

# Summary of Mobile Money Study: West Bank & Gaza

A brief summary of findings on the potential for branchless banking to extend access to financial services in the West Bank and Gaza.

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This brief summarizes the findings of a study conducted in August 2008 to assess the feasibility of using information and communication technologies (ICTs) to expand access to financial services in Palestine. In particular, the study examined the use of mobile phones and Point of Sale (POS) devices to facilitate electronic financial transactions outside of traditional brick-and-mortar branches. The goal of the study was to determine whether such “branchless banking” delivery mechanisms could be used to overcome restrictions on movement and increase access to finance in Palestine.

The Palestinian Territories of West Bank and Gaza (hereinafter “Palestine”) are small and densely populated. There is an average of 5.8 people per household, while the average enterprise has only 2.6 employees. Poverty rates vary according to location (rates are much

higher in Gaza than the West Bank) and method of calculation (rates are much higher if calculated according to income rather than consumption). Overall, 57.2% of Palestinians are relatively poor and 46.3% are absolutely poor, if calculated using income figures; the corresponding poverty rates based upon consumption figures are 30.3% and 18.3%, respectively.<sup>1</sup>

There are 21 commercial banks with 161 branches and offices in Palestine. In addition, there are 9 MFIs with 63 branches, and 181 registered money changers. While the financial infrastructure is fairly well-developed overall, it varies dramatically by governorate, with some governorates having much more limited access to banks and other financial service providers. Most members of the population have a bank account but lack access to electronic transaction cards, such as debit, ATM, and credit cards. The ATM and POS infrastructure is similarly imbalanced; for example, 3 of the 16 governorates account for 75% of the total POS devices. Mobile phone use is widespread, with over 1 million subscribers and 81% of households having access to a mobile phone as of 2006.

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<sup>1</sup> “Relative poverty” is defined by the Palestinian Central Bureau of Statistics (PCBS) to refer to a family of six (2 adults and 4 children) that earns less than the minimum monthly expenses for food, clothing, housing, and other expenses such as health care, education, transportation, personal care, and housekeeping supplies. “Absolute poverty” refers to a family of six that earns less than the minimum monthly expenses for food, clothing, and housing alone. See PCBS, “Press Release: Poverty and Living Conditions in the Palestinian Territory, 2007” ([http://www.pcbs.gov.ps/Portals/\\_pcbs/PressRelease/poverty\\_ee.pdf](http://www.pcbs.gov.ps/Portals/_pcbs/PressRelease/poverty_ee.pdf))

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## BRANCHLESS BANKING (BB) MODELS

The technology platforms for BB can be grouped into the following categories:

- POS-based solutions
- Closed systems
- SIM-based mobile banking platforms
- Mobile banking platforms using other technologies, including SMS, WAP, and Java.

The business models for BB include *bank-based models* (in which the customer has a direct contractual relationship with a fully prudentially regulated financial institution); *mobile network operator-based models* (in which the customer's contractual relationship is with a mobile network operator (MNO) and not with a fully prudentially regulated financial institution); and *independent models* (in which the customer's contractual relationship is with a party that is neither a bank nor an MNO).

BB services in Palestine and in the Middle East and North Africa (MENA) region are still in the early stages of development. Services in Palestine are limited – customers may perform debit/ credit transactions on POS devices, and they may access certain account information and receive SMS confirmation of transaction via their mobile phones. Other countries in the region are just beginning to offer BB services. The MNO-based model is being rolled out in Algeria, Tunisia, Egypt, and Iraq, while the bank-based model is being rolled out in Kuwait, Qatar, and Israel.

## IS THERE A CASE FOR BB IN PALESTINE?

To evaluate whether there is a case for BB in Palestine, we first need to understand the benefits of BB delivery mechanisms (as demonstrated in other countries) and consider the use of such mechanisms in the Palestinian country context. Then, we need to focus specifically on the financial services demanded by low-income Palestinians and consider whether BB delivery mechanisms are likely to play an important role in the provision of these services.

