CCGAP

FOCUS NOTE

Bank Agents: Risk Management, Mitigation, and Supervision

No. 75
December 2011

Kate Lauer,
Denise Dias, and
Michael Tarazi

In countries across the globe, banks are increasingly using agents to provide financial services to customers. In Brazil, for example, banks use approximately 160,000 agents—many with multiple outlets—to provide financial services to all 5,564 Brazilian municipalities.[1] In 2010, bank agents in Brazil handled 3.1 billion transactions (6 percent of all bank transactions), 2.85 billion of which involved the movement of funds.[2] In Pakistan, there are approximately 17,500 bank agents (State Bank of Pakistan 2011). In the quarter ended September 2011, these agents handled 15.88 million transactions totaling Rs 58,710 million (US$674 million) with an average transaction amount of Rs 2,700 (US$ 42.53). These arrangements, which involve the use of both agents and technology to transmit transactions details, are often referred to as "branchless banking."[3]

The use of bank agents has the potential to significantly increase financial access by poor and underserved populations to a range of formal financial services, including savings, payments and transfers, and insurance.[4] In particular, agents—who may be individuals, small retail shops, post offices, or large retailers—can offer customers a convenient and affordable opportunity to cash-in and cash-out of an electronic payments system. See Box 1 for a discussion of the use of the term "agent."

Box 1. What Is an Agent?

This Focus Note uses the term "agent" to refer to any third party acting on behalf of a bank (or other principal), whether pursuant to an agency agreement, service agreement, or other similar arrangement. In most countries, a principal is liable under law for the actions of its agents, whether such actions are explicitly or implicitly authorized. Liability for the actions of a nonagent acting on behalf of the bank may be different and will often depend on the contractual agreement. However, a bank's liability (whether by law or contract) for third-party actors will likely impact the bank's policies and procedures, which will in turn impact the supervisor's oversight of the bank.

Although a number of countries (e.g., Colombia, Pakistan, Kenya) over the past several years have issued regulations defining the terms and conditions of using bank agents,[5] there has not been any global guidance to supervisors that directly addresses how best to supervise such use and whether and how to supervise agents themselves. Drawing on the experiences of supervisors in several countries where branchless banking and the use of agents is flourishing (Brazil,[6] Colombia, India, Kenya, Mexico, Pakistan, Peru) as well as on general principles regarding outsourcing, this Focus Note provides evidence and analysis that may be useful to supervisors in their development of an approach suitable to their supervised institutions.[7]

Today's reality is critical to the observations made in this paper: in most countries, bank agents handle a very small percentage of total assets in banking systems. In Brazil, the country with the most extensive network of bank agents, agents handle almost 18

1 http://www.bcb.gov.br/fis/info/correspondentes.asp, accessed 3 October 2011. Bill payment is the primary service offered by these agents. In addition to the 160,000 transactional agents, banks in Brazil use approximately 500,000 informal "credit agents," described as "individuals on foot who sell payroll-consigned loans" (Kumar and Seltzer 2011).

2 The remaining 250 million transactions were nonfinancial, such as balance enquiries (Febraban 2011).

3 There are also branchless banking models in which a nonbank provides financial services directly to the customer, although typically such nonbanks are required to hold customer funds in a bank account or low-risk securities, such as government bonds. See Tarazi and Breloff (2010). A well-known example is Kenya's M-PESA, a mobile phone-based money transfer service established by the Kenyan mobile phone operator Safaricom. See Box 2 for a discussion of supervision of nonbank agents.

4 For example, a 2011 study of 327 customers of easypaisa (Tameer Microfinance Bank's mobile phone-based money transfer service) showed that (*i*) 45 percent of the customers did not have a bank account, (*ii*) over 40 percent lived on less than US$2.50 per day (in 2005 PPP adjusted dollars), (*iii*) almost 70 percent lived on less than US$3.75 per day, and (*iv*) approximately 5 percent lived on less than US$1.25 per day (Bold 2011b).

5 The regulatory issues regarding bank agents (e.g., who can be an agent, agent qualifications, permitted agent services) and how regulators have addressed them are discussed in Tarazi and Breloff (2011).

6 This Focus Note relies heavily on Brazil, which has the longest history and the most extensive experience with the bank agent business and its supervision.

7 Any conclusions that may be drawn should be viewed in light of the specific countries studied for purposes of this Focus Note and the limitations of using a small sampling.

Box 2. Supervising Agents of Nonbank Institutions

The analysis and conclusions of this Focus Note regarding supervising a bank agent business are generally applicable to other deposit-taking institutions (e.g., microfinance depository institutions). With respect to agents of nonfinancial institutions, such as mobile network operators, the applicability of the analysis and conclusions will depend on how such institutions are regulated and supervised and whether they are supervised by the same regulator. To date, nonbank institutions and their use of agents have often been subject to different treatment, due to (*i*) the fact that nonbank institutions do not typically operate under the jurisdiction of the bank regulator and (*ii*) the different risks posed by the potential failure of such institutions versus the potential failure of a bank.

In Kenya, for example, following the successful launch and roll-out of Safaricom's M-PESA service (which took place in the absence of any agency regulations for banks or nonbanks) and the subsequent interest of the Kenyan banking sector in branchless banking, the Central Bank of Kenya (CBK) issued bank agency guidelines in 2010. The guidelines have detailed agent suitability criteria and impose significant licensing, reporting, and other requirements on banks. The guidelines also impose significant supervisory duties on CBK. In comparison, the draft Kenyan e-money regulation (which would, if adopted, authorize e-money issuers to appoint and register agents) contains significantly reduced licensing, reporting, and other requirements.

While there may be justification for the different treatment regarding the agent businesses of banks versus nonbanks (i.e., the nature of a bank's core business and the potential systemic implications of a loss of deposits), such treatment interferes with the principle of a level playing field for different institutions offering similar products and services. Kenyan banks, in particular with respect to agent exclusivity, argue that Kenyan bank agent guidelines prohibit agent exclusivity but no such prohibition applies to nonbank agents. Recently adopted agent guidelines in Rwanda also prohibit exclusivity whereas nonbank agents are not so prohibited.

percent of the total assets of the banking system (viewed as small from the perspective of the country's central bank).[8] Other countries have much smaller numbers of bank agents, and the percentage of total assets handled by agents is most likely much smaller as well. Notwithstanding the absence of systemic risks presented by bank agents, it is important that bank supervision reinforce the responsible use of agents—both from a prudential perspective and a consumer protection perspective.[9] Nevertheless, such supervision must avoid the creation of unnecessary barriers to the use of bank agents, particularly given the limited nature of services most agents currently provide.

Part I of this Focus Note describes the different activities (and related risks) in which bank agents may engage. Part II discusses bank management and mitigation of agent-related risks in the context of a fully developed bank agent business. The approach taken by a bank with a small number of agents or very limited use of agents would be adjusted to reflect the limited risks presented. Part III describes different approaches to licensing and supervision of bank agent businesses, and highlights the advantages and disadvantages of different approaches. (See Annex 1 for a table of the licensing and supervisory practices in selected countries.) Part IV outlines possible corrective measures that supervisors may take with respect to a bank agent business based on research as well as general principles of bank supervision. Part V draws conclusions and cautions against over-burdensome and costly supervision.

I. Bank Use of Agents and Related Risks

The level and kinds of risk to which a bank will be exposed as a result of its use of agents will depend

8 Data provided by Central Bank of Brazil (CBB), estimate as of December 2010. From CBB's perspective, it is more important for purposes of systemic risk that agents handle only 2 percent (approximately) of the total bank credit. Different countries may be more concerned with other products (e.g., insurance) and services (e.g., payments).

