MACMILLAN KECK
New York ● Geneva

Regulation of cross-border non-bank remittances in the Philippines-Malaysia corridor

Prepared for
CGAP

Rory Macmillan and Jason Blechman

MACMILLAN KECK
ATTORNEYS & SOLICITORS

www.macmillankeck.pro

June 2019

DISCLAIMER

This work was funded in whole or in part by CGAP. Unlike CGAP's official publications, it has not been peer reviewed or edited by CGAP, and any conclusions or viewpoints expressed are those of the authors, and they may or may not reflect the views of CGAP staff.

Table of Contents

1. Introduction

This study examines the regulatory conditions that have helped to shape markets for international remittances provided by non-banks in Malaysia and Philippines. It focuses on the flow of remittances from Malaysia to Philippines, which is substantial (USD 1.86 billion in 2016), and only secondarily addresses the flow in the opposite direction, which is miniscule (less than USD 1 million in 2016).[1]

That said, in both jurisdictions, we found that regulatory policy decisions are rarely (if at all) driven by factors unique to a single corridor. This study primarily addresses only the legal, regulated market for remittances, i.e., those services provided by licensed or registered "remittance service providers" (RSPs). We understand that there are still significant illegal, informal markets for remittances in both countries.

1.1. Terminology

We have adopted the definition of "remittances" used by the Bank for International Settlements' (BIS) Committee on Payments and Market Infrastructures (CPMI), i.e., "cross-border person-to-person payments of relatively low value."[2] While remittances are a P2P service, they are part of a broader range of "cross-border retail payments" that also includes payments sent or received by businesses and government agencies.[3] We use the term "digital remittances" to refer to those remittance services through which the sending consumer uses a mobile app, SMS or the internet to initiate a transfer.

We have focused on RSPs that are "non-banks," the providers most frequently used by sending migrant workers and their recipients in the corridor. We have adopted a modified version of the definition espoused by the BIS CPMI, i.e., "any entity in the provision of [remittance] services whose main business is not related to taking deposits from the public and using these deposits to make loans."[4]

For the sake of clarity, we consistently refer to the person sending a remittance as the "sender" and the person ultimately receiving the remittance as the "recipient." Similarly, we refer to the

---

[1] Pew Research Center, http://www.pewglobal.org/interactives/remittance-map/

[2] *General principles for international remittance services*, Committee on Payment and Settlement Systems, Bank for International Settlements and World Bank, January 2007 at p5. Remittances are a form of what the Financial Action Task Force refers to as Money Value Transfer Service: "Money or value transfer services (MVTS) refers to financial services that involve the acceptance of cash, cheques, other monetary instruments or other stores of value and the payment of a corresponding sum in cash or other form to a beneficiary by means of a communication, message, transfer, or through a clearing network to which the MVTS provider belongs. Transactions performed by such services can involve one or more intermediaries and a final payment to a third party, and may include any new payment methods. Sometimes these services have ties to particular geographic regions and are described using a variety of specific terms, including hawala, hundi, and fei-chen." See the FATF Glossary at http://www.fatf-gafi.org/glossary/j-m/.

[3] "Cross-border retail payments" have been defined by BIS CPMI as "funds transfers of relatively low value and urgency where the parties to the payment are end users (i.e., individuals, businesses or government agencies) and the payer and the payee are located in different (national) jurisdictions." *Cross-border retail payments*, Committee on Payments and Market Infrastructures, Bank for International Settlements, February 2018 at p33.

[4] *Non-banks in retail payments*, Committee on Payment and Settlement Systems, Bank for International Settlements and World Bank, September 2014 at p4.

RSP through which the sender initiates a transaction with as the "sending RSP" and the RSP from which the recipient receives the remittance as the "receiving RSP."

The regulatory frameworks of Malaysia and Philippines use differing terminology for licensed or registered non-bank remittance service providers. For example, remittances are a "money services business" in Malaysia and are carried out by "remittance transfer companies" in Philippines. When referring to those markets specifically in the context of the regulatory frameworks, this report adopts the terminology of the applicable frameworks.

1.2. Methodology

We first gathered information through desk research, reviewing the relevant legal, regulatory and policy instruments of each jurisdiction, and global trends in remittances as well as in the local markets.

Next, we conducted 4-5 days of field interviews in each of Kuala Lumpur, Malaysia and Manila, Philippines. During those visits we interviewed regulators and RSPs in each market.

2. Background on the two markets

2.1. Malaysia

2.1.1. Remittances market background

There are currently an estimated 1.8 million foreign workers in Malaysia.[5] In 2017, nearly USD 6.19 billion was sent out of Malaysia as remittances, with USD 1.96 billion sent to Philippines, a destination country second only to Indonesia at USD 2.15 billion.[6]

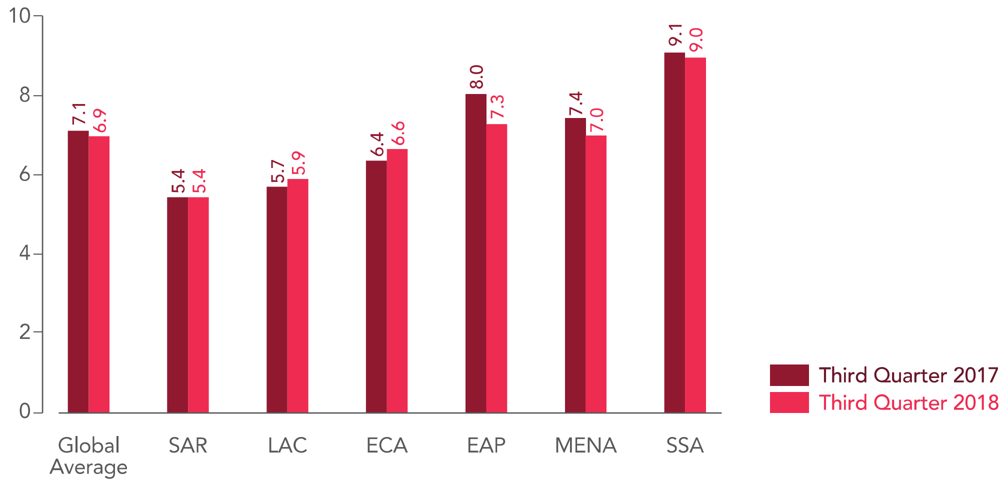
Average costs of remittances sent from Malaysia today are reportedly below the UN's SDG target of 3%. This is significantly lower than the global average costs of 7.1% in 2017 and 6.9% in 2018 and the average regional costs of 8.0% in 2017 and 7.3% in 2018 (see Figure 1). While we could not confirm this independently, all of the RSPs we interviewed agreed that Malaysia's retail market is extremely low cost and extremely competitive.[7]

[5] Meeting with the BNM, 26 November 2018.

[6] Pew Research Center, http://www.pewglobal.org/interactives/remittance-map/

[7] Meeting with the BNM, 26 November 2018.

Figure 1: Average cost globally and by region of sending USD 200, 2017-18 (percent)



Note: EAP = East Asia and Pacific; ECA = Europe and Central Asia; LAC = Latin America and the Caribbean; MENA = Middle East and North Africa; SAR = South Asia; SSA = Sub-Saharan Africa.

Source: Reproduced from World Bank & KNOMAD, Migration and Remittances, Recent Developments and Outlook, Migration and Development Brief 30 December 2018, at 5. Cited source is World Bank staff estimates using Remittance Prices Worldwide Database.

Digital remittances have recently emerged in Malaysia. The BNM estimates that use of digital remittances as a share of total remittances grew from 4% in 2016 to 8% in 2017 to about 10% in 2018.[8] Today, 20 of Malaysia's 36 licensed RSPs offer digital products,[9] and six of those offer digital products only.[10] However, RSPs we interviewed who provide both apps and traditional branch/agent networks confirmed that apps comprised a small percentage of their overall transactions.

The BNM expects the move toward digitalization to further reduce front-end and back-end costs.[11] However, nearly all interviewees expressed the belief that migrant workers have been and are likely to continue to be reluctant to embrace digital remittances. Some suggested that a large number of migrant workers view handing over cash to a real person as more secure and reliable than a digital transaction.[12] Migrant workers are also sometimes able to negotiate reductions to posted foreign exchange rates at branches, particularly if they aggregate the anticipated remittances of fellow workers and obtain volume discounts.[13]

Many retail RSPs with foreign partnerships have also begun opening their payout networks to competitors.[14] This has allowed RSPs to widen their network reach of recipient RSPs while maintaining competition on the retail sending side.[15] It has also permitted RSPs that were largely

[8] Meeting with the BNM, 26 November 2018. The BNM did not confirm whether these percentages refer to total value or number of transactions, but its public reports are typically based on value. Either way, the trend is instructive.

[9] Meeting with the BNM, 27 November 2018.

[10] Meeting with MAMSB, 27 November 2018.

[11] Meeting with the BNM, 26 November 2018.

[12] Meeting with MAMSB, 27 November 2018; meeting with Valyou, 28 November 2018.

[13] Meeting with Valyou, 28 November 2018.

[14] Meeting with the BNM, 26 November 2018.

[15] Meeting with the BNM, 26 November 2018.

corridor-specific to diversify into other corridors with minimal investment.[16] In addition, some credit the clarity of the current regulatory framework, which increased regulatory certainty, as encouraging larger global players to enter the market and increase competition.[17]

2.1.2. Regulatory reform

RSPs in Malaysia are regulated by the Bank Negara Malaysia (BNM), Malaysia's central bank. The applicable regulatory framework was overhauled in 2011 with the passage of the Money Services Business Act, which reformed the licensing framework for money services businesses (MSBs). MSBs include non-bank remittance, foreign exchange (e.g., kiosks) and wholesale currency businesses.

Prior to 2011 there were more than 1,000 MSBs, including hundreds of RSPs, leaving the market fragmented and difficult to regulate.[18] An estimated 80% of MSBs were small and unable to comply with existing regulatory requirements.[19] The reforms set out in the new framework forced many of the smaller MSBs to consolidate, become agents of larger entities or exit the market.[20] At the time of writing, largely as a result of this regulatory reform process, there were approximately 330 MSB licensees, only 36 of which were RSPs, in Malaysia.[21] The reforms also likely contributed to non-banks executing an increasing proportion of remittances (see Figure 2).

[16] Meeting with the BNM, 26 November 2018.

[17] Meeting with MAMSB, 27 November 2018.