### How Branchless Banking Facilitates Access to Financial Services

BB can dramatically reduce the costs of providing and accessing financial services. For example:

- Setting up a retail agent to provide financial services can cost less than 1% of the cost of a full bank branch.<sup>2</sup>
- Estimates of cost savings range from 50-80% per transaction.<sup>3</sup>
- In some countries, BB may be the only way for clients in remote, low-income areas to be able to afford to save, borrow, or transfer funds. In Malawi, some clients have been known to travel as far as 600 km to deposit or withdraw funds.<sup>4</sup> These transportation costs and the opportunity cost of time lost in transit could be reduced through BB.

### Which Financial Services Do Low-Income Customers Demand?

A survey of 1,202 microentrepreneurs in Palestine conducted by Planet Finance concluded that the following financial services were in greatest demand: small-value credit, savings, microinsurance, and to a lesser extent, transfers.<sup>5</sup> Discussions with a variety of sector stakeholders corroborated these findings.

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<sup>2</sup> Kumar et al., "Expanding Bank Outreach through Retail Partnerships: Correspondent Banking in Brazil" World Bank Working Paper No. 85 (2006) (<http://siteresources.worldbank.org/INTTOPCONF3/Resources/363980Retailop101OFFICIALoUSEoONLY1.pdf>).

<sup>3</sup> Nagarajan, G., "Innovations in Financial Service Delivery: Scope and Challenges" (Sept. 2008).

<sup>4</sup> Nagarajan, G., "Innovations in Financial Service Delivery: Scope and Challenges" (Sept. 2008).

<sup>5</sup> Planet Finance, "Microfinance Market Survey in the West Bank and the Gaza Strip," pp9-10 (June 2007) ([http://www.microfinancegateway.org/files/44378\\_file\\_Microfinance\\_Market\\_Survey\\_Final.pdf](http://www.microfinancegateway.org/files/44378_file_Microfinance_Market_Survey_Final.pdf)).

## Would Branchless Banking Accelerate Access to Such Services?

BB expands the network of access points for the deposit, withdrawal, transfer, and receipt of funds, and it does so at substantially lower cost than that of setting up and operating a branch or office. By increasing access points and lowering costs, branchless delivery mechanisms could certainly help to accelerate access to the products listed above if two important prerequisites are met:

- A banking and payments infrastructure is in place that connects all participating financial institutions and gives them the capability to perform all transactions online and in real time. This requires the development of a fully integrated national payment system with a central switch.
- The introduction of new delivery mechanisms is coupled with a strong focus on developing products that meet the expressed needs of low-income Palestinians. Stakeholders emphasized the lack of appropriate products as a greater barrier to access than geographic accessibility.

## WHICH BB TECHNOLOGIES ARE MOST APPROPRIATE?

Given the large number of bank accounts in Palestine, the business models available today, the current regulatory framework, and the Palestine Monetary Authority's (PMA) tolerance for risk,<sup>6</sup> the most appropriate technology would require a security level that permits direct integration into the National Payment System (NPS). Under these circumstances, recommended technologies are a **POS-based platform** and a **SIM-based mobile banking platform**. This would provide the necessary functionality and outreach, while simultaneously addressing the PMA's concerns with respect to transaction security and money laundering. The use of the GSM network to deliver communication on a POS network to enable debit card-based transactions would also significantly extend the BB environment and facilitate the use of electronic banking. As the security is contained in the POS hardware, the method of communication would not have an impact on security. Use of the POS devices could then be extended beyond merely providing debit and credit card processing and could include money transfers, bill payments, and deposits to and withdrawals from accounts.

The most cost-effective way to employ a POS- and mobile phone-based BB solution would be on a shared services model; this would enable the service to be used by all banks on a pay-per-use basis. The use of a centrally hosted service would reduce costs substantially if this were located within the national switching infrastructure.