9 This is the approach of CBB, which conducts regular inspections (at bank headquarters), focusing on the agent business, notwithstanding its assessment that there is no systemic risk in financial terms. (CBB is the only supervisor of the seven countries researched that does such regular inspections.) CBB's concern is with the potential impact of the agent business on public confidence in banks given the number of customers affected, the attention given by the media to bank agents, and the lower sophistication of agents compared to bank employees.

on (*i*) the extent of such use—the picture is quite different if a bank uses agents minimally or for 100 percent of its business, (*ii*) the activities in which its agents are engaged (see Box 3 for a discussion of different agent "types"), and (*iii*) the bank's management of the agent business, including not only proper oversight and monitoring of agent activities but also the process by which agents are selected and trained.[10]

Agent Services

The services that may be provided by bank agents can be divided roughly into four categories:

- Transmitting information
- Processing information
- Cash handling
- Electronic funds transfer

Information transmission consists primarily of providing the customer with account information (e.g., balance inquiries and bank statements) and receiving account and loan applications, including transmitting know-your-customer (KYC) information. Information processing includes processing account and loan applications (and in some cases, opening accounts[11]), analyzing the credit and other personal information of loan applicants, conducting KYC procedures (i.e., verification) for account opening applications and transactions, record keeping, and selling microinsurance. Cash handling refers to deposits (or "cash in") and withdrawals (or "cash out"), often limited to small values, to or from a customer's own account. Finally, electronic funds transfer may involve making bill payments, disbursing government benefits, and effecting payments (e.g., salary payments). Some countries permit agents to engage in all such activities; other countries are more restrictive.

Box 3. Different Agents "Types"

Agents may engage in different activities, depending on applicable regulation and the terms of the agency agreement. Some agents provide only cash-in/cash-out services (these agents are often called "cash merchants"). Some agents also enroll customers and provide a wider array of banking services. The Reserve Bank of India (RBI) has established two types of agents: limited-scope business facilitators (BFs) and full-scope business correspondents (BCs). BFs are permitted only to identify borrowers, collect loan applications, and verify and do preliminarily processing of the data; process and submit account applications; and engage in consumer financial education. They are not permitted to engage in banking activities. BCs may engage in all of the activities permitted for BFs and may also disburse small-value credit, collect loan payments, perform small-value remittances, and assist in conducting KYC for account opening purposes. The Central Bank of Brazil recently adopted a regulation distinguishing transactional agents (who engage in bill payments, withdrawals, and transfers) from correspondent agents, who provide a wide array of services, including selling credit.

It is less important to classify agents than to look at what they do. However, classification facilitates proportionate regulation and supervision, which in turn can impact the feasibility and attractiveness of the agent business.

Agent Management

Subject to what is permitted under applicable regulation, a bank might choose among a variety of arrangements for managing agents, including the involvement of agent network managers (ANMs). An ANM may perform a number of functions with respect to a bank's agents, including selecting, contracting, training, managing, monitoring, and serving as liquidity manager. To the extent that the ANM plays a key role with respect to a bank's agent

10 The Federal Reserve Bank of New York (1999) has stated, with respect to outsourcing, that a bank's risk profile may be enhanced or weakened depending on the bank's risk mitigation practices and whether the service provider's expertise is superior to that of the bank.

11 "Account opening" in most countries refers to the agent's *facilitation* of account opening (i.e., the agent collects and forwards the account application to the bank). In a few countries, however, agents may actually open accounts, but only "simplified" or "low-level" accounts with maximum balance limits and maximum throughputs per date, month, and year. This is the case in Mexico, Pakistan, and South Africa. In Colombia, agents may open accounts but the account can be *activated* only at a bank branch.

business, the bank will need to manage the risks of such outsourced activity.

There are various ANM models, including most commonly (*i*) a specialized third-party operator to whom the bank outsources the agent management functions, (*ii*) a large retailer (or other entity with a large number of outlets) that, pursuant to its agency agreement with the bank, manages its outlets as agents of the bank, or (*iii*) a third party that signs an agency agreement with the bank and subcontracts with other legal entities or individuals, each of whom functions as an agent.[12] For instance, Bank Bradesco (Brazil) manages its larger agents, which handle more high-value transactions and have a strategic importance for the bank; the bank uses ANMs to manage smaller agents. Banco BCP (Peru) managed its agent network during the first years of operation and then gradually began outsourcing some functions (such as agent selection and training) to ANMs.

Risks Posed by Use of Agents

The use of agents can trigger operational, technological, legal/compliance, reputational, and other risks.

The use of agents for a limited number of basic activities (e.g., account information) may present fewer and narrower risks than those of agents engaged in a large variety of activities including, in particular, cash-in and cash-out services. (See Annex 2 for a table that correlates agent activities with risks.) However, the range and complexity of services provided by agents do not necessarily translate into significantly increased attention required by the supervisor. Rather, it more typically requires increased attention on the part of the bank due to the bank's ultimate liability for actions of its agent. This principle is reflected in the recent amendments to the agent regulations of the Central Bank of Brazil, which now provide that agents dealing with credit and leasing must be trained and certified on relevant technical matters, applicable regulations, the consumer protection code, ethics, and ombudsman duties. Kenya's 2010 agent regulations take a different approach, specifying that the bank is responsible for determining, based on an assessment of risk, the services that any particular agent should provide.

Operational risks. The use of a nonemployee—i.e., an agent—to service bank customers introduces new operational risks that may stem from lack of capacity, poor training, and lack of necessary tools and systems.[13] These risks include the following:

- Agent fraud or theft
- Unauthorized fees
- Abusive service by agent of customers (in particular, tying—i.e., requiring clients to purchase certain goods and services to obtain other services) or misrepresentations regarding the agent's role as acting on behalf of a bank
- Loss of customer assets and records
- Data entry errors
- Poor cash management resulting in an agent not having sufficient cash on hand to enable the customer to make a withdrawal
- Agent failure to resolve or forward consumer complaints to the bank

Agents themselves may also be subjected to theft and third-party fraud (including the use of cash-in transactions to pass counterfeit bills to agents ill-equipped to identify them).

Technological risks. Utility disruptions or software or hardware failures can cause a lack of service availability and information loss.

Legal and compliance risks. Customers may sue a bank as a result of agent theft or an agent's violation of privacy laws/bank secrecy laws or other misuse of confidential customer data. Agents may sue the bank for breach of contract or for broader claims. Uncertainty in the applicability of agent-related laws or regulations and the interpretation of contracts give rise to the risk of lawsuit. For instance, in Brazil, agents

12 See Tarazi and Breloff (2010). The third category, which is viewed by some as a master agent/subagent arrangement, may be prohibited in countries that do not permit subagency.

13 The Pakistan Branchless Banking Regulations (Section 8.1) require banks to adjust their risk management policies in view of the fact that "a customer's contact to the agents is riskier than these same functions in the hands of bank tellers in a conventional bank branch. These agents may operate in hard-to reach or dangerous areas and they lack physical security systems and specially trained personnel."

are suing banks, claiming that they are the functional equivalent of bank staff and should receive the same benefits, including salary and leave. Compliance risks include risks of fines or other civil actions due to an agent's noncompliance with law or regulation, such as anti-money laundering and combating the financing of terrorism (AML/CFT) regulations, bank reporting requirements, or applicable consumer protection rules (e.g., transparency of pricing and other disclosure).

Credit risks are tied primarily to operational risk: the bank may not receive the money owed by the agent (if, e.g., an agent has a credit line to help manage its liquidity) due to robbery of the agent or agent theft. In Brazil, some agents do not have any account with the contracting bank; all customer deposits are effected at the time of transfer to the agent, and the agent's bank assumes risk of loss of the deposit until the agent deposits the funds in a bank branch. To reduce the risk of loss of cash, agents are required by regulation to go to the bank every other business day to deposit funds. In Mexico, each agent is required to have an account with the contracting bank. This requirement does not address the risk of loss of agent's own funds—i.e., cash in the till as a result of client deposits—which may have been borrowed from the bank.