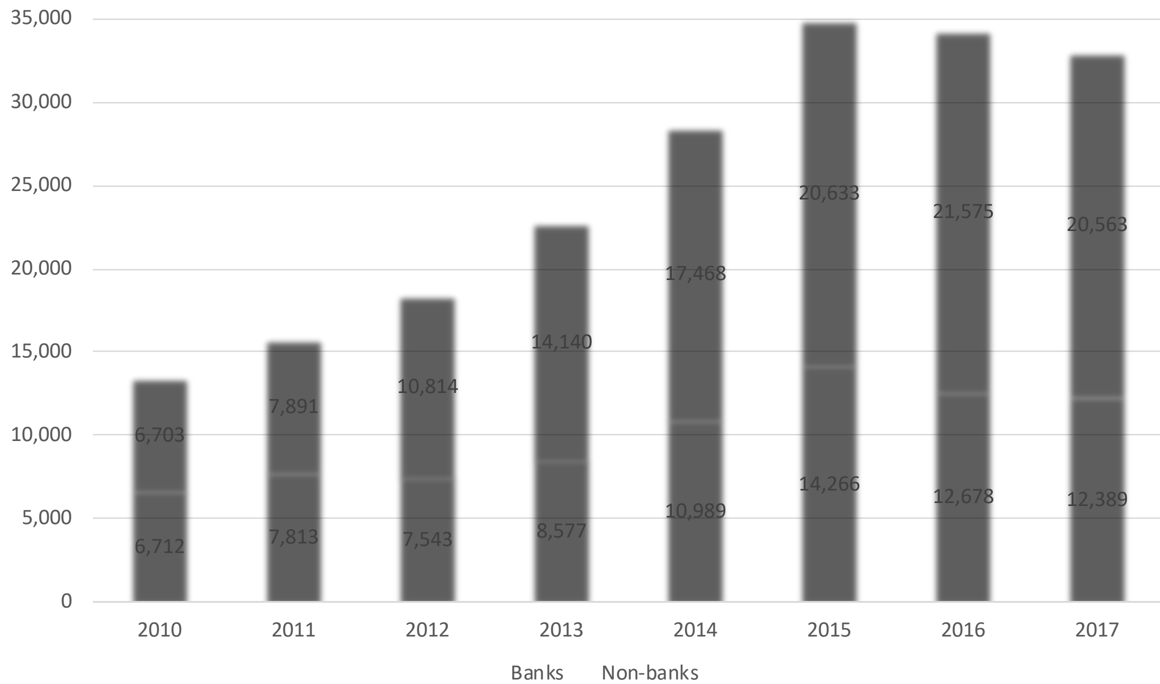
[18] Meeting with the BNM, 26 November 2018; Meng & Long, "A New Model for Money Services Business – Toward Greater Modernisation and Professionalism," *Financial Stability and Payment Systems Report 2016,* BNM at 118, http://www.bnm.gov.my/index.php?ch=en_publication&pg=en_fspr&ac=21&en.

[19] See Meng & Long at 118 (footnote 18).

[20] Meeting with the BNM, 26 November 2018.

[21] Meeting with the BNM, 27 November 2018.

Figure 2: Malaysia total outward remittances, bank vs non-bank (MYR million)[22]



Source: Macmillan Keck, derived from BNM Financial Stability Systems Reports, 2014-17, available at http://www.bnm.gov.my/index.php?ch=en_publication.

According to the BNM, the average costs of remittances were around 7% before the 2011 reforms. The BNM credits the 2011 reforms, subsequent education and outreach and a reduction in retail margins, for the current low costs of remittances. However, one BNM study contradicts this narrative, noting that costs were already as low as 3.15% in 2012, as the reforms were still being implemented.

We discuss the Malaysian regulatory framework in section 4.

2.2. Philippines

2.2.1. Remittances market background

Philippines is the World's third largest receiver of remittances,[23] reflecting an estimated 2.3 million Filipinos working overseas in 2017.[24] In 2017, Philippines received nearly USD 32.8 billion in remittances, 10.5%[25] of its GDP for that year. By country, the remittance flows into Philippines from Malaysia in 2016 rank fifth after flows from United States (USD 11.1 billion), UAE (USD 4.1

[22] Note the total volume of 2016 remittances (MYR 32.95 billion or ~USD 7.87 billion) is somewhat higher than the Pew Research Center estimates cited above (USD 6.19 billion). This may be because it reflects "total funds remitted from Malaysia to other countries for workers' remittances ***and remuneration for employees***." (Emphasis added) We included Pew Research Center figures because of the usefulness of the breakdown by sending countries.

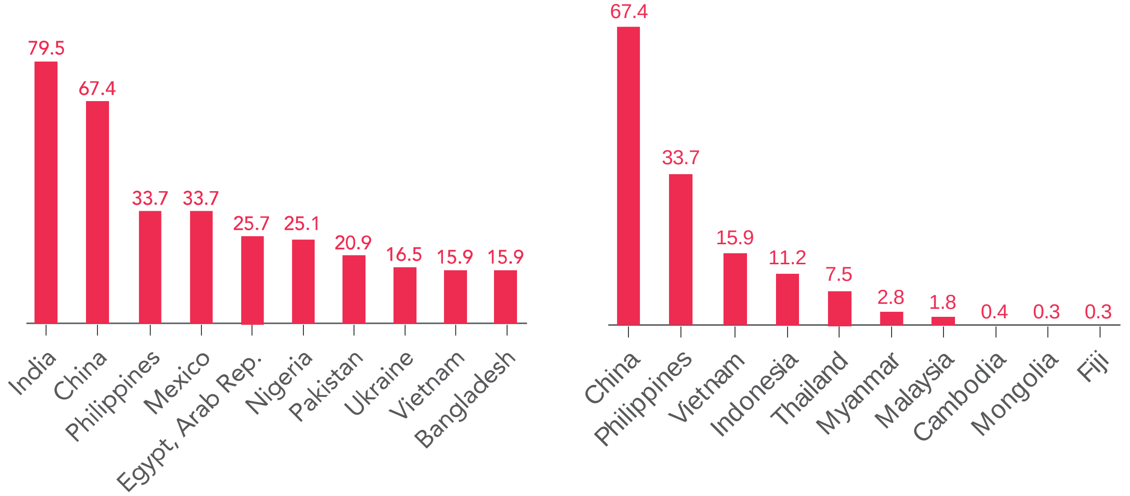
[23] Pew Research Center, http://www.pewglobal.org/interactives/remittance-map/

[24] Philippine Statistics Authority, 2017 Survey on Overseas Filipinos, https://psa.gov.ph/content/statistical-tables-overseas-filipino-workers-ofw-2017. This does not capture the potentially millions of Filipinos who live overseas but are not counted as overseas workers and may also send home remittances.

[25] Calculated based on a 2017 GDP of USD 3.13.595 billion, https://data.worldbank.org/country/philippines

billion), Saudi Arabia (USD 3.7 billion) and Canada (USD 2.4 billion).[26] Philippines received an estimated 33.7 billion in remittances in 2018 (see Figure 3).

Figure 3: Top remittance receivers in 2018, globally and in the East Asia and Pacific region (USD billions)



Source: Reproduced from World Bank & KNOMAD, Migration and Remittances, Recent Developments and Outlook, Migration and Development Brief 30 December 2018, at 3 and 15. Cited sources are International Monetary Fund, World Bank Development Indicators and World bank staff estimates. Several high-income countries are excluded from the global figure.

Remittances are a critical part of the Philippine economy and are used by recipients for a range of basic household needs. Growth in volumes of remittances into Philippines has been robust, with a cumulative increase of more than 34% from 2012 to 2017 (see Figure 4).

Figure 4: Volumes and growth of incoming remittances to Philippines[27]

Source: Reproduced from BSP presentation, 3 December 2018.

[26] Pew Research Center, http://www.pewglobal.org/interactives/remittance-map/

[27] "Sea-based" refers to workers employed by shipping companies, cruises and other sea-based enterprises. "Land-based" refers to workers employed by land-based enterprises. Note the total volume of 2016 remittances (USD 26.9 billion) is somewhat lower than the Pew Research Center estimates cited above (USD 31.1 billion). We included Pew Research Center figures because of the usefulness of the breakdown by sending countries.

While this study is focused on the role of non-bank RSPs, both banks and non-bank RSPs often collaborate and sometimes compete in different parts of the remittances value chain. For example, SM Group, a non-bank RSP that operates within its own network of department stores and markets, also acts as a sub-agent of BDO, a bank that provides remittance services, and uses its BDO Remit platform.[28] Many non-bank RSPs also have partnerships with banks to permit deposit of remittances directly into bank accounts.[29] Similarly, banks that provide remittance services also have partnerships with pawn shops and other non-bank RSPs to permit the bank remittance customers to pick up cash at non-bank branches and agent locations.[30] One bank we interviewed sees itself as a direct competitor of non-bank RSPs, has adopted a similar business model, and prices its services competitively.[31]

Services that enable digital receipt of remittances are just emerging in Philippines and some market participants expressed skepticism about near-term uptake. They felt that Filipinos tend to trust cash and the market is not yet receptive to these products.[32] Some also felt that communications infrastructure was not sufficiently developed, with some geographical regions lacking the connectivity necessary to reliably support mobile apps.[33] However, there was acknowledgement that incoming remittances originating from digital sending entities was on the rise across Asia, particularly from Hong Kong.[34]

2.2.2. Regulatory reform

Non-bank remittances are regulated and supervised by the Financial Supervision Department IX (FSD IX)[35] of Bangko Sentral ng Pilipinas (BSP), Philippines' central bank. The FSD IX regulates both domestic and international remittances, as well as money changers. Banks that provide remittances are separately regulated by the appropriate banking departments.[36]

The BSP began registering RSPs in 2005 and had its most recent major regulatory reform in 2017. Today there are 366 registered RSPs in Philippines, a much larger market than in Malaysia.[37] Receiving RSPs we interviewed expressed that, with a range of options in the market, they felt competitive pressure to keep the wholesale service fees they charge to sending RSPs low.[38] For many of these RSPs, the provision of remittances services is ancillary to a variety of other primary retail businesses, including pawn shops, department stores, supermarkets and courier services.

---

[28] Meeting with SM Group, 5 December 2018.

[29] Meeting with LBC Express, 4 December 2018; meeting with PetNet, Inc., 4 December 2018; meeting with Cebuana Lhuiller, 4 December 2018; meeting with Transfast, 5 December 2018.

[30] Meeting with Bank of the Philippine Islands, 5 December 2018; meeting with Philippine National Bank, 5 December 2018.

[31] Meeting with Philippine National Bank, 5 December 2018.

[32] Meeting with LBC Express, 4 December 2018; meeting with Transfast, 5 December 2018.

[33] Meeting with LBC Express, 4 December 2018.

[34] Meeting with Cebuana Lhuiller, 4 December 2018; meeting with Philippine National Bank, 5 December 2018; meeting with GCash, 6 December 2018.

[35] Formerly known as Integrated Supervision Department 1.

[36] Meeting with the BSP, 3 December 2018.

[37] Meeting with the BSP, 3 December 2018. This number excludes 4 registered "Remittance Platform Providers" which do not have retail operations, see discussion in section 5.1.1).

[38] Meeting with LBC Express, 4 December 2018; meeting with PetNet, Inc., 4 December 2018; meeting with SM Group, 5 December 2018; meeting with Philippine National Bank, 5 December 2018.

We discuss the Philippines regulatory framework in section 5.

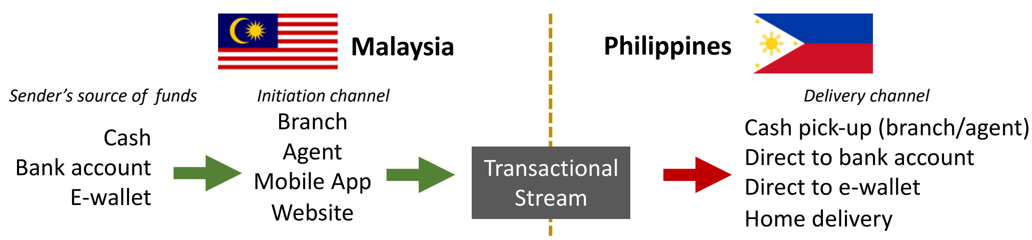
3. Mapping the flow of remittances from Malaysia to Philippines

3.1. The remittance transaction

3.1.1. Initiation channels

Senders in Malaysia have a range of channels through which they can initiate a transaction. The most common method is physically interacting with a branch or agent of an RSP and handing over cash. However, remittance transactions can also be initiated via websites or mobile apps that pull money directly from wallets or bank accounts. Money can also be pulled from bank accounts or e-wallets at the branch or an agent of an RSP. When e-money is deposited into an e-wallet prior to a remittance transaction, the e-money provider will need to deposit the sender's fund in a trust account, or similar arrangement, and credit the e-wallet with a corresponding positive balance.