## WHAT ARE THE COSTS AND BENEFITS?

### Affordability

Using comparative figures of the relative costs of six mobile banking services in four other countries, we estimate the affordability of a branchless banking product in Palestine. The cost of mobile-based banking products varies tremendously among providers and countries. Assuming that the customer uses mobile banking for a full complement of financial services – including cash-in, cash-out, person-to-person transfer, airtime top-up, balance inquiry, purchase, and bill payment – monthly costs (after adjusting for purchasing power parity) range from NIS 4.74 to NIS 45.77.<sup>7</sup>

Using average monthly household income data for Palestine and a financial services affordability benchmark of 2% of income,<sup>8</sup> we estimate that a product similar to South Africa's MTN Banking service

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<sup>6</sup> The regulatory framework and the PMA's perspective on BB delivery mechanisms will be discussed in detail below.

<sup>7</sup> Rotman, Sarah and Mark Pickens, "Mobile Banking Pricing Table." CGAP Technology Program (August 25, 2008) (<http://collab2.cgap.org/gm/document-1.9.5168/Pricing%20-%20blog%20version%20-%20CGAP.xls>).

<sup>8</sup> Finmark Trust estimates that banking services are affordable if they cost no more than 2% of income. See Genesis Analytics, "An Inter-Country Survey of the Relative Costs of Bank Accounts" (March 2005) (<http://www.finmarktrust.org.za/documents/2006/MARCH/interCountrySurvey.pdf>).

(the most expensive of the six services) would be affordable for 53% of the Palestinian population. However, banking services are relatively expensive in South Africa. Using a slightly less conservative estimate based on a service offered by Tameer Microfinance Bank in Pakistan (the most expensive service outside of South Africa), this figure rises to 90 percent.

Under the latter scenario, it is estimated that 7.5% of the potential customer base would need to take up the service each year in order to break even within three years. Given the relatively small population in Palestine, it is unlikely that such services could be provided profitably by a single financial services provider in a competitive environment. Therefore, it is recommended that a BB application be integrated into the national switch, which would substantially reduce costs.

It is important to note that the affordability estimates suffer from significant limitations. For one, since no comparable product has been rolled out in Palestine, it is difficult to estimate the costs with any level of certainty without an in-depth analysis beyond the scope of this initial feasibility study. In addition, mobile banking service costs are adjusted for purchasing power parity (PPP) using a figure that is based upon overall GDP. However, since some products and services are relatively more or less expensive than others within a given country, PPP figures for each country vary significantly depending upon the product or service in question. If the PPP rate for BB services differs considerably from the PPP rate for GDP, this would affect the accuracy of the real cost estimates. Further research and analysis is therefore needed to refine these estimates.

## **FACTORS MOTIVATING AND DISCOURAGING Branchless Banking ADOPTION**

### **Factors Enabling the Adoption of Branchless Banking**

- *Very high mobile phone penetration and extensive cellular coverage.* As noted in the Introduction, mobile phone penetration is very high in the West Bank and Gaza, with 81% of households owning mobile phones. In addition, since Palestine is such a small and densely-populated country, virtually the entire country currently has access to cellular service through the state-owned service provider, JAWWAL. A new provider, Al Wataniya, has just received a license and will begin offering services in the near future. This should further expand the coverage of cellular networks throughout the West Bank and Gaza.<sup>9</sup>
- *Well-educated populace.* Relative to other developing countries, Palestine stands out as a particularly well-educated and literate low-income country. While most Palestinians are still unfamiliar with electronic banking, the average citizen has 14 years of schooling, resulting in a literacy rate of 92.4%.<sup>10</sup> Early evidence suggests that uptake of mobile phone-based financial services is particularly successful in poor countries with high literacy rates and educational attainment.<sup>11</sup>
- *Interest from mobile network operators and banks.* While generally taking a cautious approach, every bank with which we spoke expressed an interest in using BB to expand outreach and deliver more convenient financial services at a lower cost. In addition, one bank, Bank of Palestine, already