Reputational risks are derivative of the risks noted above: underperformance by agents or agent fraud, robbery, agent liquidity shortfalls, loss of customer records, leakage of confidential customer data, and violation of consumer protection rules regarding price disclosure. There may also be negative media due to systems failures. Agent-related AML/CFT lapses that result in the bank being used for financial crimes may result in the public's association of the bank with criminals. Even if derivative, reputational risks can be the most damaging.

II. Bank Management and Mitigation of Agent-Related Risks

Banks manage and mitigate risks triggered by the use of agents through various policies and procedures, internal audits, and review processes. Regulations may specify the required policies and procedures and corporate governance arrangements or the supervisor may impose them.[14] Even in the absence of regulatory or supervisory requirements, a bank would typically have such policies and procedures in place to manage the risks of its agent business.[15]

A bank's approach to risk management in relation to its agent business will depend on the services performed by its agents, the aggregate value of the transactions they handle, as well as the number of agents and their geographic spread. There will be only minor agent-related risks to manage if a bank has only a small number of agents or uses agents for very limited services. (See Box 4 for a discussion of agents and materiality of risk.) In addition, independent and internal audits serve to determine the bank's level of compliance with its own policies and procedures and with applicable regulation, including minimum technology standards. A bank's approach to agents will, in many ways, be similar to its approach to outsourcing more generally.[16] Accordingly, the following discussion is based not only on the seven countries researched but also on the Joint Forum's Outsourcing Guidelines and the discussions of Basel Core Principle 15 in the Basel Committee on Banking Supervision's (BCBS) Core Principles for Effective Supervision (2006) and the BCBS Core Principles Methodology (2006).[17]

14 One bank noted that although the regulations required the bank to have in place a risk management system to address the risks associated with branchless banking activities, it could not formulate a manual without having had experience with branchless banking and understanding the risks. The bank developed a manual after a year of branchless banking operations and acknowledged that the manual would be revised over time as the business develops.

15 Risk-taking by banks is not merely a matter of regulation but also of corporate governance. See Laeven (2008) finding that, based on a study of 300 banks in 48 countries, regulation may have different impact on a bank's risk-taking depending on the bank's corporate structure.

16 See India's agent regulations, which notes "[i]n formulating their [agent] schemes, banks may be guided by … the [RBI's] outsourcing guidelines" (Para 5.1 of 2006 regulation).

17 See also the discussion of outsourcing and risk management in BCBS's recently issued *Principles for the Sound Management of Operational Risk*.

Box 4. Outsourcing and Agents

Banks often outsource information technology (IT) functions, card processing, call centers, accounting, and marketing. The 2005 Outsourcing Guidelines of the Joint Forum (BCBS, IOSC, IAIS) defines bank outsourcing as "a regulated entity's use of a third party … to perform activities on a continuing basis that would normally be undertaken by the regulated entity." According to the European Central Bank (2004, p. 25), "direct control over [the outsourced] operations is shifted to the external service provider."

A bank's use of agents for branchless banking can be viewed as a type of outsourcing, although the scope of any one agent's services is limited: there is no shift in control over an aspect of bank operations, and transaction volume is likely not significant. The risks of "outsourcing" to a handful of agents are therefore not material (in fact, they are likely extremely limited) and do not trigger concerns for the supervisor. However, the bank's use of a substantial number of agents or of a country-wide retail chain to act as the bank's main channel for providing financial services to a significant percentage of the bank's customers would be a clear example of outsourcing. A bank's use of an ANM to oversee and manage the bank's agents would also constitute outsourcing (i.e., of the agent oversight function).

India's Guidelines on Managing Risks and Code of Conduct in Outsourcing of Financial Services by Banks (2006) are useful in their description of "material outsourcing" as those arrangements "which if disrupted, have the potential to significantly impact the business operations, reputation or profitability" of a bank. The Guidelines further explain that materiality is based on several factors, including (*i*) level of importance to the bank of the outsourced activity; (*ii*) potential impact on earnings, etc., (*iii*) cost as percentage of total costs; and (*iv*) aggregate exposure to one provider. (The Guidelines are self-described as having incorporated the guiding principles of the Joint Forum Outsourcing Guidelines, which explicitly declined to define "materiality," leaving it to the discretion of national authorities).

Agency Policies and Procedures

A bank's agent-related policies and procedures—which are largely shaped by regulatory requirements—typically cover the selection, training, managing, monitoring, and dismissal of agents.

Agent selection and hiring policies. Agent selection and hiring policies typically include minimum suitability criteria (based on regulatory requirements and the bank's assessment of required capacity of agents) and due diligence policies to enable an assessment of the agent's financial and infrastructure resources (including IT and personnel) as well as the agent's reputation.

For example, some countries (e.g., Kenya) require an agent to be a commercial business that has been operational for at least a minimum specified time period. Illustrating the potential differences across countries, India's regulations initially prohibited any commercial establishment from being a business correspondent (a type of bank agent in India), reflecting a distrust of commercial interests and motives. RBI recently revised its regulations and now permits all commercial businesses other than nonbank financial companies to serve as BCs.

Suitability criteria and due diligence may vary depending on the services that the agents will perform. For instance, if the agent is going to be performing cash-in and cash-out functions, the agent will need to have sufficient business to have adequate liquidity, unless the bank or a third party provides a liquidity facility. The selection process also usually includes an assessment of the potential agent's foot traffic and reputation in the community—these factors may indicate customer interest in using the agent, reflecting both the agent's trustworthiness and likelihood of good behavior.[18]

Often, regulations require the bank to have a standard form of agency agreement specifying, among other things, the extent of the bank's liability for the agent's actions, the services to be provided, fees to be paid to the agent, cash holding limits, confidentiality of customer information, IT requirements, documentation and reporting requirements, as well as corrective measures that the bank may take if an agent fails to comply with applicable regulation or bank policy. In

18 For a useful discussion on selection of agents, see Flaming, McKay, and Pickens (2011).

some countries, such as Colombia, Kenya, Mexico, and Peru, the supervisor requires the standard form to be submitted as part of the licensing process.

Training policies and materials. Training policies typically set forth the content, required frequency, and timing of the agent training as well as a requirement that the trainers be properly qualified. (As noted, training may be outsourced to an ANM or another third party.) Together with constant monitoring of agents (by the bank or ANM), training is essential to ensuring that services are delivered in accordance with the bank's operating procedures and applicable law. Training should be based on and tied to the bank's operations manual or other internal guidelines, but should at a minimum include AML/CFT procedures, equipment operation and troubleshooting, complaints handling, and identification of counterfeit money.

Liquidity and cash management procedures. Liquidity facilities may be used to provide agents with an initial capital infusion and to offset future shortfalls in liquidity (i.e., if an agent does not have sufficient liquidity to manage customer demands). A liquidity facility may be provided by the bank, the ANM, or a third party.

Agents may also need assistance with cash management if they engage in significant cash-in and cash-out activities. Excessive amounts of cash present a security risk for agents; insufficient cash on hand means that an agent cannot provide demanded cash-out services.[19] A bank or service provider may deliver cash to or pick up excess cash from agents. For instance, the Indian company Financial Inclusion Network and Operations Ltd. (FINO) manages a network of agents. FINO puts up the initial capital for its agents and provides cash management facilities. FINO staff visit each agent every one or two days and either deliver cash or retrieve excess cash.[20] In many cases, particularly when agents are small and geographically isolated, these services are not be provided. In Brazil, banks (or ANMs) hire cash transportation companies for larger agents and sometimes for entire regions where smaller agents operate.