Figure 5: Remittance initiation and delivery channels



Source: Macmillan Keck

3.1.2. Delivery channels

Remittance recipients in Philippines also have a range of channels through which they can receive remittances. The most popular delivery channel is cash pick-up at a branch or agent of an RSP. Other popular channels are delivery into a bank account or e-wallet, withdrawal from an ATM, and "door-to-door" home delivery. Home delivery is typically used to send remittances to elderly, disabled or other recipients who could not physically make the trip to a cash pick-up location. From our interviews, we understand that this method comprises only a small and shrinking percentage of deliveries.

The range of delivery channels available may be narrowed by the channel or provider selected by the sender.

3.1.3. Retail pricing

In the Malaysia-Philippines corridor, the costs of the remittance transaction are charged by the Malaysian sending RSP and borne exclusively by the sender. Beyond commercial considerations, this is a result of a regulatory prohibition on charging recipients in Philippines.[39] Retail pricing of remittances in Malaysia generally consists of a flat, per transaction fee, plus a foreign exchange rate into which a small margin is built. As the receiving RSP in Philippines does not charge the

[39] This regulatory requirement was explained to us in our meeting with the BSP, 3 December 2018. However, we have not been able to identify the specific regulation.

recipient for the service, the receiving RSP earns its fee through a payment from the Malaysian sending RSP.

The transaction fee that Malaysian sending RSPs charge senders is generally standardized across providers (usually around MYR 9-15 (~USD 2.5-3.5)[40]), but the RSPs compete fiercely on foreign exchange rates.[41] There was general agreement among all interviewees in Malaysia that margins in the remittance business were extremely slim and that migrant workers are, as a group, very price sensitive.

Many of the sending RSPs and even the intermediaries in Malaysia have access to multiple pathways to enable the remittance to arrive at the same receiving RSP. This enables the sending RSP to compare quoted foreign exchange rates and ensure service continuity in case of disruption.

A sending RSP may decide to enter into direct commercial partnerships with some receiving RSPs but use intermediaries to access others.

3.1.4. Models for remittance transaction

Model #1: Single provider (closed loop) for entire transaction

A single RSP processes the entire remittance transaction internally across its own proprietary system and sets its own retail fees and foreign exchange rates. In the Malaysia-Philippines corridor, our research did not identify any popular non-bank RSPs that used this model (though some may exist).[42]

LBC Express acts as a single provider in other corridors

LBC Express began as a Philippine courier company focusing on "care packages" sent from migrant workers abroad to their families. The nature of this business naturally led to expansion into remittances. Today, LBC Express has 1,400 branches in Philippines. Remittances may be delivered to its branches, deposited directly into a bank account or delivered directly to the home of the recipient. LBC Express competes with pawn shops and other retail cash pickup locations but distinguishes itself by its presence in malls.

---

[40] Market participants quoted a variety of flat fees for remittances to Philippines, from MYR 9 to 15, while stating that the fees are largely standardized across the providers. Some market participants explained that fees to Philippines were more expensive (MYR 15) than fees to remit to some other common jurisdictions, and the lower price quotes from other providers may have prices for those lower-priced corridors. However, this inconsistency was never fully resolved.

[41] Meeting with Valyou, 28 November 2018; meeting with Merchantrade, 28 November 2018.

[42] In other corridors, Western Union might be considered an example of this single entity model. However, we have not characterized it as such in this corridor. In Malaysia, Western Union does not have its own branches and rather relies on its "agents," which are principal MSB licensees and interact with retail customers, to provide access to its platform. Western Union is licensed as an RSP in Malaysia, but we believe this is due solely to its role as an international remittance hub . In Philippines, Western Union does not have its own branches and operates through several "agents," such as PetNet, Inc., which themselves are principal RSP registrants and interact directly with retail customers. Until the last few months Western Union was not registered as an RSP in Philippines, and only recently has it registered as a "Remittance Platform Provider". Accordingly, we characterize Western Union as an intermediary, in line with Model #3, rather than an example of a single entity, in line with Model #1.

LBC Express has affiliates operating in the USA, Australia, Taiwan, Japan and Hong Kong through which remittances can be sent directly to LBC Express locations in Philippines. In those corridors LBC Express acts as both the sending and receiving RSP.

For remittances received from other countries, LBC Express enters into direct partnerships. In Malaysia, for example, it receives remittances from CIMB Bank, SMJ and TML Remittance Center.[43]

Model #2: Direct partnership between two RSPs

Two licensed or registered organizations enter into a direct commercial partnership. An interparty fee will typically be paid by the sending RSP to the receiving to cover the cost of remittance delivery, plus a margin. The receiving RSP and sending RSP also agree foreign exchange as part of the settlement arrangement.

An example of this model in the corridor is the direct partnership between Merchantrade, a licensed RSP in Malaysia, with Cebuana Lhuiller, a pawn shop company registered as an RSP in Philippines.[44]

Model #3: Hub connects two RSPs

The sending RSP and the receiving RSP do not have a direct commercial relationship. Rather, each RSP has a commercial partnership with a hub[45] (referred to as an "international remittance hub" (IRH) in Malaysia and a "platform provider" in Philippines) that does not provide significant retail remittance services in either jurisdiction and is thus not a competitor.

A sending RSP may choose to use a hub for several reasons:

- The sending RSP can avoid the investment of time and cost required to establish direct commercial relationships and technical integration with multiple receiving RSPs in a jurisdiction. This process often serves as a barrier to entry into new corridor markets, especially those where volumes do not yet justify the investment. By engaging a hub, a sending RSP can easily expand its business into a new corridor.
- Due to the high transaction volumes they process, hubs are often able to negotiate more competitive rates with receiving RSPs than a sending RSP could on its own.
- A sending RSP may want to ensure that it has redundancy in the event of a technical failure.

Hubs are typically charged transaction fees by receiving RSPs and these are passed along to sending RSPs plus a margin. The foreign exchange arrangements agreed as part of the settlement flow will again determine the quoted retail foreign exchange rates.

[43] Meeting with LBC Express, 3 December 2018.

[44] Meeting with Cebuana Lhuiller, 3 December 2018.

[45] We have used the term "hub" to describe these intermediaries. That is the terminology used in GSMA publications. See, e.g., GSMA, *Mobile money, Competing with informal channels to accelerate the digitalisation of remittances*, May 2018, https://www.gsma.com/mobilefordevelopment/programme/mobile-money/competing-with-informal-channels-to-accelerate-the-digitisation-of-remittances/.

A variation of this model occurs when a retail RSP enters the wholesale market to act as a hub, making its network of receiving RSP partners available to other sending RSPs. Such a firm will need to be licensed or registered in the jurisdiction in which it provides retail services. It may or may not require a license or registration in the other jurisdiction. The firm benefits from carrying a larger amount of traffic on its network, thus exploiting the investment it has made in building that network and benefit from economies of scale.

Hubs

TransferTo is a Singapore-based, UK-licensed wholesale provider that serves as a hub across many corridors, including Malaysia-Philippines. TransferTo provides wholesale services for some sending RSPs in Malaysia, including Valyou, Mobile Money and SMJ. In Philippines, it has direct partnerships with receiving RSPs, including the e-wallets GCash and Coins.ph (a non-mobile wallet). It also has relationships with banks and cash-pickup locations. TransferTo does not have any retail operations in any of the 90 countries in which it operates.

Tranglo is a Malaysia-based wholesale provider that serves as a hub across several corridors, including Malaysia-Philippines. Tranglo serves as a hub for RSPs in Malaysia, such as Valyou, and for some banks. In Philippines it has direct partnerships with banks, pawn shops and e-wallets.[46]

Merchantrade is a retail RSP in Malaysia that also acts as a hub. It has an extensive network of retail branches and agents, including direct commercial relationships with pawn shops in Philippines, as well as Metro Bank and, soon, BDO. In 2012 it began offering wholesale services to RSPs in Malaysia to connect them with receiving RSPs in multiple jurisdictions. Today three Malaysian RSPs and one bank use Merchantrade as a hub.[47]

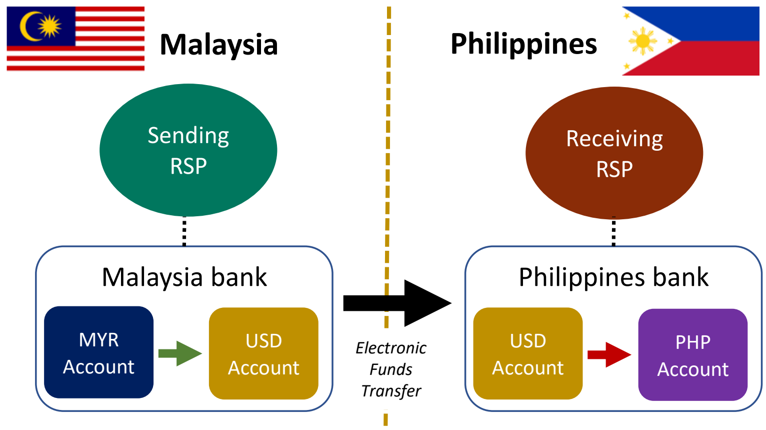
3.2. Settlement

RSPs in Malaysia and the Philippines primarily operate a pre-funded settlement model. Pre-funding involves the sending RSP (or a hub) keeping a certain amount of cash, usually based on daily estimates, on deposit in a bank account accessible to the receiving RSP in the receiving jurisdiction. The receiving RSP can then draw on this account to disburse payment to recipients or (more likely) to fund the float of branches and agents used to disburse payments. Rebalancing of settlement accounts is performed daily through correspondent banking relationships and is denominated in USD. Settlement is done in bulk and does not distinguish the individual remittance transactions.

[46] Meeting with Tranglo, 28 November 2018.

[47] Meeting with Merchantrade, 28 November 2018.

Figure 6: Settlement



Source: Macmillan Keck

Conversion to/from USD will be priced into the sending customer's fee – conversion to USD will be priced in directly by the sending provider, the conversion back to local currency will be priced in as part of the interparty rate charged by the receiving RSP to the sending RSP. Alternatively, a sending or receiving bank may be responsible for both conversions, depending on the terms of the commercial agreement.

For transactions involving hubs, the sending RSP typically pre-funds with the hub and the hub would need to pre-fund with the receiving RSP. In the simplest version of this, the hub conducts the electronic funds transfer across the border between its US dollar accounts and is responsible for the foreign exchange on both sides. However, other permutations are possible.

Not all RSPs use pre-funding. PayMaya advances funds received through Western Union. SM Group advances funds received through Western Union and the BDO Remit platform. When the receiving RSP advances the funds, settlement will reflect a transfer of an appropriate amount to make the receiving RSP whole in light of the advanced disbursements. In other cases, RSPs will use a pre-funding model but, where demand exceeds expectations, the receiving RSP may advance the excess disbursements (similar to a bank overdraft).

4. Regulatory approach in Malaysia

4.1. Licensing framework

4.1.1. License categories

The BNM's MSB department regulates MSBs which comprise non-bank RSPs, retail foreign exchange providers, and wholesale currency providers that serve money-changers. All MSBs require a license. Non-bank domestic remittances are separately regulated by the Payment System Oversight department and banks that provide remittances are separately regulated by other BNM departments.

A "remittance business" is defined in the regulatory framework as:

> *the business of transferring funds or facilitating the transfer of funds, whether in any form or by any means or whether there is any movement of funds or not, on behalf of an*

originator person in or outside Malaysia, with a view to making the funds available to a beneficiary person in or outside Malaysia […]

Figure 7 shows the four classes of MSB licenses available, with only Class A and Class B licensees permitted to carry on a remittance business. Because the regulatory framework does not use a specific term of art for an MSB licensee who is authorized to carry on a remittance business, in this report we will refer to this subset of MSB licensees generically as RSPs.