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<sup>9</sup> It should be noted as well that there is a significant level of unauthorized competition by Israeli providers, particularly in areas bordering Israel. JAWWAL estimates that Israeli providers cover 80% of the territory of Palestine and capture at least 20% of the total market. Coverage spillage from Egyptian and Jordanian providers in Rafah and Jericho, respectively, also results in some unauthorized competition, though to a lesser extent. See World Bank, "West Bank and Gaza Telecommunications Sector Note – Introducing Competition in the Palestinian Telecommunications Sector." (Jan. 2008)

([http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2008/03/20/000333037\\_20080320052257/Rendered/PDF/429870WPoGZoTe10Box327342Bo1PUBLIC1.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2008/03/20/000333037_20080320052257/Rendered/PDF/429870WPoGZoTe10Box327342Bo1PUBLIC1.pdf)).

<sup>10</sup> CIA, "The World Factbook – West Bank" and "The World Factbook – Gaza Strip" (literacy figures as of 2004, education figures as of 2006). (<https://www.cia.gov/library/publications/the-world-factbook/geos/we.html> and <https://www.cia.gov/library/publications/the-world-factbook/geos/gz.html>.)

<sup>11</sup> Such countries include BB pioneers Kenya, the Philippines, and South Africa. See the CIA Factbook (<https://www.cia.gov/library/publications/the-world-factbook/index.html>.)

has over 1,200 Point of Sale (POS) devices in place<sup>12</sup> and plans to more than double its POS network within the next year. Both mobile network operators (JAWWAL and Al Wataniya) are also interested in offering financial services, particularly through the nonbank-based BB model of providing services directly through electronic money accounts. MFIs expressed less interest in using BB delivery mechanisms than the banks and mobile network operators. In general, they questioned whether the benefits would actually exceed the costs in practice, and they emphasized other priorities for expanding access to finance and improving repayment.

## Challenges to the Adoption of Branchless Banking

*Lack of a National Payment System.* Although the branch, ATM, and POS infrastructure is fairly extensive, these figures paint a somewhat misleading picture, as there is significant duplication of infrastructure. In order to enable the mobile and branchless banking payment transactions to be cleared and settled between financial service providers, the infrastructure must become interoperable. The PMA expects to have an Automated Clearing House (ACH) in operation by 2010. However, an ACH does not provide the functionality of a national switch; this will need to be integrated into all the banks to allow for the connection of all ATM and POS devices. Therefore, it will be necessary to create a well-functioning central processing system. This requires not only the development of a national switch but also the capability to perform the centralized processing – including trained personnel to fill the clerical roles. It will also be important to provide direct or indirect system access to other financial service providers who provide services to low-income Palestinians, such as MFIs

*Restrictions and gaps in the regulatory framework.*<sup>13</sup> A significant number of restrictions and gaps in the regulatory framework will need to be addressed to ensure that agent-assisted branchless banking is legal and that it addresses all significant risks to providers, consumers, the payment system, and the financial system as a whole. Key issues to be addressed include:

- **Outsourcing financial transactions to retail agents:** The PMA issued a circular in 2007 addressing the outsourcing of important activities that could expose a bank to operational, legal, or other risks.<sup>14</sup> While the circular does not expressly prohibit outsourcing financial transactions to retail agents, the PMA has clearly stated that it is not prepared to approve an application to conduct agent-assisted branchless banking in the near future. The PMA clarified that the circular was intended to address *non-core* banking services. This could include mobile phone or Internet banking schemes that do not require the use of agents (such as accessing bank information over the mobile phone), but it does not include the use of agents for deposit-taking, withdrawals, or money transfers.

If the PMA decides in the future to permit financial service providers to outsource core banking services to agents, it will need to establish conditions for the use of agents, such as the following:<sup>15</sup>

- Holding the principal (bank or other service provider) liable for the actions of its retail agents.
- Guaranteeing that the PMA has access to data related to the agents' operations, which the PMA can obtain either through the bank or directly from the agent.
- Requiring PMA approval of agents who will provide core services such as deposit-taking, withdrawals, and account opening.
- Ensuring that consumers have a right of redress to the principal if they experience problems with a transaction at a retail agent.