Monitoring. Monitoring agent activities enables a bank to ensure that agents are performing bank services adequately. A bank (or its ANM) will also monitor agent use and maintenance of the equipment and systems that are typically provided to the agents, including systems to ensure information security and an enabling IT platform.[21]

The bank should have a remote transaction monitoring system so that it can review transaction logs and new customer registration. Remote transaction monitoring is crucial to preventing and identifying fraudulent transactions and to identifying breaches to liquidity management and suspicious transactions for AML/CFT purposes. Transaction monitoring can be outsourced,[22] but the bank should have immediate access (whether online or otherwise) to the monitoring system or its information.

A bank's monitoring and analysis of complaints related to agent transactions and related follow-up measures can be particularly useful. Brazilian regulation requires banks to have a quality control plan for agents and agent networks, which should draw on complaint information. Banks may be required by law or regulation (as in Brazil) to provide a customer complaint hotline or other mechanism for customers seeking recourse regarding problems with agents. Even in the absence of a legal requirement, the bank should have procedures to receive and resolve customer complaints of agents and other inquiries as well as agent complaints regarding its ANM or branch staff.

19 This agent cash management issue has not triggered bank runs as customers appear not to associate agent-related cash shortfalls with bank stability and liquidity. This is an interesting contrast to client response to lack of liquidity at a bank branch. In this respect, banking agents present less risk than branches.

20 See CGAP blog "Boosting the business case for agents" (15 February 2011) by Prakash Lal, assistant manager at FINO. http://technology.cgap.org/2011/02/15/boosting-the-business-case-for-agents/#more-3812.

21 ANM systems have become a new line of business in Brazil. A number of IT companies are specializing in equipment and systems for banks managing agents and ANMs.

22 Brasil Telecom assumes such responsibility for several banks in Brazil.

Other Risk Management Techniques

In addition to policies and procedures regarding the selection, training, and monitoring of agents, a bank often will have other risk management policies and processes for its branchless banking operations, including periodic review, internal controls and audits, and contingency planning. In addition, while not common, banks may also seek insurance coverage and risk-sharing arrangements with ANMs.

Periodic review of agent network. Banks should periodically review the financial and operational condition of their agent networks and agency arrangements to identify new or growing material risks, weaknesses in the bank's risk management policies or procedures, and the performance of the network against targets set for the period (e.g., minimum number of average monthly transactions).

The bank may make periodic onsite visits to agents based on a predetermined sampling method or based on information from the monitoring activities. Banks should have written policies for applying corrective or punitive measures against agents and ANMs in case of noncompliance with the regulations or the bank's policies. These could include temporary suspension of services, reduction in transaction limits, or termination of the agency agreement.

Monitoring together with periodic review should enable a bank to identify and act on the need to make provisions in its books to cover significant risks, such as potential losses from legal disputes. The lawsuits brought by agents in Brazil claiming equal treatment with bank staff, for instance, have caused some banks with large agent networks to make provisions for damages in the event that the courts decide in favor of the agents.

Internal controls, audits, and regulatory reporting. The bank's internal control function should cover agent operations.[23] It is advisable that there also be a bank manager or high-level executive responsible for agent operations. In some countries (such as Brazil and Mexico), this is required by regulations. The appointed executive should be the main point of contact for the regulator and should be responsible for regulatory reporting as well as reporting to the bank's board of directors and audit committee. In Brazil, regulation also requires that each agent be the responsibility of the nearest branch manager.

Independent audits and internal audits should include reviews of compliance of the bank's use of agents with bank policies and with applicable regulation, including the effectiveness of the internal controls. Pakistan's branchless banking regulations require that the internal audit function encompass the increased complexity and risks of branchless banking activities. The regulations also require audit department staff to have sufficient expertise. Similarly, Brazilian banks must adapt their internal audit function to the number of agent points, and the complexity and volume of agent operations. Mexican regulation requires, as a prerequisite for the authorization to operate an agent business, that a bank conduct a special internal audit to evaluate agent equipment and systems against regulatory and bank requirements.

Contingency planning. Contingency planning in the case of any significant disruption, discontinuity, or unplanned or uncontrolled event affecting the bank's agent business needs to address the potential failure of, or cyber attacks on, the system or technology backing agent operations, and natural disasters damaging agent or ANM facilities. It is critical for a bank to conduct periodic contingency simulations and testing of contingency facilities, procedures, and systems.

Insurance coverage. The bank may obtain insurance or may offer or require the agent or ANM to obtain insurance covering a variety of risk situations affecting agent facilities and equipment and the cash being handled by the agents (BCBS 2011b, para. 55). The insured risks may include robbery, natural disasters, and fraud. Insurance coverage for agent operations is common in Brazil, with the cost being borne by the agents or the ANMs.

23 See BCBS (2011b, para. 54).

Risk-sharing with ANMs. As noted, an ANM may be responsible for selecting, hiring, training, and managing agents; providing and maintaining systems and equipment; and handling cash management services. The agreement between the bank and the ANM may hold the ANM liable for certain actions of its agents.[24] Similarly, a master agent may be liable by contract for the agents of its subagents.

Licensing and Supervision

Supervisors address the risks of a bank's use of agents *ex ante* via licensing requirements and/or *ex post* via supervision of a bank's use of its agents and ANMs and, in some cases, direct supervision of the agents and ANMs themselves. Licensing requirements are usually set by regulation and restrict who may be an agent, establish the minimum criteria, and identify the permitted activities. They often include the evaluation of the bank's ability and willingness to engage in this business without incurring undue risks. Supervision is less clearly delineated and requires more subjective decision-making on the part of the supervisor. However, there may be a dynamic relationship between licensing and supervision: rigorous licensing requirements may justify less rigorous supervision, saving the supervisor and potentially the bank time and money. A burdensome licensing process can, however, slow down the initial roll-out of agent networks.

Brazil, for example, requires no licensing but has developed specialized onsite and offsite examination manuals a decade after agents started operating in large scale. Mexico and Colombia are much stricter during licensing—particularly in their review of technology standards—but do not conduct regular onsite or offsite examinations of agents.

Approaches to Licensing

Some countries require a bank's use of agents to be approved by regulators and, in some of these countries, each agent must be licensed individually. Other countries require only agent registration and do not have any agent licensing requirements. And at least one country (India) does not require registration or licensing.

In several countries that require regulatory approval, the following must be submitted by the bank as part of the application process:

- Proposed number of agents, locations, and, if applicable, use of ANM(s)
- Proposed agent activities
- Bank's agency policies, including proposed standard agency agreement and the operating manual to be provided to agents
- Bank's risk management policies, including liquidity management and procedures and staffing to monitor agents
- Bank's IT policies and infrastructure related to agents

Some countries (such as Kenya, Mexico, and Colombia) require more detailed information in the license application, including some or all of the following:

- A delivery channel strategy and role of agents in the strategy
- A declaration by a senior bank officer or the internal auditor that its proposed agents meet minimum qualifications
- A feasibility study, including scope (geographic/service), outreach, bank's proposed agent management structure, technical report, and fees to be paid to the agent, by type of transaction
- Policies for the customer complaint function for agents
- Policies for the compliance management function

After receiving general permission to use agents, the bank—depending on local law—may have to submit an application for each individual agent that states the agent's name, address, phone number, and services to be provided. Some countries require more information on each agent, including the agent's business, variations to the standard form of agency agreement, and a declaration by a bank officer regarding the due diligence performed and the

24 Under its agreements with banks, Brasil Telecom assumes the costs and damages resulting from agent fraud and agent error.

suitability of the agent. If the bank has many potential agents, this approach will be very burdensome to both the supervisor and the bank. In light of this, the Philippine supervisor (Bangko Sentral ng Pilipinas) began to permit "mass" licensing of remittance agents in 2010.[25]

In other countries (e.g., Colombia and Mexico), after receiving general permission, the bank is required simply to provide periodic updates on all agents engaged and basic information (agent's name, location, services to be provided).