Figure 7: MSB license categories

Class	Description
A	License to carry on money-changing business and remittance business only
B	License to carry on remittance business only
C	License to carry on money-changing business only
D	License to carry on wholesale currency business only

Malaysia currently has 36 licensed RSPs,[48] a significant reduction from prior to 2011 licensing reforms, with several players entering and others exiting or converting to agents of RSPs in response to the reforms. Since the implementation of these reforms, this number has fluctuated slightly.[49]

The BNM does not have a separate license category for wholesale-only providers, sometimes referred to as "hubs" but which the BNM calls "international remittance hubs" (IRHs). However, the BNM requires all IRHs to inform it of their activities. The BNM then takes a view on whether an MSB license is required. Even if it does not require them to apply for a license, the BNM will monitor the activities of the IRH.[50] For example, TransferTo is a Singapore-based, UK licensed wholesale provider to Malaysian RSPs which BNM determined did not need to be licensed as an RSP in Malaysia (likely because of the robust regulatory supervision of UK's Financial Conduct Authority).[51]

Licensed RSPs that provide retail services and want to expand their business as an IRH do not require a new license but do need BNM approval of the additional wholesale activities.

4.1.2. Licensing criteria

The BNM tightly restricts market entry through its licensing application and evaluation process. Under the applicable laws and regulations, an applicant is required to submit information on its business model, corporate governance and integrity practices including AML compliance, and in support of its key persons as "fit and proper."[52]

In addition, the BNM's practice requires that an applicant demonstrate a "clear value proposition" that includes a contribution toward further modernization of the industry. This could include meeting demand in an underserved market, closing specific gaps in supply, or

[48] Meetings with the BNM, 26 and 27 November 2018.

[49] Meeting with the BNM, 26 November 2018.

[50] Meeting with BNM, 27 November 2018.

[51] Meeting with TransferTo, 30 November 2018.

[52] BNM written responses to consultants' questions, 27 November 2018.

introducing a new technology or a distinctive proposed business model.[53] Failure to meet the value proposition requirement is the cause of most application rejections.

The BNM adopted the value proposition criterion after concluding that the current market for remittances is finite and already intensely competitive with low prices. The BNM is concerned that allowing too many additional players into the market would drive down revenues to the point that competitors would "cut corners" and fail to comply with regulatory requirements.

BNM is also concerned with ensuring that applicants will be able to adhere to AML/CFT requirements. However, deficiencies identified in the applications can usually be addressed and are rarely the cause of rejected applications.[54]

4.1.3. Capital requirements

The BNM requires RTCs to maintain minimum capital requirements, as set out in the BNM's Minimum Capital Funds Regulations and shown in Figure 8.

Figure 8: Minimum capital requirements for Malaysian MSB licensees

Class	Criteria	Minimum capital funds (MYR)
A	The licensee carries on money-changing and remittance business.	2 million (~USD 480,000)
B or C	The licensee carries on money-changing or remittance business with more than five branch offices.	2 million
	The licensee carries on money-changing or remittance business with not more than five branch offices.	500,000 (~USD 120,000)
	The licensee carries on money-changing or remittance business, where— (a) it has no branch office; or (b) it is also a money services business agent of a licensee of a different class and has no branch office.	300,000 (~USD 72,000)
D	The licensee carries on wholesale currency business.	10 million (~USD 2.4 million)
A and D	The licensee carries on all types of money services businesses.	12 million (~USD 2.9 million)
C and D	The licensee carries on wholesale currency and money-changing businesses.	12 million

The required capital for RSPs is currently linked to the number of branches, which ignores the contributions of digital services. The BNM may review its approach if the volume of digital remittances significantly increases.[55] None of the interviewees expressed any difficulty complying with these capital requirements or any negative effects on the market. However, these capital requirements likely contributed to pushing out smaller providers when the framework was introduced in 2011.

[53] BNM written responses to consultants' questions, 27 November 2018.

[54] Meeting with the BNM, 27 November 2018.

[55] Meeting with BNM, 27 November 2018.

4.1.4. Remittance partners

The BNM requires sending RSPs to conduct their own due diligence on the receiving RSPs and intermediaries in other jurisdictions to ensure, for example, that they are appropriately licensed or registered. RSPs must also conduct their own due diligence to identify and assess money laundering and terrorism financing risks that may arise from new products or business practices. They must undertake a risk assessment prior to launch and take appropriate measures to manage and mitigate risks. The BNM does not require RSPs to submit the results of these diligence processes, but it may check that the appropriate diligence was conducted when it performs routine inspections of RSPs.[56]

4.1.5. Use of agents

The current agency framework was another innovation of the 2011 reforms. Many of the smaller MSBs would otherwise have had to exit the market because they lacked the ability to continue as MSBs in compliance with the new regulatory requirements. Instead they were able to adjust and requalify their activities and continue in business, but as agents of larger entities. The larger entities benefited by being able to expand their network without the expense of having to open new branches.[57]

According to the BNM, agents are not permitted to have multiple principals with respect to a particular corridor. The BNM has adopted this position to ensure a clear line of accountability of a single principal who has invested in and oversees the agent.[58] Also, in order to push RSPs to serve the underserved, the BNM has adopted a "two-kilometer" rule when it approves agents, meaning an agent may not set up a branch if there are already two agents within a two-kilometer radius.[59] One provider was critical of both of these policies, believing that they impede expansion of its agent network. The BNM believes the approach has benefitted the overall market, but it is possible that it has reduced some of the competitive dynamics in some areas.

4.1.6. Ongoing approval requirements

The BNM requires an RSP to obtain prior written approval each time it opens or changes location of a branch or agent. The rationale relates to the BNM's seeking to ensure a healthy balance of available access points in cities and across the country. Some RSPs find this requirement overly burdensome. For example, one RSP uses mobile branches which it sets up temporarily at factories with high numbers of migrant workers, rotating periodically through several factories. However, registration requirements make the model impractical.[60] The BNM is aware of these challenges and has indicated that in 2019 it will no longer require these approvals.[61]

---

[56] Meeting with the BNM, 27 November 2018.

[57] See Meng & Long at 119 (footnote 18).

[58] Meeting with the BNM, 30 November 2018.

[59] Meeting with the BNM, 30 November 2018. We have not been provided with the regulatory provision that establishes this rule.

[60] Meeting with Lotus, 29 November 2018.

[61] Meeting with BNM, 30 November 2018; meeting with Lotus, 29 November 2018.

4.2. Regulatory engagement and innovation

4.2.1. Engagement with the sector

The BNM has used its licensing system, authorization requirements and regulations to raise the standard of business models, corporate governance and integrity practices. Its role as gatekeeper to the market and regulator appears to be widely respected within the industry.

The BNM's MSB department has a strong understanding of the sector, clear views on their objectives for the sector (about which they appear to be transparent), and professional competence. It has proactively sought to increase the digitalization of remittances to lower costs and improve capability of monitoring. It now gathers detailed data on remittance transactions, and is now applying data analytics to identify trends and patterns and analyze individual transactions where needed.

In general, the BNM appears to have a constructive relationship with market participants. Several RSPs suggested that the BNM operates differently than most regulators of non-bank remittance services, particularly in the way it has actively nurtured the growth and direction of the market.[62] For example, in many jurisdictions interaction with regulators is limited to written responses to market participant queries. By contrast, the BNM has been known to reach out to market participants on its own initiative to inquire about their business and any challenges they face and even advise on strategic business decisions.[63]

A key conduit for BNM's engagement with market participants is the Malaysia Association of Money Services Business (MAMSB), established in 2013. All MSB licensees are required by the BNM to become members of the MAMSB and all approved MSB agents are entitled to become "associates" (essentially members without voting rights).[64] The MAMSB holds quarterly engagement meetings with the BNM and conducts ongoing training, certification and accreditation programs for its members.[65] It has adopted a Code of Conduct[66] that addresses a range of topics, including compliance with AML/CFT requirements, confidentiality of customer information, anti-competitive behavior and fair and transparent dealings with customers. Breaches of the Code may result in censure by the MAMSB as well as submission of a report to the BNM.[67]

The MAMSB walks a fine line acting in multiple roles as an advocacy organization for its members, a self-regulatory organization, and a channel for the BNM to push the market participants in a particular direction.[68] In an example of this third role, the BNM recently applied pressure to reluctant members to participate in a new MAMSB-developed mobile app that uses location

[62] Meeting with MAMSB, 27 November 2018.

[63] Meeting with MAMSB, 27 November 2018.

[64] See MAMSB website, Membership, https://www.mamsb.org.my/membership/type-of-memberships/. This includes a link to a 23 August 2012 BNM circular for which no English-language translation is available.

[65] Meeting with MAMSB, 27 November 2018.

[66] Available at https://www.mamsb.org.my/about-us/code-of-conduct/.

[67] MAMSB Code, §17.

[68] Meeting with MAMSB, 27 November 2018.

information to inform users of the nearest foreign exchange and remittance providers and their rates.

4.2.2. Project Greenback 2.0

In November 2015, the BNM launched Project Greenback 2.0 in Johur Bahru, Malaysia, in partnership with the World Bank.[69] The purpose of this remittances project was to "understand issues faced by consumers through surveys, face-to-face workshops, [and] interviews and to intervene with migrant communities, remittance service providers (RSP) and other stakeholders in order to promote changes."[70] Interventions included education of migrants on the availability and use of non-bank RSPs. Reportedly, the cost of remittances was reduced in the Johur Bahru region as a result of increased competition.[71]

The BNM has since launched the project in other regions. Some market participants felt that these efforts have increased migrants' trust in and use of licensed non-bank RSPs, particularly through digital channels.

4.2.3. Regulatory sandbox

In October 2016, the BNM issued the Financial Technology Regulatory Sandbox Framework "to enable innovation of fintech to be deployed and tested in a live environment, within specified parameters and timeframes." As of December 2018, two prospective RSPs then applying for MSB licenses were using the regulatory sandbox to test their e-KYC solutions (see section 4.3.4).[72]

The framework permits financial institutions including MSBs to test products in the market with proper safeguards and BNM oversight where these would otherwise not be permitted or addressed by the existing regulatory framework. Applicants must demonstrate their eligibility, in particular by showing that the product, service or solution is "genuinely innovative" and has the potential to:

i. improve accessibility, efficiency, security and quality in the provision of financial services;

ii. enhance the efficiency and effectiveness of Malaysian financial institutions' management of risks; or

iii. address gaps in or open up new opportunities.

If approved, the product, service or solution can go forward with an initial testing period of up to 12 months, plus any approved extensions. Once the testing is complete, the BNM will determine whether the product, service or solution may enter the market on a wider scale.

---

[69] World Bank, *Greenback 2.0 Johor Bahru Report, Migrant Workers' Remittances from Malaysia*, June 2017, at 5, http://documents.worldbank.org/curated/en/369391509457405143/Greenback-2-0-Johor-Bahru-Report-migrant-workers-remittances-from-Malaysia.

[70] World Bank, *Greenback 2.0 Johor Bahru Report, Migrant Workers' Remittances from Malaysia*, (Footnote 69)

[71] Reportedly, approximately 170,000 new customers registered with MSBs within 13 months and the average cost of remittances was reduced from 3.33% in 2015 to 2.02% in 2016. Meng & Long at 122 (footnote 18) .

[72] Meeting with BNM, 27 November 2018.

4.3. AML/CFT

4.3.1. General approach

RSPs must take a "risk-based approach" to AML/CFT. They are required to conduct risk assessments, institute and monitor policies, controls and procedures to manage and mitigate identified risks, and conduct risk profiling on their customers. The BNM sets out specific requirements on customer due diligence, maintenance of records, submission of suspicious transaction reports, institution of compliance programs and inclusion of certain information in remittance instructions.