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<sup>12</sup> Statistics from the Palestine Monetary Authority on "ATMs and Payment Cards at the end of June 2008."

<sup>13</sup> In conducting the regulatory analysis, the authors made extensive use of a Branchless Banking Diagnostic Template designed by CGAP in cooperation with DFID. The authors are grateful to CGAP and DFID for developing and sharing this valuable template.

<sup>14</sup> See Circular 2007/52, *Organization of Outsourcing Activities*.

<sup>15</sup> See Lyman et al., "Regulating Transformational Branchless Banking: Mobile Phones and Other Technology to Increase Access to Finance." CGAP Focus Note No. 43 (Jan. 2008) ([http://www.microfinancegateway.com/files/46734\\_file\\_FocusNote\\_43.pdf](http://www.microfinancegateway.com/files/46734_file_FocusNote_43.pdf)); Lyman et al., "Use of Agents in Branchless Banking for the Poor: Rewards, Risks, and Regulation." CGAP Focus Note No. 38 (Oct. 2006). ([http://www.cgap.org/gm/document-1.9.2585/FocusNote\\_38.pdf](http://www.cgap.org/gm/document-1.9.2585/FocusNote_38.pdf)).

- Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT): In order to comply with international AML/CFT standards, most countries (including Palestine) require banks and other financial service providers to perform extensive Customer Due Diligence (CDD) on potential customers, particularly when they are opening an account or effecting a money transfer. CDD requirements vary somewhat by country, but most countries require at a minimum the production of an official identity document, along with proof of residence. This can create a barrier to access in countries where a large percentage of the low-income population lacks official identity documents, utility bills, or even a formal address.

On the positive side, lack of access to identity documents is not a problem in Palestine. Virtually everyone receives an official document at the age of 16, and children younger than 16 are listed on their parents' identity documents.

However, the Financial Follow-up Unit (FFU – the administrative body responsible for ensuring that banks comply with money laundering requirements) is very young, understaffed, and lacks both sufficient expertise and the necessary hardware and software to effectively monitor large and suspicious transactions. In addition, a key priority for the FFU is to try to rein in the money changers, many of whom facilitate both domestic and international transfers without following CDD requirements, and who lack an electronic system for record-keeping and reporting. Introducing a new electronic delivery channel into such an environment could increase the risks of money laundering or terrorist financing, which is why both AML/CFT experts and key PMA staff would oppose taking such a step until the FFU is well-established and has the capacity to effectively monitor BB transactions.

- Electronic Money (E-Money): Currently, there are no regulations defining e-money or providing guidelines on the types of providers who could issue e-money, and under what conditions. While some banks feel they could issue e-money without PMA approval, the PMA has stated that it would have to approve any proposed e-money scheme. In addition, the PMA does not intend to permit nonbanks (including MNOs) to issue e-money in the foreseeable future, as they do not perceive a significant need for such services, and they consider the risks to be quite high.
- Electronic Commerce/Electronic Security: The regulatory framework for e-commerce and e-security is not fully developed. The PMA recognizes the need for clarity with respect to the certification and legal effect of electronic signatures, and it has stated that this issue will be addressed in the law and regulations on payment systems. Initial drafts of the law and regulations have been created, and the new Payment Systems Law is scheduled to be enacted by March 2009.<sup>16</sup> In the interim, banks are following their own internal policies, although they recognize the need for an appropriate regulatory framework, particularly as the volume of electronic transactions continues to increase.
- Consumer Protection: BB delivery mechanisms raise specific consumer protection concerns resulting from conducting transactions through retail agents. Key issues include the lack of clarity over whether the principal or the retail agent is legally responsible to the customer; the risk that a retail agent could defraud a customer; and the greater difficulty of ensuring price transparency when services are provided through a retail agent, rather than directly through a bank.<sup>17</sup>

Since agent-assisted banking is currently not permitted in Palestine, corresponding consumer protections for services provided by agents are not yet in place. In addition, the general consumer protection framework for banking services is still developing. The consumer protection framework will be improved considerably following the passage of the Fair Credit Act that is currently being drafted. This act will clearly explain to the customer her rights and

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<sup>16</sup> PMA, "Vision and Action Plan for the Palestine Payment System" (Sept. 19, 2007).

