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Somalia

Regulatory Digest

In Somalia and other parts of Africa, Electronic Mobile Money Transfer (E-MMT) providers are becoming systemically important operators whose failure, or potential service outage, could create significant civil and economic disruption. ***Part One*** *of this Issue provides insights into the risks and benefits of E-MMT business models and why regulating them effectively must be a top priority.*

Overview

Part 1: The economically important functions of E-MMT providers

On the 1st of June 2018, VISA, one of the global electronic money transfer giants, suffered network outage that impacted all card clearing services globally. Whilst the outage lasted for a few hours, the impact on businesses and individuals was considerable. More recently, in the United Kingdom, a technology glitch in one of UK’s biggest banks – TSB, led to significant disruption in payment clearing for customers, lasting several weeks.

In the summer of 2017, an internet outage caused significant disruption across many cities in Somalia, including Mogadishu. This had a huge commercial impact on the operations of companies and cut off all internet-based telephony services for several weeks. This issue also showed that a number of critical service providers in Somalia did not have basic operational continuity planning in place to mitigate these foreseeable operational risks.

In today’s cashless society, one important thing that these and many other events, whether they happen in advanced economies or in Somalia, have in common is that disruptions like these are always possible with real and immediate impact on customers. If unmitigated, the financial consequences could be profound not only for service users but could imperil entire economies. These risks are particularly elevated in a country like Somalia where service users have no regulatory safety net if they were to lose their funds overnight.

Regulatory Digest

The Regulatory Digest focuses on financial services innovation and regulation in Somalia. It is intended to help regulators and businesses understand and identify financial/non-financial risks and implement good practices.

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An important and key regulatory objective in many countries is therefore ensuring the contingency planning of the companies that provide critical financial services infrastructure remains robust and ensures service continuity in periods of crises.

The question of how best to regulate Electronic Mobile Money Transfer (E-MMTs) operators is therefore quite an important one, especially in Somalia where the regulatory oversight is non-existent. Somalia's E-MMT operators provide both internal payment clearing, depository and remittance facilitation services, making them systemically important companies. The sudden default, or disorderly failure, of one of these key operators is likely to have profound and damaging social and economic consequences for Somalia's economy and its people.

"Ii Soo Tuur" – How E-MMTs work

Somalia's E-MMT network is a modified version of the well-known M-PESA system (the then ground-breaking money transfer system which was launched in Kenya in 2007). An E-MMT system allows customers to send and receive electronic money nationally and internationally, buy goods and services and settle bills – all through the touch of a button. It is an innovation that has transformed Somalia's economy, providing convenient payment and clearing settlement for millions of Somalis. It is also an innovation whose development created significant macroeconomic, competition and systemic financial infrastructure risks.

Muhiimadda ugu weyn waa in ay shirakaddaha lacagaha moobiladda ka fikiraan sidii ay u keeni lahaayeen nidaam kor u qaadi kara kalsoonidda macaamiishooda. Tusaale ahaan, in ay ku fikiraan nidaam magdhow ah hadii ay dhibaato timaado, geedi socodka hawlgalka lacagaha haddii ay dhibaato timaado, IWM. Shirkadaha ku guuleysta arrimahan ayaa helaaya aqoonsi weyn, adeegyadoodana garsiin kara meel walba oo dhan, xitaa wadanka dibaddiisa.

E-MMT is not a mobile banking system, although some of the features include "banking" facilities...

The main function of the E-MMT is the transfer of funds, either via person-to-person or person-to business. At its simplest, it is best to think of it as a mobile voucher system where one tops up credit and uses that credit for airtime (in this case to buy goods/services with it) or transfer the cash – all within the same company's network.

Some E-MMT providers are large organisations that include banking institutions. However, most of those that have the E-MMT facilities do not have bank accounts into which their mobile services are linked. Users are therefore unlikely to accrue any value, in terms of enhanced credit standing, from its use. This is one of the key reasons E-MTT systems cannot provide the level of service traditional mobile banking would.

E-MMT is a closed system which does not allow inter-network transfer facilities…

E-MMT users must transfer funds within the same companies. For instance, User 1 who is on Network A must use that company's network to transfer funds electronically to User 2 who must also be on the same Network A. There is no option to transfer funds to another user in a different network. Most users have multiple SIM cards to use when transacting across multiple networks. This is a key limitation of the system as it inhibits competition, economic innovation and is costly for users.

E-MMT system is also closed to the Somali Shilin and can only be used in the USD…

Unlike other African countries, the E-MMT system in Somalia is closed to the Somali Shilin. There are many reasons for this, including the network operators' preference for the USD and the widely counterfeited nature of the Shilin which makes it impossible to be accepted as a medium of exchange.