In addition to meeting the requirements needed to obtain a license, the Malaysia Money Services Business Act requires licensees to obtain approval prior to use of the underlying technical system that the licensee will use to enable the remittances. The BNM's Remittance Business Regulations require that a remittance system:

- *(a) is able to record, transmit and receive information on remittance transactions;*
- *(b) is equipped with adequate security controls to prevent unauthorized or fraudulent transactions;*
- *(c) is able to establish an audit trail;*
- *(d) has the ability to track and consolidate on real-time basis, the outward remittance transactions undertaken by a customer at all of the offices and money service business agents of a licensee [. . .];*
- *(e) is able to track the status of remittance transactions and to automatically generate alerts for any incomplete or unsuccessful remittance transactions; and*
- *(f) is able to effectively monitor compliance with the Anti-Money Laundering and Anti-Terrorism Financing Act 2001.*

4.3.2. Transaction limits and currency restrictions

The BNM's Remittance Business Regulations set out the daily outward transaction limits, as shown in Figure 9.

Figure 9: Daily outward transaction limits for remittances

Remittance type	Daily outward transaction limits per customer (MYR)
Business to business	Not greater than: (i) 200,000 (~USD 48,000) in aggregate or; (ii) Another amount approved by the BNM on a case by case basis that is not greater than 50 million (~USD 12 million) in aggregate.
All others	50,000 (~USD 12,000) in aggregate.

These amounts are quite high in comparison to typical monthly wages of migrant workers. None of the RSPs we interviewed expressed any difficulties complying with these limits, or any negative impact on their customers. The BNM requires remittances to be initiated and disbursed (in the case of incoming remittances) exclusively in ringgit.[73]

4.3.3. Customer due diligence (CDD)

Malaysia's framework requires RSPs to conduct due diligence on new customers. In the case of individuals, the following information must be obtained:

(a) full name;

(b) National Registration Identity Card (NRIC) number or passport number or reference number of any other official documents bearing the photograph of the customer or the beneficial owner;

(c) residential or mailing address;

(d) date of birth;

(e) nationality; and

(f) purpose of transaction.

4.3.4. Remote customer identification and verification

In November 2017, the BNM issued guidelines permitting remote identification and verification (referring to this as "e-KYC"[74]) as part of the customer due diligence process, subject to approval by the BNM. Permitted electronic means of identification include video calls, communications with customers at a verified address and verification with certain databases maintained by government authorities.

The BNM expects that e-KYC will reduce the costs of CDD, currently estimated at over MYR 50 (~USD 12) per person, by half or more.[75] Three RSPs are currently approved to perform e-KYC, but only one, Merchantrade, has publicly announced the approval.[76] As mentioned above, two other unlicensed entities are separately testing e-KYC solutions as part of the regulatory sandbox framework.[77]

To be eligible for e-KYC, a customer must have a bank account with a licensed institution. Transactions performed by an individual are subject to a daily limit of MYR 30,000 (~USD 7,200), unless otherwise approved by the BNM. Further restrictions apply to foreign workers, including:

- a monthly transaction limit of MYR 5,000 (~USD 1,200) per month; and
- remittances may only be sent to the worker's home country and to a beneficiary registered when the business relationship was established.

[73] Meeting with the BNM, 27 November 2018. We have not been able to identify the specific regulatory provision that requires this.

[74] BNM defines e-KYC as establishing business relationships and conducting customer due diligence by way of electronic means, including online channel and mobile channel.

[75] Meeting with the BNM, 26 November 2018.

[76] Meeting with the BNM, 26 November 2018.

[77] Meeting with the BNM, 27 November 2018.

The RSPs we interviewed were almost unanimously critical of the requirement that customers have a bank account to use e-KYC because this requires the customers to have already met traditional KYC requirements, effectively eliminating any value in e-KYC as a tool to expand the access frontier. They noted that migrant workers generally do not have bank accounts and thus cannot meet the e-KYC requirements.[78] The BNM may relax this requirement in the future as its confidence in the use of e-KYC grows.

4.3.1. De-risking

Based on our interviews, de-risking by banks has not been a significant problem for RSPs in Malaysia. The BNM and RSPs attribute this to its strong regulatory framework that gives banks confidence in the RSPs, their activities and their compliance with AML/CFT requirements.[79]

4.4. Consumer protection

The MSB framework requires extensive disclosures to consumers to ensure transparency and fair dealing, both prior to and following a remittance transaction.

When executing a remittance transaction, RSPs must disclose:

- the exchange rate, fees and charges;
- the amount in the currency that will be paid to the recipient;
- the estimated time for the funds to be transferred to the recipient; and
- the location where the funds are available for collection by the beneficiary.

Customers must additionally receive a receipt specifying:

- the name, address and details on how to contact the RSP;
- the date of the remittance transaction;
- a serial number for the receipt;
- the name of the sender;
- the name of the recipient;
- the rate of exchange;
- the amount of funds to be remitted in ringgit and its equivalent amount in foreign currency to be received by the beneficiary; and
- the fees and charges for services rendered to the customer.

The MAMSB also plays a role in consumer protection. The MAMSB Code of Conduct requires members to ensure transparency in dealing with customers and that its business is conducted in a fair and transparent manner. This requires disclosures of relevant and accurate information in

[78] Meeting with Valyou, 28 November 2018; meeting with Mobile Money, 29 November 2018.

[79] Meeting with the BNM, 27 November 2018; meeting with Tranglo, 28 November 2018.

relation to products and services and establishing proper channels for receiving and managing customer complaints.[80]

4.5. Other market issues

4.5.1. The unlicensed market

According to the BNM and market participants, a substantial illegal, unlicensed market still exists in Malaysia. The BNM believes this may be driven by demand from illegal workers who cannot satisfy customer due diligence requirements, as well as deceptive practices that prevent foreign workers from differentiating between licensed and unlicensed providers.[81]

The BNM believes that the 2011 reforms and subsequent supporting policies squeezed large illegal, unlicensed MSB markets. The BNM attributed the high usage of these "informal" markets to "low awareness of the availability of authorized non-bank channels that provide money services."[82] The BNM, along with the MSB industry, reacted by carrying out extensive education and outreach programs to raise awareness of non-bank channels and highlight the risks of using informal markets, such as the Project Greenback 2.0 described above.[83] A quarter of the growth in the formal market from 2012-16 was estimated to be derived from transactions previously carried out by unlicensed entities.[84] The BNM believes that the illegal market continues to shrink due to robust enforcement actions, but data is not available.[85]

Some RSPs indicated that they still face competitive pressure from the illegal, unlicensed market for remittances, even though it has diminished in size.[86] They indicated that illegal networks are often cheaper and permit the recipient to pay a transaction fee upon receipt of the funds, rather than the sender when sending, which is attractive to some migrant workers.[87]

4.5.2. Relationship to e-money

In Malaysia, e-wallet providers are regulated by the BNM as e-money issuers. Non-banks require BNM approval to become e-money issuers.

The applicable regulatory framework distinguishes between small and large e-money schemes, with a maximum purse limit for a large e-money scheme of MYR 1,500 (~USD 360), or another amount approved by the BNM. Funds collected from customers as part of a large e-money scheme are required to be deposited in a trust account with a licensed financial institution. Funds from a small e-money scheme are only required to be deposited in a deposit account separate from the issuer's accounts. The framework further sets out minimum capital requirements, prohibited business conduct and other requirements of e-money issuers. E-money issuers can use agents, known confusingly as "merchants," to facilitate cash-in and cash-out.

[80] MAMSB Code, §13.

[81] Meetings with the BNM, 27 November 2018 and 30 November 2018.

[82] See Meng & Long at 120 (footnote 18).

[83] See Meng & Long at 120 (footnote 18).

[84] See Meng & Long at 118 (footnote 18).

[85] Meeting with BNM, 30 November 2018.

[86] Meeting with Mobile Money, 29 November 2018; meeting with Lotus, 29 November 2018.

[87] Meeting with Mobile Money, 29 November 2018.

There are several e-money wallets available in Malaysia, but their use for domestic P2P transfers and payments is limited. This has been attributed to Malaysia's high bank account penetration, which was estimated at 85% in 2017.[88]

E-money providers are regulated by the Payment System Oversight department, the same department that regulates domestic remittances. Three RSPs have received e-money licenses: Mobile Money, Numoni and Merchantrade. In the context of remittances, e-wallets appear to function mostly as a staging ground to convert cash into e-money so that it can be transferred as a digital remittance.

E-money as a bridge to digital remittances

Valyou is a licensed RSP and e-money issuer. It has launched an e-money wallet and a mobile app that allows customers to send e-money remittances via mobile phones. Customers can bring cash to one of Valyou's e-money agents (referred to as "merchants" in the regulations) to have it converted to e-money in Valyou's e-wallet. Valyou uses the agent network of the MNO Diji, which, like Valyou, is owned by Telenor, for its agent network. Alternatively, customers with bank accounts can load their wallets from their bank accounts at ATMs.

Once converted to e-money, the customer can access the funds through a mobile app and easily send it as a remittance. Valyou's e-money agents are not licensed as RSPs or RSP agents and so are not permitted to provide remittance services to Valyou customers, such as performing customer due diligence or executing remittance transactions for them. However, the e-money merchants are permitted to assist customers in using the app to complete a remittance transaction.[89]

Valyou offers direct wallet-to-wallet remittances to Pakistan, Bangladesh and Cambodia.[90] However, even when remittances are sent via the mobile app, cash pick-up remains the most popular channel at the receiving end.[91] For remittances to Philippines, Valyou uses the network of Transfast as an intermediary to link its sending customers with a network of receiving RSPs.[92]

Merchantrade is a licensed RSP and e-money issuer that offers an e-wallet linked to its digital app, eRemit, which can be funded with money from a bank account or a cash deposit machine at an ATM. The e-wallet comes with a VISA debit card which can be used for domestic purchases and cash-out can be executed through ATMs and at Merchantrade branches. Merchantrade has made arrangements with some employers to have their employees' payroll deposited directly into the e-wallet.

Use of the digital app is still limited and Merchantrade estimates that only 12% of its business is conducted through eRemit, with 84% coming from branches and agents and 8% through a separate B2B app. Although, from the customer's perspective, remittances can be made directly

[88] Meeting with the BNM, 26 November 2018; meeting with Valyou, 28 November 2018; World Bank 2017 Global Findex Database, available here https://globalfindex.worldbank.org/#data_sec_focus.

[89] Meeting with Valyou, 28 November 2018.

[90] Valyou Website, Remittance, https://www.valyou.com.my/remittance.

[91] Meeting with Valyou, 28 November 2018.

[92] Valyou Website, Remittance, https://www.valyou.com.my/remittance.

into an e-wallet in Philippines, this is actually accomplished through Metrobank as intermediary, not a direct partnership.[93]

Mobile Money is a licensed RSP and e-money issuer. Rather than using branches and agents, Mobile Money exclusively uses its e-money merchant network under its e-money issuer license. For initial registration, a merchant will take photos of customers and customer documentation. This information is then transmitted to Mobile Money, which performs the actual due diligence.

When a customer is registered, he or she receives a chip card that is specific to a recipient. Multiple cards, reflecting multiple beneficiaries, can be issued to a single customer. When a customer wants to send a remittance, he or she goes to a merchant who performs a cash-in, converting cash to e-money in the Mobile Money wallet. The customer submits the card corresponding to the intended recipient, which the merchant scans. The customer will then receive an SMS asking to confirm whether the customer wishes to remit the amount to that recipient. The customer then responds to the SMS with a PIN to confirm the transaction.