<sup>17</sup> CGAP, "Branchless Banking Diagnostic Template" (public comment draft of February 2008).

responsibilities; describe the means of calculating interest; require the disclosure of total interest, fees, and other costs on the front page of the contract, in large print; specify what happens in case of default; ensure that all fees that are charged are related to actual services provided; and assess a fine on any bank that asks a customer to sign a blank loan agreement.

- **Payment Systems:** Currently, there is no National Payment System in Palestine, and no law on payment systems has been enacted. As discussed earlier, the PMA is developing a law and regulations on payment systems, and it hopes to have the law enacted no later than March 2009.

The current law is still in an early draft stage, and the PMA is seeking feedback from payment system experts. One key issue the law and regulations should address is the need to prevent anti-competitive behavior and to ensure competition in the market for payment services. The draft regulations would appear to give the PMA broad latitude in this regard, permitting the PMA to establish and vary rules on access to designated payment systems.<sup>18</sup> In addition, the draft regulations permit an organization that has been denied access to a designated payment system to petition the PMA, which can then direct the designated payment system to allow access.<sup>19</sup>

*PMA reservations.* At the present time, it is clear that the PMA is not prepared to embrace agent-assisted BB, whether bank-based or nonbank-based. Currently, the PMA views the use of agents to provide deposit-taking, withdrawals, or money transfers as a risky proposition whose benefits are far outweighed by the potential risks. This opposition is largely due to money laundering concerns, given the youth of the formal financial sector, the lack of a well-developed legal framework, and the absence of a national payment system (NPS). These concerns are magnified in Palestine, where even the perception of banks' involvement in money laundering or terrorist financing can lead to lawsuits,<sup>20</sup> and where the PMA has gone to great lengths to isolate itself from politics in the West Bank and Gaza. Anecdotal evidence of the use of prepaid cards to launder money in wealthy countries has convinced the PMA that opening up the financial sector to new payment methods before a fully-functional NPS and regulatory framework are in place would be unwise.

*Conservative banking sector.* As a consequence of political instability, most commercial banks – particularly the non-Palestinian banks – invest largely outside of Palestine. While the PMA stipulates that banks should lend out at least 40% of deposits in Palestine, in practice only 22% of deposits are lent out, and the 40% requirement is not enforced.

Of the lending services that banks do provide within Palestine, little is directed at micro and small enterprises, leaving most microenterprises starved for capital. Most commercial banks do not understand microfinance, and they do not know how to work with small and micro enterprises.<sup>21</sup> As a result, they view this market as high-risk and generally lend only to enterprises that can fully collateralize the loan. It is, then, no surprise that lack of collateral is the most common reason for denial of credit to microentrepreneurs.<sup>22</sup>

*Consumer education/financial literacy needs.* High rates of mobile phone penetration, a well-educated populace, and an expanding network of ATMs and POS devices would suggest that Palestine is well-suited to rapidly adapt to using mobile phones and POS devices to access financial services. However, due to the collapse of the banking sector following the 1967 war and subsequent Israeli occupation, many consumers did not grow up using banks. As a result, overall financial literacy is relatively low. In

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<sup>18</sup> PMA, "Payment and Securities Settlement Systems Oversight Regulation" (draft of Sept. 2007), Art. 6.8.

<sup>19</sup> PMA, "Payment and Securities Settlement Systems Oversight Regulation" (draft of Sept. 2007), Art. 10.

<sup>20</sup> See, e.g., CBS News, "Arab Bank Sued over Israel Terror"

(<http://www.cbsnews.com/stories/2004/07/06/terror/main627703.shtml?CMP=ILC-SearchStories>).

<sup>21</sup> An exception is Al Rafah Microfinance Bank, which uses solidarity lending, accepts nontraditional collateral, and offers incentives for on-time repayment.