There may be various ongoing requirements to update the information. Kenya and Brazil both require information on agents to be renewed annually. Mexico requires banks to seek regulatory approval before any major operational or infrastructure change, and Colombia requires such approval even for changes in the standard agency agreement.

Supervision

Materiality is the main filter for supervision. Some supervisors may therefore supervise only the larger banks' agent operations. Materiality with respect to a bank's use of agents may be measured by a number of factors: the activities performed by the agents, the percentage of the bank's business (as measured by bank assets or bank revenues or profits) flowing through agents, the percentage of the loan portfolio handled by agents (viewed by at least one supervisor as the most important), the number and aggregate size of all transactions handled by the agents, and the number of agents. The most basic information to assess materiality can be obtained through regular reporting (although some supervisors may consider the review of such information to be too burdensome). Further information may be obtained through onsite examinations. CBB singles out agent networks that are large enough to justify such reporting and requires the reports only as preparation for onsite examinations.

Reporting and offsite monitoring. The main purpose of reporting and offsite monitoring is to enable the supervisor to assess and monitor risks (particularly material risks) and feed the examination planning process. Reporting requirements should be proportional to this objective.[26]

Transaction information. Reporting on agent transactions and other financial information may include some or all of the following:

- Agent transactions by type, amount, number, and location (gives supervisors a perspective on how large the sector is and trends that may indicate future material risks) (e.g., Colombia, Mexico)
- Incidents of fraud, theft, robbery by type and location (gives supervisors a better understanding of the stability of the sector that will impact consumer confidence and present reputational risks) (e.g., Pakistan)
- Customer complaints by numbers of complaints, type of transaction, location, and bank responses (gives supervisors an indication of the key customer experience pitfalls and how they can be remedied to avoid reputational risk) (e.g., Pakistan, Peru, Mexico)[27]

As noted, some supervisors do not require periodic transaction and financial information on the agent business (Brazil, Peru) as it can add substantial burden to their workload. Instead, such supervisors would request information from specific institutions only when examinations are conducted or planned (annually or less frequently, depending on the risk matrix of each institution) or when deemed necessary by the supervisor for any other reason (e.g., if the supervisor, based on the agent database, feels an agent network needs more detailed risk assessment).

Many countries require that banks keep an updated database of active agents (agent name, location) and permitted activities. Some countries (e.g., Brazil) require information to be kept up to date at all times

25 However, remittance agents in the Philippines are not agents of a bank; they are agents of the customers.

26 Some supervisors (such as Mexico's Banking Commission and Colombia's Financial Superintendency) use reporting as input for financial inclusion indicators and require much more detailed information regarding monthly transactions. Such reporting usually focuses on transaction types, amounts, and volumes in locations known to have low levels of financial access.

27 Although CBB requires banks to produce complaint statistics segregating the agent channel, banks are not required to send these reports to CBB on a regular basis. This information is analyzed during examinations of the bank's agent business.

via the central bank's Web-based system and require annual "due diligence" of the database. Others require monthly or quarterly updates (e.g., Mexico, Colombia, and Peru), and others may require annual reports (especially if the list is not public but is used for supervisory purposes only—e.g. to plan for offsite or onsite examinations) or semi-annual updates (which is preferable to annual reports, at least in the initial period of fast growth). In contrast, RBI only requests that banks post their agent databases on their respective Web sites. (See Box 5 for a discussion of RBI's approach to supervising bank agent businesses.)

Databases, when made public, can help protect consumers since consumers (at least those with access to the Internet) can verify an agent's authenticity and more easily avoid being scammed by fake agents.[28] In Colombia, Brazil, and Kenya, banks are required to publish on their Web site (and keep up to date) a complete list of agents. The Peruvian Superintendency of Banks and Insurance publishes on its Web site a list of all 9,204 agents operating in the country and their locations.

Reporting is not the only means for supervisors to monitor the market. Review of local media for signs of stress in a bank's business can provide valuable information. For example, Brazil adopted supervision procedures on the bank agent business based on media reports related to agent fraud and poor customer service by agents.

Onsite inspection. In many countries, onsite inspection of a bank is planned based on the materiality of operations or the risk assessment conducted through offsite monitoring. Some supervisors (e.g., Colombia, Mexico, and Peru) conduct onsite or offsite monitoring of a bank's agency business only if it is identified in the bank's risk matrix as an area affecting the bank's risk profile. In Pakistan, the supervisor inspects each bank (there are currently 54 banks) once every two years, although many inspections are

Box 5. RBI's Approach to Supervision

RBI does not collect general or specific information on agents or bank agent businesses nor does it inspect agents or have any specific supervision of bank agent businesses. However, during annual financial inspections, RBI will review a bank's implementation of RBI's Outsourcing Guidelines to assess the bank's risk management systems, particularly with respect to material outsourcing.[a] RBI does not require a bank to obtain a license to use agents nor are banks specifically required to adopt agent-related policies and procedures. In general, RBI relies on bank risk management and supervision procedures and oversight and on bank compliance with regulations.

To ensure a bank's ability to manage and supervise its BCs (see Box 3 for discussion of BCs and their permitted activities), RBI set a maximum permitted distance (30 kilometers) between a bank's BC and the nearest bank branch.[b] Other regulations set criteria for agents[c] and include general statements on minimum standards for agent technology and other measures (e.g., the agency agreement must adhere to the requirements of RBI's Outsourcing Guidelines). RBI also directs banks to "put in place an institutionalized system for periodically reviewing the implementation of the [agent] model" approved by the bank's board.[d] RBI has recently suggested that banks conduct a form of "know your agent" due diligence on prospective BCs and their "(*i*) reputation/market standing, (*ii*) financial soundness, (*iii*) management and corporate governance, (*iv*) cash handling ability and (*v*) ability to implement technology solutions in rendering financial services."[e]

a. See discussion in Box 4 regarding the description of "material outsourcing" in RBI Outsourcing Guidelines.
b. Banks may apply for an exemption from such requirement for BCs operating in areas with an underserved population where a branch would not be viable. No such requirement applies to the BFs (limited purpose agents) and none of the other six countries studied imposed such a requirement.
c. RBI permits a variety of types of entities to be BFs, including NGOs, community-based organizations, and companies' IT-enabled rural outlets. The range of possibilities is broader for BCs, but banks must "ensure that they are well established, enjoying good reputation and having the confidence of the local people" (RBI/2005-06/288, para 3.1). In fact, over the past five years, RBI considerably expanded the list of entities permitted to serve as BCs. For a discussion on the evolution of what entities may act as agents in India, see Tarazi and Breloff (2011).
d. RBI/2007-2008/295, para. 6.
e. RBI/2010-11/217, Annex, para. 1.

28 BCBS's Core Principle Methodology (2006) requires the supervisor or licensing authority to publish, and keep current, a list of licensed banks and branches of foreign banks operating in the jurisdiction (Principle 2, Essential Criteria 5). Some supervisors may interpret this requirement as also requiring an updated list of agents.

limited in scope. Inspection of a bank's use of agents would be a component of a routine inspection.

Onsite inspection is preceded by analysis of a bank's risk management and regulatory compliance systems and procedures. This analysis will be based on the supervisor's review of the information submitted by the bank: technical reports (e.g., information security), training materials and records of trainings, the bank's operations manual (and, if a summary is provided to agents, such summary), transaction logs, complaints handling reports, reports to senior management regarding the status of the agent business and related follow-up measures, internal and external audit reports, and select agency agreements. The analysis will indicate whether the bank is in compliance with its policies and with applicable regulation. Among the countries reviewed for purposes of this paper, CBB is the only supervisor with standard inspection manuals for the agent business.

