort by supervisors, when prior regulatory approval is required. Moreover, it is not an easy task for the supervisor to determine if uses such as education campaigns and customer care result in positive consumer outcomes. On the other hand, the possibility of being rewarded or benefiting indirectly through improved services (e.g., a more extensive agent or merchant network) or lower transaction fees may encourage unserved segments to open e-money accounts or increase usage, and make EMIs more competitive relative to other financial service providers.[12]

APPROACH 3

Mandate the distribution of a minimum percentage of the float interest to customers

Examples: Ethiopia, Ghana, Malawi, Rwanda

In Ghana, the 2019 payments law established that EMIs must distribute at least 90% of the float interest (net of fees) to their customers. This had been 80% under the 2015 Guidelines for E-Money Issuers. The Bank of Ghana approves the interest calculation and imposes a common formula for distribution, based on each customer's e-money account balance and transaction volume. Every year, it publishes the schedule of the quarterly distributions. Customers obtain a return comparable to the returns on savings accounts (around 4%).[13] Bank of Ghana held some difficult discussions with EMIs to implement this approach (Buruku and Staschen 2016). From a customer's perspective, this highly controlled approach may make the experience of owning an e-money account very similar to owning a savings account.

Malawi takes an approach similar to Ghana's, where the distribution of float interest is highly regulated. Malawi's regulation requires EMIs to distribute at least 95% of the float interest (net of fees, costs and charges) to customers, except corporate clients and agents. Other rules include the following:

- the float interest must be distributed on a quarterly basis;
- customers must receive their share by the 14th calendar day of the month that follows the end of the quarter;
- customers must be notified each time the float interest is distributed;
- the independent auditor must certify compliance with the rules for distribution annually;
- the distribution shall be based on the daily average balances of individual e-money accounts using a formula defined in the regulation;
- all float interest from all trust accounts must be deposited in a single bank account held in the EMI's name, and the central bank must be informed of this account.

Yet another example is Ethiopia. The e-money regulation issued in early 2020 requires EMIs to distribute no less than 80% of the float interest, net of any account management fees. The EMIs must submit a proposal for the float interest distribution for approval by the central bank.

In Ethiopia, Ghana, and Malawi, the float interest that is not distributed can be used by the EMIs as they please. But this is not the case in Rwanda, where the regulation requires distribution of at least 80% of the float interest (net of any fees or charges related to the administration of the float accounts) and the remaining 20% must directly benefit customers in a way that is subject to approval by the central bank. The regulation states that any "use of frivolous fees and charges (…)" that unfairly limits the amount to be distributed "will be seen as an attempt to defraud the e-money holders and grounds for severe sanctioning." EMIs that fail to distribute the float interest are subject to a fine of 0.5% of the total undistributed interest and suspension of the license.

We could not find a country example where the regulation requires distribution of 100% of the float interest.

There are several arguments in favor of Approach 3. Mandating all EMIs to distribute the float interest under similar rules may be easier for customers to understand. It could encourage prospective low-income customers to

12 This approach is recommended by Tsang, Malady and Buckley (2017) and by the SADC Mobile Money Guidelines 2019, which were adopted by the Southern Africa Development Community (SADC).

13 GhanaWeb, BoG releases MoMo interest payment schedule (2019). https://www.ghanaweb.com/GhanaHomePage/business/BoG-releases-Mo-Mo-interest-payment-schedule-740604

open an e-money account and to actively use it, though as noted above there is still no evidence on this. Distributing float interest to e-money agents could be an incentive to agents to keep larger balances, which could improve e-money liquidity at agents.[14] One might also see it as a matter of principle, arguing that any balance in trust accounts legally belongs to customers, so any float interest should go to customers (net of administrative costs of managing the trust account).

There are also counter arguments. First, even if there is legal recognition that the float belongs to customers, this does not necessarily mean that customers are entitled to the float interest. Also, in some jurisdictions, current accounts and savings accounts with low balances do not earn any interest. In such cases, EMIs would be at a disadvantage compared to banks and other providers handling accounts with similarly-sized balances. However, the float interest could encourage the shift of customer funds from banks to EMIs, then putting banks at a disadvantage. If massive funds are shifted, this could impact the cost of funding for banks and affect their lending rates. However, such a risk has not materialized anywhere to date.[15]

Approach 3 may also increase compliance costs for EMIs and supervisory costs. This is particularly significant in the first years of operation of an EMI, when the float (and the float interest) may be too small to justify the costs. EMIs may pass on the additional costs to customers by increasing fees, which could further discourage usage and potentially offset the benefit of distributing the float interest. Supervisors also face costs as they need to assess compliance with the float interest distribution rules and, in some cases, authorize such distribution. And, as float interest distribution becomes a cost of doing business, it could act as an entry barrier for new EMIs, effectively protecting incumbents with an already established level of operations. It also limits the flexibility of EMIs to differentiate themselves from their competitors by freely choosing a combination of transaction fees and distribution of float interest.

APPROACH 4

No specific provision on the use of the float interest

Examples: Afghanistan, Australia, European Union, Hong Kong, Japan, Malaysia, Mexico, Peru, the Philippines, Singapore, Thailand, West African Economic and Monetary Union

The most common approach of e-money regulations is to prohibit EMIs from paying interest on e-money account balances in a manner similar to savings accounts. Beyond that, most regulations are silent on whether the float interest can be distributed to customers. Many jurisdictions have modelled their e-money regulations after the European Union (EU) Directive on E-Money, which prohibits payment of interest on e-money accounts but has no provisions addressing how the float interest can be used.[16] The framework is broadly understood as prohibiting both the payment of interest on e-money balances and distribution of the float interest to customers. Countries taking this approach include Afghanistan, members of the EU, Malaysia, Mexico, Peru, the Philippines, Singapore, and members of the West African Economic and Monetary Union. A similar approach emerges when regulations are silent about these issues but e-money is classified as a payment instrument, which ends up having the same practical effect due to the interpretation of what a payment instrument can offer. Examples include Australia, Hong Kong, Japan, and Thailand.