5. Regulatory approach in Philippines

5.1. Registration framework

5.1.1. Registration categories

Under the Philippines' framework a "remittance business" is defined as:

> *the transferring of funds or facilitating the movement of funds or monetary instruments from the sender or originator to a receiver or beneficiary locally and/or internationally and undertaken by any financial institution.*

An RSP operating in Philippines is required to register as a Remittance and Transfer Company (RTC). RTCs include Remittance Agents (RAs), which operate a remittance business network, of which there are several types. This terminology can be somewhat confusing as RAs are not "agents" in the legal sense of principal-agent relationship in which the agent is an outlet for, and acts with the legal authority to bind, a principal. Rather RAs are themselves "principals," contracting with customers to provide the remittance service. Agents of RSPs in the legal sense are referred to in the framework as Remittance Sub-Agents (see section 5.1.5).[94]

Beyond RAs, the other types of RTCs are Remittance Platform Providers (RPPs) and those E-Money Issuers (EMIs) that are authorized to conduct remittances. RPPs are a new category of RTC and they do not directly transact with retail customers. Rather they solely provide the shared or common platforms or IT infrastructure for remittance systems by which other RTCs service

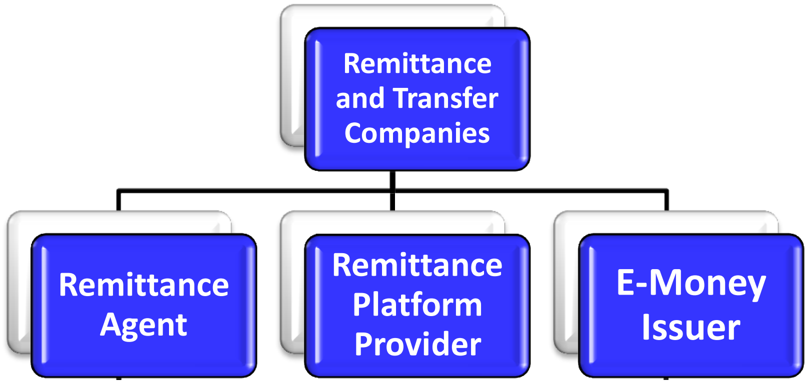
---

[93] Meeting with Merchantrade, 28 November 2018.

[94] The 2017 Regulation defines Remittance Sub-Agents as such: "refers to any person authorized by the RTC to perform certain relevant undertakings in the remittance business. This includes any person that is allowed by a Remittance Direct Agent, Remittance Agent Network Provider, and/ or EMI to do any part of the remittance business in their behalf." It also provides, "Duly registered RTCs may accredit their own RSAs. The RSA shall be treated as an extension of the RTC and shall be subject to the same obligations of an RTC as provided in this Section and stated in the Deed of Undertaking. In this regard, the RTC shall ensure that it conducts appropriate due diligence in the accreditation and shall provide effective continuing oversight of its RSAs."
http://www.bsp.gov.ph/downloads/regulations/attachments/2017/c942.pdf

their customers – i.e., they are wholesale-only RSPs.[95] Western Union, which was not formerly registered as an RTC, and Transfast, which is currently registered as an RA, are both in the process of registering as RPPs.[96] As of December 2018, there were 370 registered RTCs, comprised of 358 RAs, 4 RPPs and 8 EMIs.[97]

Figure 10: Regulatory categories of RTCs in Philippines



Source: BSP presentation, 3 December 2018.

As part of recent 2017 reforms, every RTC was required to re-register and execute a deed of undertaking which includes compliance with AML/CFT provisions.[98] The registration process is perceived by RSPs as straightforward and the BSP is seen as eager to assist in the application process.[99] Several RSPs found the 2017 re-registration process particularly burdensome,[100] but it was generally perceived as a positive step for the market which rationalized and simplified the registration process, removing some smaller players and those entities that would not or could not comply with regulatory requirements.[101] Many of those who could not meet the new registration process became Remittance Sub-Agents of RAs.[102]

Western Union, one of the first Remittance Platform Providers

Western Union does not offer services directly to consumers in Philippines. Rather it operates through its "direct agents," which are registered RTCs, providing the platform through which the remittances are transacted. Its largest direct agent in Philippines is PetNet, Inc., operating under the brand Perahub. Perahub, in turn, has a network of Remittance Sub-Agents through which it operates.

---

[95] Meeting with the BSP, 3 December 2018. RPPs are defined by the 2017 Regulation as "any entity that provides a shared or common platform/IT infrastructure and maintains settlement accounts in order to provide funds for remittance transactions within its network."

[96] Meeting with PetNet, Inc., 4 December 2018; meeting with Transfast, 5 December 2018.

[97] Meeting with the BSP, 3 December 2018.

[98] Cordero, Ted, "Money service businesses are now under BSP control," *GMA News Online*, 20 January 2017, https://www.gmanetwork.com/news/money/companies/596453/money-service-businesses-are-now-under-bsp-control/story/.

[99] Meeting with Transfast, 5 December 2018.

[100] Meeting with LBC, 4 December 2018; meeting with Cebuana Lhuiller, 4 December 2018; meeting with PetNet, 4 December 2018.

[101] Meeting with LBC, 4 December 2018; meeting with Cebuana Lhuiller, 4 December 2018.

[102] Meeting with LBC, 4 December 2018; meeting with Cebuana Lhuiller, 4 December 2018.

While Western Union has never previously been registered as an RTC in Philippines, the overhaul of the regulatory framework in 2017 has changed its registration obligations. It is now in the process of registering as a Remittance Platform Provider and will be subject to reporting obligations to the BSP.[103]

5.1.2. The registration process

Under the applicable regulations, the registration process is divided into two-stages: a preliminary screening process to determine eligibility and, if eligibility is met, a review of supporting documentation, including identifying tie-up partners. However, in our interviews, the BSP framed this process slightly differently from the description in the regulations. It characterized the first stage as an opportunity to demonstrate compliance with AML/CFT requirements, including by presenting to the BSP in person a description of the workings of its remittance systems. It characterized the second stage as more document-focused and emphasizes compliance with the "fit and proper" standards applicable to the entity's principals and other requirements.[104]

One difficulty noted by several market participants is the lack of coordination between the BSP and municipal authorities with respect to registration. Municipal authorities which issue general business licenses to those active in their municipalities often require proof of registration of an RA's branch or Remittance Sub-Agent before issuing municipal approvals; yet the BSP required proof of municipal licenses before issuing registrations. This "chicken-and-egg" problem had previously caused bureaucratic problems for RSPs, particularly during the 2017 "re-registration" period. This appears to have been partially resolved by the BSP building in a grace period for submission of municipal documents.[105]

5.1.3. Capital requirements

An RTC is required to maintain minimum capital, based on its regulatory classification, as set out in the following table:

Type	Classification	Benchmark Capital (PHP)
A	Large-Scale Operator- Remittance Agent with or without money changing/foreign exchange dealing operations with average monthly network volume of transactions of at least PHP 75 million (~USD 1.4 million)	At least 50 million (~USD 950,000)
B	Small-Scale Operator- Remittance Agent with or without money changing/foreign exchange dealing operations with average monthly network volume of transactions of less than PHP 75 million (~USD 1.4 million)	Less than 50 million (~USD 950,000)
C	E-Money Issuer	100 million (~USD 1.9 million)
D	Remittance Platform Provider	10 million (~USD 190,000)

[103] Meeting with PetNet, Inc., 4 December 2018.

[104] Meeting with the BSP, 3 December 2018.

[105] Meeting with PetNet, 4 December 2018; meeting with SM Group, 5 December 2018.

E	Large-Scale Operator- Money Changer/Foreign Exchange Dealer with average monthly network volume of transactions of at least PHP 50 million (~USD 950,000)	At least 10 million (~USD 190,000)
F	Small-Scale Operator- Money Changer/Foreign Exchange Dealer with average monthly network volume of transactions of less than PHP 50 million (~USD 950,000)	Less than 10 million (~USD 190,000)

None of the RTCs interviewed expressed any difficulty meeting these capital requirements. However, there was general acknowledgement that these requirements had previously contributed to smaller players exiting the market or becoming Remittance Sub-Agents of larger RTCs.

5.1.4. Remittance partners and new products

RTCs are required to notify the BSP of the addition and/or termination of RSP partners abroad, including submission of the commercial agreement and proof that the partner is authorized to engage in the remittance business and is subject to AML laws in the country in which it operates. However, beyond that, the BSP does not independently investigate the sending partners of its RTCs.[106]

The BSP also requires that it be notified of all new products.[107] It will generally enter into a consultation process with the RTC regarding the product and provide guidance.[108]

5.1.5. Use of agents

The RTC must conduct due diligence as part of the accreditation process and provide "effective continuing oversight" of sub-agents (RSAs). An RTC, other than those that are EMIs, must notify the BSP of any newly accredited RSAs within 5 business days.

The ability of RTCs to accredit their own RSA is part of the recent 2017 reforms. Market participants have noted that it puts more pressure on the RTCs to monitor and supervise their RSAs than under the previous framework.[109]

Operating exclusively as an RSA

SM Group provides cash pick-up remittance services at its 165 "SM Store" department store locations and its 294 "SM Markets," which include supermarkets, hypermarkets and its "Savemore Market" brand. Despite its vast network, SM Group is not itself a Remittance Agent, but rather operates as a Remittance Sub-Agent for both BDO and PetNet, Inc. (in turn a direct agent of Western Union), using the Western Union and BDO Remit platforms.

SM Group competes directly with pawn shops and other cash pick-up providers. However, it distinguishes itself as safer and more convenient than pawn shops, given its location inside its retail stores. Also, as its department stores and markets are its primary business, it is better able to ensure that its outlets do not run out of cash, which is reportedly a problem for some pawn

[106] Meeting with the BSP, 3 December 2018; meeting with PayMaya, 4 December 2018.

[107] The BSP and RSPs informed us of this requirement, but we have not been able to identify the specific regulatory provision.

[108] Meeting with Cebuana Lhuiller, 4 December 2018.

[109] Meeting with PetNet, 4 December 2018.

shops. SM Group advances the float of its remittance providers and settles through BDO and PetNet, Inc. at the end of each day. SM Group receives a flat rate fee from BDO Remit for each transaction and a share of the service fee that Western Union charges the sending customer.[110]

5.1.6. Ongoing notification requirements

After obtaining registration, RTCs are subject to ongoing obligations to notify the BSP of commencement of operations, newly accredited Remittance Sub-Agents, transfer of location, closure of office/business, and change of tie-up partner/s (described above), business name, and ownership/control.

5.2. Regulatory engagement and innovation

5.2.1. Engagement with the sector

As with the BNM in Malaysia, the BSP has made major efforts to develop an effective regulatory regime, including licensing and AML/CFT. The FSD IX conducts offsite supervision, including risk profiling and monitoring of risk management systems, as well as onsite examinations.[111] It appears to be well respected within the industry, and to have a strong understanding of the sector, clear views on their objectives for the sector (about which they appear to be transparent), and professional competence.

RTCs described the BSP as open to proposals, feedback and discussions, including allowing RTCs to make informal proposals before submitting a white paper.[112] When introducing new products, which are required to be notified to the BSP,[113] the BSP will provide guidance on compliance.[114] The BSP is seen as eager to assist in the registration and reporting processes.[115]

One RTC felt that the BSP should have more regular interaction with industry players to inform them of the direction of future regulatory actions, suggesting quarterly meetings with RTC industry representatives.[116] Some RTCs indicated that the reporting requirements, including quarterly remittance reporting, were very burdensome and document heavy.[117]

5.2.2. 'Test and learn' approach

While there is no formal regulatory "sandbox" framework, the BSP is open to approaches from participants with innovative ideas that may require special regulatory treatment or forbearance. The BSP frequently applies a "test and learn" approach to these innovations. The BSP is considering formalizing this approach in a regulatory sandbox framework.[118]

[110] Meeting with SM Group, 5 December 2018.