Onsite inspection of a bank's agency business should be conducted only if the bank is slotted for an onsite inspection as a matter of course or, in accordance with a proportionate approach to supervision, if justified by the preinspection analysis or the bank experiences another significant event, such as a fraud or a sudden breach in the data security system of the bank that affects agent operations.[29] The onsite inspection will typically involve the following:

- Confirming that senior management (*i*) is familiar with the bank's policies and procedures regarding the bank's agent business and its risks and mitigation mechanisms and (*ii*) has received and acted on the reports analyzed during the pre-examination phase, including reports from the complaints handling unit and audit reports
- Checking the robustness of the IT systems and controls for agent transactions against the operation manuals and policies and checking the contingency arrangements against the contingency plans, using tests and simulations (e.g., to test whether systems properly identify agent transactions that exceed the established balance and transaction limits)
- Conducting interviews to confirm that the relevant bank personnel know the bank's policies regarding the agent business and its operations and conduct their activities based on written manuals and clear reporting lines
- Conducting interviews with the internal auditor to confirm the auditor is knowledgeable and attentive to the agent business

Onsite inspections of agents. Supervisors may conduct random visits and targeted visits to agent premises (based on a standard sampling method or on reports identifying agents that have been the subject of multiple complaints) to check agent compliance with disclosure and other consumer protection rules, signage, KYC requirements, adherence with operations manual, and knowledge of agent personnel. These visits may involve simulations of transactions at agent points and mystery shopping. Supervisors (e.g., Mexico) may also take agents' equipment to an IT laboratory for testing. Some supervisors (e.g., Brazil and Peru) have a general policy not to inspect agents based on the principle that the supervisor's role is to supervise banks. The supervisors in six of the countries researched for purposes of this Focus Note (all except Mexico) visit agents only as an exceptional measure to deal with particular situations that justify the effort.[30]

Corrective Measures

Supervisors can employ a variety of corrective measures if a bank fails to comply with applicable regulations regarding its agent business, including the following:

- Instructing the bank to develop a plan to address weaknesses
- Requiring additional capital
- Issuing instructions for the bank to take or desist from specified action, including directing the bank

29 As noted, of the seven supervisors interviewed, only CBB conducts regular inspections at bank headquarters focusing on the agent business. CBB completed 47 of such specialized inspections between 2007 and 2010. In 2010, 16 special inspections were conducted to verify practices related to payroll loans.

30 The Mexican Banking Commission is unusual in that it has conducted, *as part of its licensing process*, 22 visits to agents since 2009 when the agent regulations were issued.

to take action against (or on behalf of) an agent or to remedy the misconduct of an agent

- Requiring the bank to terminate an agency agreement
- In the case of an egregious violation of applicable law, prohibiting the bank from further use of agents or from contracting with new agents (e.g., if the bank's agent business has expanded beyond its ability to manage)
- Imposing fines

Although few countries have yet implemented the Basel II operational risk capital requirements, in the countries studied for purposes of this Focus Note, a bank's use of agents would not affect its minimum regulatory capital requirement.[31] However, the operational risk discipline (measurement, assessment, and management, including reserving adequate capital) is evolving (BCBS 2011a) and some supervisors may impose an additional capital requirement for outsourcing. Notwithstanding the absence of regulatory requirements, some banks do reserve capital to cover agent-related risk although quantifying the risk requires data that most banks will not yet have.

As for interacting directly with a bank agent, a supervisor may wish to request information directly from an agent. As discussed, a supervisor may also conduct an onsite inspection of books and premises, in the case of fraud or other situations. However, supervisors may (as is the case in Brazil, Colombia, Mexico, and Peru) take the approach that it will not take direct action against an agent but instead require the bank to do so.

Conclusion

The seven countries studied for purposes of this Focus Note present different models of licensing and

Box 6. Supervisory Findings on Bank Agents in Brazil

CBB has been conducting inspections on the agency business of banks since 2007, when it developed a specialized supervisory program. It has found the following main weaknesses of bank agent businesses:

- Lack of registration of agents in CBB's online system
- Noncompliance of agency agreements with regulatory requirements
- Agents charging unauthorized fees
- Lack of supporting documentation for loan transactions
- Fraud (e.g., noncredited deposits by agents and bank employees, fake agents)
- Agents advancing cash to loan applicants before the loan operation is approved by the bank
- Bank attempts to deflect customer complaints by transferring liability to the agents or ANMs
- Acceptance of loan applications originated by persons with whom the bank does not have an agency agreement

Most of the findings are not of great concern to the supervisor, resulting in only minor corrective measures as agreed with the bank. While CBB considers agent fraud to be a serious problem, it has not been a common problem. The supervisor is most concerned about consumer protection issues related to the extension of credit through agents, such as advance lending prior to bank approval. Many consumer protection-related problems have been due to lack of supervision by the bank of subagents engaged in the outsourced activities, particularly loan origination.

Based on its findings, in 2011, CBB revised the agency regulation to introduce, among other things, stricter rules for the extension of credit. Most importantly, CBB has shifted its supervisory focus from operational risk (which is considered lower now than it was some years ago) to consumer protection issues, including the review of redress mechanisms in agency arrangements.

The use of agents continues to be a minor element of CBB's review of the bank sector, but one that draws the attention of the media and civil society. As a result, it is viewed by the supervisor as a potential source of reputational risk.

31 In contrast, in some countries, branches do impact a bank's minimum capital requirement.

supervision of the bank agent business, ranging from (*i*) minimal or no licensing or supervision (India), to (*ii*) some licensing and some supervision (Brazil), to (*iii*) regulatory approval required of banks and each agent and supervision of all (Kenya). It is too early to determine how specifically the different supervisory approaches impact bank use of agents, although there have been indications that heavy or cumbersome licensing requirements may dissuade some banks from pursuing the model. However, each country's approach will reflect its more general approach to supervision, which is shaped by staffing and other capacity issues (e.g., experience in technology) as well as legal tradition.[32] Supervisors will also likely observe their market and adjust their regulations and supervision in response, as the central bank in the Philippines has done.

At base, it is clear that the focus of risk management as well as risk identification, assessment, monitoring, and reporting should be on material risks. Thus, today, given the relatively limited scope of bank use of agents and the low systemic risk, supervision of bank use of agents should not be too complex and burdensome. Supervisors should be guided by the principle of proportionality—measuring risk against the cost of supervision and bank compliance.[33] A disproportionate approach will negatively impact the growth of the sector. As indicated by the countries researched, the supervision of a bank's agent business appears to be treated generally as a type of outsourcing, although the approaches vary, in part, based on the weight and importance given to the licensing process.

32 E.g., some countries (e.g., Mexico) may have a tradition of regular reporting whereas other countries (e.g., Brazil and Peru) may not.

33 See CGAP (2011) for a discussion of the risks specifically relevant to financial exclusion and the changed risks triggered by increasing financial inclusion.