Despite the above, the EU E-Money Directive presents a nuance worth exploring. It states that member states must prohibit the *granting of interest or any other benefit related to the length of time during which the electronic money holder holds electronic money*. One interpretation of this provision could be that while the Directive does not allow EMIs to grant interest or other benefits based on *length of time*, it does not prohibit providing interest or other benefits related to other factors. The Financial Conduct Authority of the United Kingdom (UK) has issued

14 This argument was presented in Tsang, Malady and Buckley (2017), although many agents are likely to face the other type of liquidity shortage: cash on hand to conduct cash-out customer transactions.

15 Tsang, Malady and Buckley (2017) argue that this risk is unlikely unless EMIs pay interests significantly higher than that paid by banks.

16 European Directive on E-money, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02009L0110-20180113

an interpretation that this provision does not prohibit providing benefits related to factors such as spending levels.[17] In our understanding, this enables distribution of the float interest as a benefit if the EMI wishes to do so, as long as it is not based on the amount of time the customer stores value in the e-money account. Still, we did not find evidence that EMIs in the UK or within the EU are distributing the float interest to their customers.

When regulations are silent on what EMIs are allowed to do with float interest, they may be interpreted in different ways, unless the regulator clarifies its position. In Brazil, where e-money accounts are considered a payment instrument, the regulation was previously silent on the float interest. This was interpreted by the market as prohibiting the distribution of the float interest, since payment instruments shall not remunerate customers. The matter was later clarified by a 2019 reform that explicitly allowed – but did not mandate – EMIs to distribute the float interest.

APPROACH 5

Prohibit distribution of the float interest to customers and specify how EMIs must otherwise use it.

Examples: Kenya, Namibia

Namibia requires the float interest (after fees and charges) to be used to "benefit the e-money scheme" to ensure that "e-money fees and charges are in the public interest." In this case, it seems that EMIs can use the float interest, for instance, in ways that end up reducing transaction fees or increasing operational efficiency. It is not clear how this provision is being implemented in practice. Kenya's regulation is more prescriptive. It determines that any float interest must be donated to a public charitable organization. M-Pesa, the largest EMI in Kenya, donates the float interest to the M-Pesa Foundation, which was created specifically for this purpose.[18] In both cases, the reward of receiving part of the float interest, which could encourage customers to increase usage of their e-money accounts, is absent.

Conclusion

While most e-money regulations prohibit e-money accounts from paying interest in a manner similar to savings accounts, regulators have taken various approaches to determine what can be done with the float interest. Many jurisdictions seem to allow EMIs to use it as they please, without restrictions, by being silent on the issue. In such jurisdictions, there is no evidence that EMIs are distributing the float interest to their customers. Depending on the country context, being silent can be interpreted as *prohibiting* distribution, unless the regulator clarifies its position.

We believe Approach 1 is the preferred approach, where the regulation explicitly permits the distribution of the float interest to customers but does not require it. This approach allows EMIs to use the float interest (even if tiny) for themselves during difficult times, giving them flexibility to decide whether, to what extent and how they distribute the float interest; any of which could become a competitive differential.

In cases when distribution is allowed or required, regulators should impose disclosure requirements on EMIs to inform customers of the differences between e-money accounts and savings accounts. If float interest distribution is not guaranteed and/or e-money accounts are not protected by deposit insurance coverage (which is often the case[19]), this should be clearly communicated to customers.

More research is needed. We need to probe the impact of these approaches on e-money transaction fees. We need to know more about the challenges EMIs face in negotiating the terms of float accounts with banks,

17 Financial Conduct Authority of the UK, Payment Services and Electronic Money – Our Approach, 2019, https://www.fca.org.uk/publication/finalised-guidance/fca-approach-payment-services-electronic-money-2017.pdf.

18 M-Pesa Foundation, Annual Report, 2017-2018, https://m-pesafoundation.org/wp-content/uploads/2018/08/MPESA-Foundation-Annual-Report-Print-FA.pdf

19 Izaguirre, Dias, and Kerse (2019) discusses deposit insurance treatment of e-money.

whether banks are discriminating against them, and whether EMIs might be incentivized to shift funds to riskier banks that pay higher interest. We need to understand how EMIs are affected by distribution requirements, including whether the requirements form an entry barrier. Also, further research is required to explore whether and how these approaches impact competition between banks and EMIs and among EMIs. What happens when EMIs distribute more to customers than savings accounts pay (which seems to be the case in Tanzania)? Does the distribution of float interest lead to a considerable amount of customer funds moving from savings accounts and current accounts to e-money accounts? Does this shift increase the cost of funding and lending offered by banks? Even more importantly, we need to understand whether and how different approaches ultimately benefit and are perceived by consumers. How do they react to float interest distribution? Does it lead them to use their e-money accounts more and increase their balances? Does it lead to a shift from informal savings to e-money accounts? Does it encourage customers to shift to an EMI that distributes more? When distribution is permitted, should a common formula and disclosure format be imposed so that consumers can compare across EMIs? What other types of consumer protection rules should be imposed?

As digital financial services take center stage in the post-pandemic world, these issues will become ever more important.

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