[111] Meeting with the BSP, 3 December 2018.

[112] Meeting with PayMaya, 4 December 2018; meeting with Transfast, 5 December 2018; meeting with Bank of the Philippine Islands, 5 December 2018; meeting with Philippine National Bank, 5 December 2018.

[113] This regulatory requirement was explained to us in our meeting with the BSP, 3 December 2018. However, we have not been able to identify the specific regulation.

[114] Meeting with Cebuana Lhuiller, 4 December 2018; meeting with SM Group, 5 December 2018.

[115] Meeting with Transfast, 5 December 2018.

[116] Meeting with Transfast, 5 December 2018.

[117] Meeting with Cebuana Lhuiller, 4 December 2018.

[118] Meeting with the BSP, 3 December 2018.

5.3. AML/CFT

5.3.1. General approach

Under the Anti-Money Laundering Act of 2001 and subsequent regulations,[119] Philippines' AML/CFT requirements apply to "banks, non-banks,. . . pawnshops, foreign exchange dealers, money changers, remittance and transfer companies, electronic money issuers and other financial institutions which under special laws are subject to [BSP] supervision and/or regulation . . ."

The framework sets out requirements for:

- customer due diligence, including the specific information that must be verified for all new customers;
- record-keeping, generally subject to a requirement of retaining records for 5 years;
- reporting of covered transactions (those in excess of PHP 500,000 (~USD 9,500) per day) and suspicious transactions;
- AML training of personnel; and
- development and implementation of risk management policies and practices.

Some RSPs have suggested there is friction between CDD requirements in Philippines and confidentiality and data protection requirements in other jurisdictions.[120] For example, one RSP noted that the framework requires receiving RTCs to obtain the address of the sender, but in some cases the legal requirements in the sending jurisdiction prevent sharing of this information.[121] Such requirements may go beyond what is necessary as Financial Action Task Force (FATF) recommendations require financial institutions to conduct customer due diligence on other financial institutions with which they do business, but not on the individual customers of those other financial institutions. Further harmonization with other jurisdictions was recommended.

The AML/CFT framework established an Anti-Money Laundering Council (AMLC), whose functions include, among others:

- requiring and receiving suspicious transaction reports from covered institutions;
- issuing orders relating to determining the true identity of owners of monetary instruments or property that is the subject of a "covered transaction" or "suspicious transaction" report;
- instituting civil forfeiture procedures or other remedial proceedings;
- filing complaints with the relevant entities for prosecution of money laundering offenses;
- investigating suspicious transactions and covered transactions deemed suspicious;

[119] See, Section 4802Q of the BSP Manual of Regulations for Non-Bank Financial Institutions.

[120] Meeting with PayMaya, 4 December 2018; meeting with Transfast, 5 December 2018.

[121] Meeting with PayMaya, 4 December 2018.

- implementing necessary measures to counteract money laundering; and
- imposing administrative sanctions for violations of laws, rules, regulations and order and resolutions issued thereto.

RTCs must register with the AMLC Secretariat within 30 days after the commencement of operations. All proprietors, partners, directors, officers and other personnel directly involved in the remittance business must attend a BSP or AMLC accredited seminar on legal requirements under the Anti-Money Laundering Act, particularly relating to "customer due diligence, reporting of covered and suspicious transactions and record keeping." Refresher training is required at least every two years. Training requirements can present a significant cost barrier where carried out only in the capital city, but AMLC now carries out "training caravans" in big cities across the country.[122]

5.3.2. Transaction limits and currency restrictions

There are no caps on the amount of remittances that may be received. However, a large value payout of more than PHP 500,000 (~USD 9,500), or foreign currency equivalent, in any single transaction with customers or counterparties, must be made via check payment or direct credit to a deposit account, which effectively imposes this amount as a limit on remittances to non-bank RSPs. There is no requirement that remittances be received in Philippine pesos, but as a practical matter, remittances are generally received in pesos or United States dollars.[123]

5.3.3. Customer due diligence (CDD)

Philippines' framework requires RSPs to "establish and verify the true identity of their customers based on official document . . . or other reliable, independent source documents, data or information." For new customers, the following information must be confirmed with official or valid identification documents:

(1) name of customer and/or PhilSys Number (when available)[124]

(2) date and place of birth;

(3) address;

(4) contact number or information;

(5) citizenship or nationality;

(6) specimen signature or biometric of the customer;

(7) name, address, date and place of birth, contact number or information and citizenship of beneficiary or beneficial owner whenever applicable.

As part of the customer due diligence process covered persons must conduct "face-to-face contact and/or personal interviews at the commencement of the relationship."

---

[122] See http://www.amlc.gov.ph/images/PDFs/23%20April%202018%20Training%20Program.pdf.

[123] Meeting with the BSP, 3 December 2018.

[124] PhilSys Numbers are part of the Philippines' new national identification system which is in the process of being implemented.

5.3.4. *Remote customer identification and verification*

Although the process is not referred to as "e-KYC" as in Malaysia, covered persons are permitted to use "ICT in the conduct of face-to face contact and/or interview" so long as the covered person "has measures in place to mitigate the ML/TF risks" and "the entire procedure is documented." In practice, e-money issuers have used video calls, facial recognition software and photographs of identification documents as part of customer due diligence.

5.3.5. *De-risking*

Bank de-risking is a concern for some RTCs in Philippines. Under AML/CFT requirements, when RTCs are customers of banks, and deemed to be of "greater risk," banks must subject the RSPs to "enhanced due diligence," including, requiring proof of registration with the AMLC, reviewing and assessing their AML/CFT program, and obtaining additional information for establishing the business relationship. In addition, banks in sending countries may block transfers to an RTC, essentially cutting off the entity from a corridor.

Some RTCs have described receiving enhanced due diligence requests and increased scrutiny from local banks since the 2016 Bangladesh cyber-heist in which USD 100 million was stolen from Bangladesh's central bank, most of which was traceable to Philippines.[125] The effects have disproportionately affected smaller players and also some Remittance Sub-Agents in Philippines.[126] The BSP has formulated an approach to address the effects. This includes close coordination with stakeholders, improvement of the domestic AML/CFT framework, international policy coordination, and continued improvement of financial system infrastructure and enabling technology.[127] Other RTCs were not affected by de-risking.[128]

Banks had a different perspective on de-risking, noting that they were compelled to take their lead from the BSP circulars. They felt that accounts were closed because the account holders could not meet their required compliance obligations, rather than the banks making a choice to exit from a particular market.[129]

5.4. Consumer protection

RTCs are subject to their own remittance-specific disclosure requirements. An RTC must disclose to the remittance sender and recipient the following minimum items of information regarding remittance transactions:[130]

- *Transfer/remittance fees*, i.e., charges for processing/sending the remittance and receiving the remittance;
- *Exchange rate*;

[125] Meeting with the LBC Express, 4 December 2018; meeting with PetNet, 4 December 2018.

[126] Meeting with PetNet, 4 December 2018.

[127] Meeting with the BSP, 3 December 2018.

[128] Meeting with Cebuana Lhuiller, 4 December 2018.

[129] Meeting with Bank of the Philippine Islands, 5 December 2018; meeting with Philippine National Bank, 5 December 2018.

[130] Meeting with the BSP, 3 December 2018.

- *Exchange rate differential/spread*, i.e., any foreign exchange mark-up or the difference from the BSP reference/guiding rate
- *Other currency conversion charges,* i.e. commissions or service fees, if any;
- *Other related charges*, such as, surcharges, postage, text message or telegram charges;
- *Amount/currency paid out in the recipient country*, i.e., the exact amount the recipient should receive in local or foreign currency; and
- *Delivery time to recipients/beneficiaries* (stated in number of days, hours, or minutes).

Non-bank remittance service providers are also generally required to post this information on their websites and display it prominently in conspicuous places within their premises and/or remittance service centers.

In addition, all transaction fees must be paid by the sender, and the amount expected to be received by the beneficiary cannot be reduced by the receiving RTC.[131] While it is unclear whether non-banks had engaged in this practice, especially in light of the intense competition, one bank described this change as removing a significant revenue stream in its remittance business.[132]

The BSP has a complaints-handling process to receive complaints from consumers and, where necessary, facilitate mediation with an RTC.[133] The most common complaints are:

- fees are perceived as too high (in the case of sending transactions),
- beneficiaries perceive that that they were charged by the receiving RTC,
- remittances are expected but not received, and
- an unauthorized person has claimed a remittance (also, typically in the case of sending RTCs where the unauthorized person was receiving outside of Philippines).[134]

5.5. Other market issues

5.5.1. The unlicensed market

There remains a significant illegal market for remittances provided by unregistered RSPs. The BSP estimates that the illegal market had once comprised as much as 50% of all remittances prior to the first registration requirements issued in 2005, but since then it has been drastically reduced. However, the BSP could not provide an estimate of the scale of the current illegal market.[135] One

[131] Meeting with the BSP, 3 December 2018. We were not able to identify the source of these requirements (other than BSP statements).

[132] Meeting with Bank of the Philippine Islands, 5 December 2018.

[133] Meeting with the BSP, 3 December 2018.

[134] Meeting with the BSP, 3 December 2018.

[135] Meeting with the BSP, 3 December 2018.

market participant downplayed the scale of the illegal market, claiming that in the countryside brands are strong and customers prefer security.[136] Others think it is still significant.[137]

5.5.2. Relationship to e-money

In Philippines, e-wallet providers are regulated by the BSP as e-money issuers. E-money issuers (EMIs) may be banks, non-banks that are supervised by the BSP, and registered RTCs (EMI-Others).

The BSP conducts on-site examinations to ensure that e-money issuers have the appropriate dedicated banks accounts for fund safeguarding.[138] Unlike in some jurisdictions, the liquid assets are not required to be held in a trust account and are theoretically at risk from creditor claims in the event of bankruptcy.[139]

The BSP permits the creation of "KYC-zero" accounts for e-money issuers which users may open by inputting first name, last name and mobile number and creating a password. These accounts have a monthly load limit of PHP 50,000 (~USD 950). The accounts may be used for bill payments, merchant payments and transferring of airtime.[140] Both PayMaya and GCash use these accounts.[141] These "basic" accounts are particularly appealing due to low bank account penetration in Philippines. According to the World Bank's Global Findex Database, only 34% of Filipinos had bank accounts in 2017.[142]

The basic accounts are also subject to limitations. They may not be used to receive international remittances, conduct any P2P transfers or cash out. Rather, the customer must complete the CDD process to upgrade the account and access those services.[143] However, the basic accounts may serve as a stepping stone to upgraded accounts.

EMIs are subject to an aggregate monthly load limit of PHP 100,000 (~USD 1,900) per customer on each issued e-money instrument, unless a higher amount is approved by the BSP. When remittances are sent to an e-wallet that exceed the limit, the EMI has some discretion to determine how to address the situation. Some EMIs will automatically reject the transaction while others will hold the balance that exceeds the limit and deposit it in the customer's e-wallet the following month.[144] Some providers have been critical of this limit and feel that it should be increased, citing it as a barrier for receiving international remittances into wallets.[145]

---

[136] Meeting with PetNet, 4 December 2018.

[137] Meeting with SM Group, 5 December 2018.

[138] Meeting with the BSP, 3 December 2018.

[139] Meeting with the BSP, 3 December 2018.

[140] Meeting with the BSP, 3 December 2018; meeting with PayMaya, 4 December 2018. We have not been able to identify the relevant specific regulatory provisions; they may be contained in direct communications between the BSP and the applicable RSPs.

[141] Meeting with PayMaya, 4 December 2018; meeting with GCash, 6 December 2018.