Annex 1: Supervision of Bank Agents in Six Countries

	Licensing Requirements	Reporting Requirements	Pre-Examination Planning and Analyses	Onsite Inspections of Banks	Onsite Inspections of Agents	Enforcement Powers
Brazil	None	Banks are required to provide information on all agent locations (name, location, services provided) within 5 days of the start of agent operations in a Web-based system of CBB, and keep it updated at all times.	Examination procedures described in specialized inspection manual (not publicly available). Criteria triggering examination (onsite and offsite) include the size of the agent business relative to the bank business, number of agents, complaints reports, results from previous inspections, problems highlighted in the media, and demands from other government agencies, such as the public prosecutor	Examination procedures described in specialized inspection manual (not publicly available). The focus is on the internal controls relative to agent transactions, such as back office processes; monitoring of transactions by the bank; policies to select, train, and dismiss agents; AML systems; complaints handling; and the evaluations of the internal and external auditors.	Only in extraordinary cases. The regulations or supervisory manuals do not identify such cases upfront.	CBB has the power to impose corrective measures to address weaknesses, require suspension of the services through agents, and condition use of agents to prior authorization
India	None (although regulation specifies certain agent criteria and sets a maximum permitted distance between a bank's agent and the nearest bank branch).	None	None	Permitted	Permitted to obtain reports.	Fines and other penalties and enforcement powers as may be permitted by the Banking Regulation Act and applicable regulation.
Kenya	Bank must be licensed (application includes submission of detailed documents, including plan for agent business; feasibility study; draft agency agreement; policies and procedures applicable to provision of services by agents, including technology to be used; risk assessment report; internal audit report regarding adoption of internal controls performed in	Monthly: value, volume, and geographic distribution of transactions; incidents of fraud, theft, robbery; customer complaints, and remedial measures taken.				

(Continues)

Annex 1: Supervision of Bank Agents in Six Countries *(continued)*

	Licensing Requirements	Reporting Requirements	Pre-Examination Planning and Analyses	Onsite Inspections of Banks	Onsite Inspections of Agents	Enforcement Powers
Kenya	readiness for agent business; AML/CFT policies; agent operational policies and procedures). An application must be submitted for each agent that is to include name and location of proposed agent, description of commercial activity for past 18 months, variation from standard contract, services to be performed, declaration by senior officer of suitability of agent, fee.	Annually: report on each agent (names, address, business, date opened, services)	There are no specific examination procedures. The agency business is evaluated as one of the items in general risk analysis of reporting.	Permitted; examination procedures described in specialized inspection manual (not publicly available).	Permitted; examination procedures described in specialized inspection manual (not publicly available).	Any corrective action permitted under the Banking Act, prohibiting bank from continuing to engage in agent business, prohibiting bank from contracting with new agents, revoking agent approval; terminating agency agreement; withholding corporate approvals.
Mexico	Bank must obtain license to sign a contract with each agent. In practice, licensing requests come in bulk and are examined in bulk, but should include the name, location, and operations of each agent. Application includes submission of detailed business plan (including feasibility study) for the agency business and the agent locations, the model agency agreement, a risk assessment related to agents, agent selection criteria, agent training policies, and the bank's written policies and controls to manage agent risks, with focus on operational risk, including internal audits of the agency business. After the documentation is reviewed, the supervisor conducts onsite inspection of a sample of agents, whose size depends on each roll-out plan.	Banks report on a monthly basis: agent names, tax ID numbers, activities, and location; transaction types, amounts, and volumes of each agent. Bank agent's customer complaints are subject to quarterly reports, whereas fees and revenues are not subject to reporting. These reports are submitted through a Web-based system.	Pre-examination planning and analyses are based on written examination guidelines (not publicly available). The only agent-focused examination is the prelicensing inspection, which is done jointly by the IT supervision team and the institution-focused supervision team. Ongoing supervision is based on the information reported by banks on a regular basis as part of the ordinary annual review. Special agent-focused examinations	The focus is primarily on prelicensing onsite inspection. The supervisor also, as a part of its annual review of each bank, reviews the bank's oversight of agent activities to ensure adequate monitoring and compliance with the established operation policies. The main focus of this annual review is the handling of customer complaints (claim management process).	The prelicensing inspection is done on a sample of agents to ensure the systems and staff are adequate and in accordance with the descriptions submitted for authorization purposes. In these examinations the supervisor conducts transactions to test the infrastructure and the readiness of the agent. It includes IT management, infrastructure, information security, operating capacities, operations flow, regulations.	The supervisor has the power to deny approval of the agency business based on the prelicensing examination and require corrective measures by the bank within an established timeline. Ultimately, the supervisor has the power to shut down agent operations partially or totally.

			(outside the annual review) could be triggered by information from such reports (unusual transaction patterns, unexpected change in banks' operational patterns)		A certification review conducted by the bank's Internal Audit or a third party must be conducted before this examination.	
Pakistan	Submit application for branchless banking, including description of services to be offered, certification by bank president/CEO regarding compliance with minimum conditions (adequate risk management process in place; manual on corporate security policy and procedures; business continuity planning process and manual, including a section on electronic banking channels and systems), relevant sections of security and policies manual. Following approval in principle, bank must submit further documentation: banking services to be offered and business objectives, description of electronic banking system and capabilities, list of hardware and software components, description of contingency and disaster recovery plans for electronic banking, copies of service level/agency agreements, evidence of systems testing and user acceptance testing	Quarterly reports on number of new accounts, new agents, and transaction details (number and volume), broken down according to transaction types. Monthly reports of customer complaints of fraud and forgery and the action taken by the bank.	Includes approved organigram; details of computer applications; account opening form, policies, and procedures; approved KYC and due diligence policies for customers and franchise/ merchants; policy for dispute resolution; transactional data; list and description of disputes and fraud cases; primary and secondary site or data center location; inventory list of equipment installed at primary and backup sites; technical and operational manuals.	Permitted. Examination procedures described in specialized inspection manual (not publicly available).	Yes; regulations require full and timely access to internal systems, documents, reports, records, and staff of agent.	Regulation requires banks to establish procedures that include "corrective actions to ensure proactive agent management." Banking Companies Ordinance (1962) gives ability to central bank to direct a bank to take a "recommended" enforcement action, including against agents.

(Continues)

Annex 1: Supervision of Bank Agents in Six Countries *(continued)*

	Licensing Requirements	Reporting Requirements	Pre-Examination Planning and Analyses	Onsite Inspections of Banks	Onsite Inspections of Agents	Enforcement Powers
Peru	Licensing application is for operating the agent channel (i.e., no individual application). The bank is allowed to install as many agents as it sees fit after receiving authorization to operate this channel. Licensing application should include the bank's policies to select and train agents, its risk management procedures regarding agent operations (including liquidity), policies to comply with consumer protection regulations, standard agency agreement, and the opinion of the bank's internal audit	Quarterly reporting on (*i*) the number of agents, including their name and address, and (*ii*) complaints related to agents.	No specific examination procedures. The agency business is evaluated as one of the items in the operational risk examinations.	No specific examination procedures. The agency business is evaluated as one of the items in the operational risk examinations.	No onsite inspection of agents is conducted.	The supervisor has power to require corrective measures that may affect the agency business according to its evaluation of the banks' overall risk management process. These include, e.g., suspension of the agency business or some operations through agents.

Note: Colombia is not included in this table because the supervisor does not supervise bank agent businesses on a regular basis.

Annex 2: Agent Activities and Consequent Bank Risk

AGENT ACTIVITIES	RISKS			
	Operational	**Legal**	**Reputational**	**Other**
Account information (e.g., balance inquiry); providing client with bank statements	Agent error	Violation of privacy/consumer protection rules	Minor—resulting from operational risks	
Receiving loan applications	Data entry error		Resulting from operational risks	
Analyzing credit and personal information of loan applicants	Agent error Data entry error	Violation of consumer protection rules	Resulting from both operational and compliance risks	
Loan disbursement and collection	Data entry error Abusive collection	Violation of consumer protection rules	Resulting from both operational and compliance risks	
Sale of microinsurance (e.g., India)	Data entry error Abusive sales techniques	Violation of consumer protection rules	Resulting from both operational and compliance risks	
Data processing (e.g., receiving account opening applications)	Data entry error		Resulting from operational risks	
Cash-in/cash-out (in some cases, cash-in is limited to collection of small-value deposits; sometimes there are limitations on cash holding and on individual customers' payments and receipts)	Agent fraud, misappropriation of assets, information theft Third-party fraud (particularly due to lack of security systems), theft (including information)	Lawsuits against bank for theft by agents and third parties Violation of account and/or transactional limits Violation of AML/CFT regs	Inability of agent to fund customers' withdrawal requests (due to inability to manage liquidity or otherwise) Other reputational risk resulting from operational and legal risks	If agent doesn't have real-time connection with bank, there can be a risk in the time between customer deposit and deposit by agent with bank. Liquidity shortage due to poor internal controls to monitor agent transactions (although agent-related liquidity risk is most likely not tied to the bank's own liquidity risks).