<sup>22</sup> Planet Finance, "Microfinance Market Survey in the West Bank and the Gaza Strip," p33 (June 2007)

([http://www.microfinancegateway.org/files/44378\\_file\\_Microfinance\\_Market\\_Survey\\_Final.pdf](http://www.microfinancegateway.org/files/44378_file_Microfinance_Market_Survey_Final.pdf)).

addition, most low-income customers are used to transacting in cash, and many MFI customers are intimidated by new technologies.

To address financial literacy needs, the PMA is adding lessons on financial literacy to the school curriculum and is developing a Fair Credit Act that will require banks to provide customers with detailed information on interest rates, fees, and their rights and responsibilities.

*Lack of appropriately designed products for low-income/microenterprise market.* As discussed earlier, the most important barrier to access to financial services in Palestine is the lack of appropriate financial products for the low-income market, not the lack of innovative mechanisms to deliver such products to clients. Lower-cost delivery mechanisms will fail to measurably increase access to finance unless banks and MFIs are able to develop financial products that truly meet the needs of microentrepreneurs and low-income citizens.

*Well-established bank and money changer infrastructure.* Bank-based BB models have generally been used to expand banks' outreach into areas where a branch would not be cost-effective.<sup>23</sup> Nonbank-based BB models that target the poor have seen the most success in countries where access to money transfer services is limited.<sup>24</sup> Palestine – being a small, densely-populated country with a fairly extensive bank and money changer infrastructure – fits neither scenario.

## **RECOMMENDATIONS**

### **Support the Development of the National Payment System**

To expand access to finance through electronic transactions in Palestine, it is critical to facilitate transactions and payments between banks. The PMA is in the process of developing the systems required to automate the settlement process. However, in order to also integrate ATMs, POS devices, and mobile phone-based banking into the national payment system, a national switch needs to be developed and implemented. This switch should be able to integrate into the clearing and settlement system, the banks, and the credit card associations. It must be fully secure, and fraud management systems and mobile-based application standards should be built in.

Once this has been achieved, the operational processes need to be mapped to address reconciliation and mark-off processes, settlement timing, inter-bank dispute resolution, customer queries, and fraud management. A pilot usability application should be built before finalizing designs, and customer usability tests should be conducted.

Finally, the building and implementation of the switch can commence. System operators must be trained properly, and customer education strategies need to be implemented.

### **Create an Enabling Legal Framework for the Payment System and for Branchless Banking**

Given the critical role of a National Payment System (NPS) in lowering costs, increasing electronic activity, reducing AML/CFT risks, and expanding access to finance, creating an enabling legal framework for the payment system should be an important priority. The PMA's Payments Division is energetic but understaffed, and they would welcome legal and payment system expertise as they proceed with their plan to enact a Payment Systems Law by March 2009 and have a fully-functional NPS in place by 2015.

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<sup>23</sup> For example, remote municipalities with low population density in Brazil.

<sup>24</sup> For example, M-PESA in Kenya.

Once the legal framework for the NPS is in place, attention should be turned to the legal framework for BB. The gaps and limitations noted in the “Challenges” section should be addressed before rolling out BB in Palestine.

### **Ensure Proper Sequencing/Timing**

While branchless banking has generated a great deal of interest from a variety of stakeholders, BB delivery mechanisms create new risks related to the use of retail agents to process transactions and the issuance of electronic money by MNOs and other non-banks. Financial service providers, retail agents, and customers must address the operational, reputational, credit, liquidity, consumer protection, and AML/CFT risks that BB delivery mechanisms can create.<sup>25</sup>

These risks are real, and some problems have already surfaced in other countries, including Brazil (retail agent fraud and robbery),<sup>26</sup> Kenya (consumer protection),<sup>27</sup> and wealthy countries (money laundering).<sup>28</sup> Given the weak legal framework; the limited capacity to monitor transactions to detect money laundering; the absence of an NPS; and the pressing need to avoid even the impression that the formal financial sector is being used to launder funds or finance terrorism, rollout of an additional electronic transaction channel in Palestine in the short term would be inadvisable. Proper sequencing is important: prior to approving the use of BB as a transactional technology, the AML/CFT framework and the NPS should be fully operational; the legal framework governing electronic transactions should be well-developed, and the PMA should have sufficient capacity to monitor BB activity and ensure that BB providers are properly addressing the relevant risks.