Somalia's E-MMT System: convenient but little economic or consumer benefits

The M-PESA system, from which the different versions of the E-MMTs we see today are derived, was hailed as the new way of bringing millions of the world's poorest into the financial system. For the system to succeed, it was imperative to create an accommodative regulatory environment through light-touch banking/telecommunication regulation. This is why the system created significant enthusiasm amongst policymakers and international donors as the way of supporting the economic development aspirations of the world's poorest economies.

However, in many countries in Africa and elsewhere, the success of the E-MMT system was varied and often disappointing and we are yet to see the predicted explosive penetration of this business model. This is generally for one reason: the inherent risks in E-MMT's business models are largely disproportionate to their economic benefits and many regulators are wary of the potential material downside risks.

In my view, an unregulated (or loosely regulated) E-MMT system has the potential to inject significant risks into an economy, is inefficient as regards to the cost paid by service users and inhibits innovation by restricting competition. Somalia is an important case in point and provides key lessons for the sort of regulatory approaches needed to ensure consumer protection and financial stability remain at the heart of any regulatory framework.

Some of the key risks and issues E-MMT business models include:

(i) Competition and Innovation

E-MMT operators generally start as large telecommunication companies with significant mobile coverage. This creates a natural barrier to entry for new nimble operators as the cost of building and operating mobile coverage is a long-term and prohibitive investment. As the largest companies push for market share, so will the share of their payment clearing system and more people are forced to join that network for ease and convenience (or take advantage of service extras such as free minutes/texts). Without new competition, users get sub-optimal service because of absence of the incentive to innovate or provide value for money for service users.

(ii) Market Access

E-MMT companies do not provide inter-network transfer facilities, limiting the users' market access and concentrating systemic risks amongst largest market participants. It also means the service is not available to everyone across the country where users would have benefited the most (e.g. in rural areas where use of cash may pose a security risk). For other frequent users (such as merchants), it increases their transaction cost as they are forced to accommodate their customers' multiple payment networks. A significant capture of the market by the largest networks is not economically sustainable, is problematic from a systemic risk perspective and does not provide value for consumers.

(iii) Macroeconomic

E-MMTs are only open to the USD and not Shilin Soomaali and this has quite profound economic consequences: Somalia's poorest who rely on the Shilin for their day-to-day subsistence are completely locked out of the system altogether, creating two parallel economies in most cities in Somalia. Whilst this issue is not all due to the E-MMT operators, the facilitation of USD money flow through E-MMT system exacerbates galloping inflation by increasing dollarization of the economy, devaluing the Shilin to almost a worthless currency.

(iv) Financial Stability Risks

(a) Safety of customer funds

An important justification for regulating the E-MMT operators is the critical economic function they perform. E-MMT companies handle large amounts of customer funds every day (anything from salary payments, remittances, payment clearing, merchant receipts and other transactions) without any regulatory oversight.

The safeguarding of the customers' funds is entirely left to the companies to manage and there are no regulatory safeguards in the event the potential loss of funds. As a consequence, if these operators were to fail or default overnight, the cost to the economy and detriment to customers, whose livelihoods are on their E-MMT wallets, will be hugely catastrophic.

(b) Financial Stability

There is no regulatory scrutiny of the effectiveness of the E-MMT companies' contingency and operational continuity plans in case of disruption or failure which will result in major economic and civil disruption. Nor have any of their contingency preparations tested. The absence of a systemic oversight of their systems and governance continues to be a major regulatory weakness and an unmitigated risk.

(c) Liquidity Risks

E-MMT operators act as de-facto cash clearing centres and provide important standby liquidity facilities to companies and consumers when there is a need for USD hard cash. However, the profitability of the E-MMT business model relies heavily on customers' continued use of funds in mobile wallets, rather than actual cash. If there were to be a loss of market confidence in one of the operators, resulting in a sudden increase in cash demand / redemptions or a run on an E-MMT company, the liquidity stress could lead the operator's failure and will create a domino effect. This is another material inherent risk which the E-MMT business model creates.

(v) Service Disruption: High Impact / High Likelihood Events

Given the importance of the E-MTT to the financial system, there are no enhanced service continuity regulatory requirements to ensure they have appropriate systems in place to deal with major disruption events, including operational risks events (cyber-attacks, system outages, people and process risks, etc.). The current system relies heavily on the untested assumption that the E-MMT operators have appropriate service continuity planning in place to deal with these risks.

A New Approach to Regulation

This analysis does not suggest that all E-MMT operators are detrimental to economies and consumers and should be regulated out of existence. The E-MMT business model is an important innovation which has improved the economic activities of millions of Somalis and continues to facilitate important economic activities across the country.

What is needed is a new regulatory approach which recognises the risks in the E-MMT innovation, protects consumers and opens the market to competition and innovation. Key to this is the development of new regulatory requirements that are proportionate to the scale and risks the different E-MMT business models create.

Part 2 of this Digest will set out the regulatory framework that strikes a careful balance between the emphasis on consumer protection and the need to encourage E-MMT market innovation and competition.

Figure 1

Illustration 1: Electronic Mobile Money Transfer (E-MMT)