(Continues)

Annex 2: Agent Activities and Consequent Bank Risk *(continued)*

AGENT ACTIVITIES	RISKS			
	Operational	Legal	Reputational	Other
Bill payments	Agent fraud, misappropriation of assets, information theft Third-party fraud, theft (including information)		Resulting from operational risks	
Processing loan application				Credit: Lax credit risk analysis of loans
Processing government benefits and other payments to customers	Agent fraud, misappropriation of assets, information theft Third-party fraud, theft (including information)		Resulting from operational risks	Liquidity: Liquidity shortage due to poor internal controls to monitor agent transactions (although agent-related liquidity risk is most likely not tied to the bank's own liquidity risks).
AML/CFT (sometimes restricted to limited accounts—e.g., Pakistan; other times restricted to "account opening formalities" with the bank being ultimately responsible—India 9/28/2010)		Noncompliance with AML/CFT regs (ID and verification; monitoring for and reporting on suspicious transactions; recordkeeping)	Resulting from association (even inadvertent) with criminals	
Account opening	Agent fraud		Resulting from operational and legal risks	
Reporting obligations	Agent error			
Any/all activities listed above	Business disruption due to system failure (e.g., utility disruptions, software and hardware failures) Robbery of or other loss to bank's equipment Data leaks or third-party theft due to unencrypted storage of data on agents' information system or unencrypted data communication between bank and agents Excessive or unauthorized fees Agents' general subpar performance	Fines, penalties, damages resulting from supervisory actions Private settlements due to omissions/ commissions of agent	Agent misrepresenting its position regarding the bank Resulting from operational and legal risks	

Bibliography

Basel. 2006. *Core Principles.*

Basel. 2006. *Core Principles Methodology.*

BCBS. 2003. *Risk Management Principles for E-Banking*, July.

______. 2005. *Outsourcing in Financial Services.* Joint Forum: BCBS, IOSC, IAIS, February.

______. 2006. *International Convergence of Capital Measurement and Capital Standards: A Revised Framework—Comprehensive Version.* Basel II.

______ 2011a. *Operational Risk—Supervisory Guidelines for the Advanced Measurement Approaches.* June.

______. 2011b. *Principles for the Sound Management of Operational Risk.* June.

Bold, Chris. 2011a. "Branchless Banking in Pakistan: A Laboratory for Innovation." Brief. Washington, D.C.: CGAP, October.

______. 2011b. "Does Branchless Banking Reach Poor People? The Evidence from Pakistan." Blog post. http://technology.cgap.org/2011/06/07/does-branchless-banking-reach-poor-people-the-evidence-from-pakistan/.

CGAP. 2011. *Global Standard-Setting Bodies and Financial Inclusion for the Poor: Toward Proportionate Standards and Guidance.* White Paper prepared for Global Partnership for Financial Inclusion. Washington, D.C.: CGAP, October.

Committee of European Banking Supervisors. 2006. "Guidelines on Outsourcing." London: Committee of European Banking Supervisors, 14 December. Available at http://www.eba.europa.eu/getdoc/f99a6113-02ea-4028-8737-1cdb33624840/GL02OutsourcingGuidelines-pdf.aspx.

European Central Bank. 2004. "Report on EU Banking Structures." Frankfurt am Main, Germany: European Central Bank, November.

Febraban (the Brazilian Federation of Banks), The Banking Sector in Numbers, 2011, http://www.febraban.org.br/p5a_52gt34++5cv8_4466+ff145afbb52ffrtg33fe36455li5411pp+e/sitefebraban/Setor%20Banc%E1rio%20em%20N%FAmeros%204%2005%20%282%29.pdf (accessed 15 November 2011).

Federal Reserve Bank of New York. 1999. "Outsourcing Financial Services Activities: Industry Practices to Mitigate Risks." New York: Federal Reserve Bank of New York, October.

Flaming, Mark, Claudia McKay, and Mark Pickens. 2011. "Agent Management Toolkit: Building a Viable Network of Branchless Banking Agents." Technical Guide. Washington, D.C.: CGAP, February.

Joint Forum. 2005. "Outsourcing in Financial Services." Basel: BIS, February.

Jack, William, Caroline Pulver, and Tavneet Suri. 2009. "The Performance and Impact of M-PESA: Preliminary Evidence from a Household Survey." Kenya: FSD Kenya, June.

Kumar, Kabir, and Yanina Seltzer. 2011. "Will Brazil's Agents become a Channel for a Wide Range of Financial Services for the Poor?" Blog post. http://technology.cgap.org/2011/06/14/Will-Brazil's-agents-become-a-channel-for-a-wide-range-of-financial-services-for-the-poor?

Laeven, Luc, and Ross Levine. 2008. "Bank Governance, Regulation and Risk Taking." Available at SSRN: http://ssrn.com/abstract=1142967.

Lal, Prakash. 2011. "Boosting the business case for agents." Blog post. http://technology.cgap.org/2011/02/15/boosting-the-business-case-for-agents/#more-3812

Office of Thrift Supervision. 2010. Memo to CEOs re risk assessment, 8 October.

State Bank of Pakistan, Development Finance Group. 2011. Branchless Banking Newsletter. Issue 1. Karachi: SBP, September.

Tarazi, Michael, and Paul Breloff. 2010. "Nonbank E-money Issuers: Regulatory Approaches to Protecting Customer Funds." Focus Note 63. Washington, D.C.: CGAP, July.

______. 2011. "Regulating Bank Agents." Focus Note 68. Washington, D.C.: CGAP, March.

Williams, Julie L. 2005. Remarks before the Conference on Bank Structure and Competition, FRB Chicago, 6 May.

CGAP

No. 75
December 2011

Please share this Focus Note with your colleagues or request extra copies of this paper or others in this series.

CGAP welcomes your comments on this paper.

All CGAP publications are available on the CGAP Web site at www.cgap.org.

CGAP
1818 H Street, NW
MSN P3-300
Washington, DC
20433 USA

Tel: 202-473-9594
Fax: 202-522-3744

Email:
cgap@worldbank.org

The authors of this Focus Note are Kate Lauer, consultant; Denise Dias, consultant; and Michael Tarazi, CGAP. The authors would like to thank the following regulators for the time they spent discussing the issues and providing information and comment: Syed Irfan Ali (State Bank of Pakistan), Benjamín Bernal (Mexican Banking and Securities Commission), Regina Fadel (Central Bank of Brazil), Samuel Jabbie (Bank of Sierra Leone), Daniel Mauricio (Colombian Financial Superintendency), Matu Mugo (Central Bank of Kenya), and Giovanna Prialé (Peruvian Superintendency of Banks, Insurance and Pensions). The authors also greatly appreciate input from Johann Bezuidenhoudt, Abbas Sikander (Tameer Bank), and Chris Bold, Greg Chen, Claudia McKay, and Yanina Seltzer (all of CGAP).

The suggested citation for this Focus Note is as follows:
Lauer, Kate, Denise Dias, and Michael Tarazi. 2011. "Bank Agents: Risk Management, Mitigation, and Supervision." Focus Note 75. Washington, D.C.: CGAP, December.