### **Analyze Product Design and Methodology Constraints that Currently Limit Financial Access**

While the issues of product design and methodology are ostensibly outside of the scope of this study, the success of BB as a delivery mechanism will invariably depend in large part upon the ability of providers to design appropriate products, establish key partnerships, and provide clients with incentives to repay microloans. Some banks are beginning to explore risk-sharing mechanisms, including partnerships with other value chain actors and donor-supported first-loss loan guarantees. Expanding banks’ and MFIs’ views of what is acceptable collateral – including greater use of group guarantees, moveable assets, gold, livestock, and inventory – will help,<sup>29</sup> as will the development of customer credit histories through the submission of bill payment and microloan repayment information to the nascent credit registry. By addressing product design/methodology issues now, providers and customers will be able to take full advantage of BB delivery channels once the necessary macro- and meso-level infrastructure for BB is put in place.

### **Build the Institutional Capacity of the MFI Sector**

Currently, the PMA believes that MFIs have weak Management Information Systems and are not financially self-sufficient after accounting for all donor support. Unless MFI capacity is improved, the PMA is unlikely to permit MFIs either to use retail agents to expand access to finance or to act as retail agents on behalf of banks or MNOs.

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<sup>25</sup> See CGAP, “Use of Agents in Branchless Banking for the Poor: Rewards, Risks, and Regulation.” Focus Note No. 38 (Oct. 2006) ([http://www.cgap.org/gm/document-1.9.2585/FocusNote\\_38.pdf](http://www.cgap.org/gm/document-1.9.2585/FocusNote_38.pdf)).

<sup>26</sup> See CGAP, “Use of Agents in Branchless Banking for the Poor: Rewards, Risks, and Regulation.” Focus Note No. 38 (Oct. 2006) ([http://www.cgap.org/gm/document-1.9.2585/FocusNote\\_38.pdf](http://www.cgap.org/gm/document-1.9.2585/FocusNote_38.pdf)).

<sup>27</sup> Business Daily Africa, “Regulators Pass the Buck on Risks Posed by M-Pesa” (Aug. 4, 2008) ([http://www.bdafrica.com/index.php?option=com\\_content&task=view&id=9118&Itemid=5822](http://www.bdafrica.com/index.php?option=com_content&task=view&id=9118&Itemid=5822)).

<sup>28</sup> Sienkiewicz, S. “Prepaid Cards: Vulnerable to Money Laundering?” Federal Reserve Bank of Philadelphia: Discussion Paper (Feb. 2007) (<http://www.philadelphiafed.org/pcc/papers/2007/D2007FebPrepaidCardsandMoneyLaundering.pdf>).

<sup>29</sup> USAID, “Study on Options, Management and Enforcement of Collateral for Microfinance Loans in the West Bank and Gaza Strip.” FIELD Report No. 4 (Nov. 2007) ([http://www.microlinks.org/ev.php?ID=23758\\_201&ID2=DO\\_PRINTPAGE](http://www.microlinks.org/ev.php?ID=23758_201&ID2=DO_PRINTPAGE)).

However, if sufficient institutional capacity is proven, the PMA is receptive to the possibility of permitting select MFIs to accept voluntary savings from clients and deposit these funds in a pooled bank account in the MFI's name. This would be an important first step towards full mobilization and intermediation of voluntary savings, which MFIs view as critical to meeting the needs of low-income Palestinians. BB delivery mechanisms could help to facilitate savings mobilization, particularly in areas that are relatively far from MFI or bank branches. By developing their institutional capacity today, MFIs hopefully will be able to join banks and other providers in using branchless delivery mechanisms in the not-too-distant future.