[142] World Bank 2017 Global Findex Database, available here https://globalfindex.worldbank.org/#data_sec_focus.

[143] Meeting with the BSP, 3 December 2018; meeting with PayMaya, 4 December 2018.

[144] Meeting with the BSP, 3 December 2018.

[145] Meeting with PayMaya, 4 December 2018.

EMIs and some banks are able to complete CDD remotely using a mobile app. PayMaya credits this as one of the factors that allowed their e-money wallet business to grow.[146] GCash previously used video chat for CDD, but now the customer can take a photo of their ID and GCash uses facial recognition software to match the customer's face against the ID. This process is generally automated, but when there is not a match, it is escalated to a person to review.[147]

Leading e-wallet providers and their ability to receive remittances

Today, the two most prominent e-wallet providers operating in Philippines are PayMaya and GCash.

PayMaya is the successor to Smart Money, which was linked to a Smart mobile account. Re-named and re-launched in 2015, PayMaya is accessible through a mobile app and there is longer a requirement to have a Smart mobile account. PayMaya customers receive a "virtual" VISA or MasterCard through the app, with the option to obtain a physical card upon request, which can be used as a debit card to make payments from the wallet. P2P domestic transfers can be made to other PayMaya wallet and bank accounts. Cash-out is available at ATMs or by transferring to PayMaya agents.

PayMaya has partnered with Western Union and Transfast to receive international remittances. Through Western Union, receipt is direct into the Pay Maya account. With Transfast, the recipient must collect the cash at an agent. PayMaya indicated that its international remittances business is still very small.[148]

GCash accounts were formerly linked to a Globe mobile subscription but now are accessible through a standalone app. GCash permits cash-out through ATMs, and at partner outlets, such as pawn shops, supermarkets, "sari-sari" neighborhood convenience stores, and department stores. GCash is currently emphasizing use of QR codes for retail payments, but also offers a debit card through MasterCard. GCash also offers "GCredit" (the lender is its owner, Mynt) to qualifying customers, using a credit score (GScore) based on customers' prior transactional activity, which is similar to an overdraft line of credit. It also has a feature that allows customers to invest in money market funds.

GCash has partnered with Western Union, MoneyGram and Hong Kong's Alipay to enable two means of receiving international remittances. The first is "receiver's choice" whereby a recipient expecting a remittance via Western Union or MoneyGram, which would normally be picked up at an RSP, can instead enter the reference number into the app and receive the remittance directly into the GCash wallet. The second, which applies to MoneyGram and Alipay, is "sender's choice" whereby the sender of the remittance designates the recipient's GCash wallet as the means of delivery. GCash requires that remittances be pre-funded by its partners. GCash characterized their volumes for these services as "not giant, but a meaningful part of the business."[149]

[146] Meeting with PayMaya, 4 December 2018.

[147] Meeting with GCash, 6 December 2018.

[148] Meeting with PayMaya, 4 December 2018.

[149] Meeting with GCash, 6 December 2018.

Through **InstaPay**, an automated clearinghouse established under the BSP's National Retail Payments System policy and regulatory framework, the two major e-wallets are in the process of becoming fully interoperable. Through the GCash app, payments can be sent to PayMaya and other InstaPay participants for no fee. According to GCash, at the time of research, PayMaya did not yet have sending capability through InstaPay, only receiving capability, but was expected to have sending capability soon.[150]

5.5.3. National Retail Payment System (NRPS)

The NRPS framework requires that all clearing of retail payments between BSP-supervised financial institutions (BSFIs, which include banks, RSPs and e-money issuers, among others) be done through the central switch, bilateral clearing arrangements between BFSIs are no longer permitted.

Receiving institutions are prohibited from charging senders or sending institutions for payments, i.e., recipients must receive the transferred amount in full. Sending institutions may still charge senders, but these fees must be lower than fees collected from transactions made manually or over-the-counter. All BSFIs must be initially able to receive funds, and all BFSIs are expected to also eventually develop the capability to send across network.

Under the NRPS framework, the BSP and industry participants have established two automated clearing houses (ACHs) that facilitate these electronic funds transfers: Philippine EFT System and Operations Network (PESONET) and InstaPay.

All BSFIs were required to join either PESONET or InstaPay by 30 November 2018. However, we could not confirm the level of compliance.[151] Several EMIs, including the two most prominent e-wallets, GCash and PayMaya, have joined InstaPay, though at the time of research, no e-wallets had joined PESONet.[152]

Neither InstaPay nor PESONet are open to RTCs who are not EMIs. However, these two ACHs are expected to have an impact on how remittances can be transferred to bank and e-wallet accounts. RSPs, including sending RSPs in other jurisdictions, intermediaries or receiving RTCs in Philippines, will be able to partner with only a single bank to access any bank or wallet account through the two ACHs.[153]

This change has been disruptive to the businesses of banks providing remittance services. Banks generally charge their remittance partners a fee for deposit into their customer bank accounts and large banks with a large number of accounts could charge a premium. However, the RSPs and intermediaries are now free to enter into relationships with small or rural banks, which charge a much lower fee, and then have the money routed through one of the ACHs to any other bank account. In this scenario, the bank that holds the final destination account does not receive any revenue for the remittance that lands in one of its accounts because the NRPS prohibits

[150] Meeting with GCash, 6 December 2018.

[151] Meeting with Chemonics, 6 December 2018.

[152] Meeting with Chemonics, 6 December 2018.

[153] Meeting with PetNet, 4 December 2018.

charging recipients or receiving institutions. This change will force the banks to compete directly on service charges to access the ACHs.[154]

6. Lessons for policy makers and regulators in other jurisdictions

Below we set out observations for policy makers and regulators gleaned from the findings of this study. However, we caution that every market is different, having different remittance volumes, regulatory structures, geographical peculiarities and cultural norms, and so regulatory intervention will have different objectives and impacts depending on the starting point.

6.1. The benefits of market competition and risk-based regulation

6.1.1. Enable competition from non-banks

The proliferation of non-bank RSPs in many countries and the resulting competitive pressure have contributed to a gradual decline in the global average cost of remittances. Malaysia and Philippines have made substantial efforts to develop the market, adopting and implementing regulatory frameworks that support a vibrant market for non-bank RSPs. In Malaysia, competition has driven prices down below the SDG target of 3%.

Market entry procedures are relatively transparent and the requirements are not onerous. In Philippines, the registration process is perceived as straightforward and the BSP is viewed as eager to assist in the registration application process. In Malaysia, the BNM does limit new licenses to RSPs that can demonstrate a value proposition, but this is in the context of an already highly competitive market for non-bank RSPs. Minimum capital requirements in both jurisdictions are not a significant barrier to market entry. To the extent they forced smaller RSPs out of the market, agent frameworks opened another opportunity for these RSPs to participate in the market.

6.1.2. Apply an effective and proportionate regulatory framework

Regulators should apply risk-based regulation and encourage innovation in order to improve governance, reduce vulnerability to bank de-risking, and strengthen consumer confidence.

In Malaysia and Philippines, the BNM and BSP have introduced transparent and coherent regulatory frameworks to make regulation relevant and proportionate to the risks when implementing FATF principles and prudential regulation. In Malaysia in particular, bank de-risking has been limited as confidence in the integrity of RSPs and their oversight has grown.

6.1.3. Enable wholesale markets to grow

Allowing international wholesale remittance providers to act as hubs connecting local RSPs with a vast network of foreign partners increases competition and reduces costs. These arrangements allow sending and receiving RSPs to widen their reach of networks and permit RSPs that were largely corridor-specific to diversify into other corridors with minimal investment.

In both Malaysia and Philippines, the wholesale activities of retail RSPs are monitored as these entities are already licensed or registered by virtue of their retail activities. However, in Malaysia, pure "international remittance hubs" with no retail activities in Malaysia will sometimes not even

[154] Meeting with Bank of the Philippine Islands, 5 December 2018.

require an MSB license, although they will still need BNM confirmation of this and will have their activities monitored. A hub regulated in a well-established regulatory regime elsewhere will be less likely to require a license in Malaysia. The BSP previously did not require registration of entities without retail activities in Philippines, but has recently introduced the "Remittance Platform Provider" category which requires registration and some reporting obligations.

These different approaches have enabled the wholesale market to flourish in each of these jurisdictions. In other jurisdictions, regulators may try other approaches. However, the goal should similarly be to permit growth of a wholesale market which will enable further retail competition while collecting a minimum level of information necessary to monitor the development of the wholesale market.

6.1.4. Allow agent networks to facilitate expansion and compliance

The regulatory frameworks in both Malaysia and Philippines permit RSPs to establish agent networks. RSPs are responsible and accountable for ensuring that agents comply with regulatory requirements. Agent networks provide a lower-cost means of expansion for RSPs than establishing additional branches. This is particularly valuable in remote areas that would not have sufficient remittance volumes to support a stand-alone branch.

In both Malaysia and Philippines, the agent model also helped to address the exodus of RSPs that were unable to comply with the formalization of the sector and increasingly stringent licensing or registration requirements, often driven by AML/CFT concerns. Many smaller players who would have been forced to exit the market entirely were able to transition to serving as agent network providers of larger RSPs. The larger RSPs could support regulatory compliance through training and supervision of the agents.

6.1.5. Avoid rigid CDD requirements that lock in an illegal market

Comprehensive CDD requirements may form a barrier for use of formal, regulated remittance channels. In Malaysia, migrant workers who are present in the country illegally cannot access formal remittance services because they lack the necessary documentation to satisfy the CDD process. As a result, they are often driven to the illegal, unregulated remittance market.

Reducing demand for such services should reduce money laundering and terrorist financing risk. In jurisdictions with substantial numbers of undocumented workers, policy makers and regulators could find ways to permit these undocumented workers to complete CDD processes without risk of prosecution or deportation. One possible solution is a tiered CDD system that permits the transfer of small amounts with minimal CDD, which should be implemented with FATF and other AML/CFT requirements in mind.[155] Another possibility is forbearance of prosecution of immigration violations discovered through the CDD process.

[155] For a discussion of tiered CDD in the context of FATF requirements see FATF, *FATF Guidance, Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion*, 2017 at 7, www.fatf-gafi.org/media/fatf/content/images/Updated-2017-FATF-2013-Guidance.pdf.

6.2. The opportunity of digital services

6.2.1. Embracing experimentation

Encouraging innovation can enable development of the market while regulatory effectiveness is improved.

In Malaysia, the BNM has adopted a regulatory sandbox framework to promote experimentation with innovative technologies in the market. It has promoted the use of e-KYC to further digitize the remittance process, and it supported Project Greenback 2.0 to familiarize migrant workers with digital remittance channels, reportedly leading to significant uptake and reduced costs.

In the Philippines, the BSP has used its 'test and learn' approach, creating an environment that is more conducive to receipt of remittances through digital channels. The BSP also permits remote customer identification and verification technologies such as facial recognition software and video streaming as a substitute for conventional face-to-face contact.

6.2.2. Allowing e-money for digital remittances

E-money may be a useful channel to develop digital remittances services. Although e-money is not yet used extensively for P2P payments in Malaysia and Philippines, e-wallets do serve as a significant bridge between cash and digital remittances channels.

In Malaysia, e-wallets serve as a staging area for digital remittances, affording customers a virtual "place" to cash-in or transfer funds from bank accounts before sending a remittance. In Philippines, e-wallets can be used to receive remittances electronically, a useful option in a country with very low bank account penetration. Where barriers to opening e-wallets are low and there is demand for remittances services among the unbanked (e.g., migrant workers), policies supporting and promoting e-money are likely to foster growth of digital remittances.

In both jurisdictions, the use of e-money for remittances is supported by a transparent and straightforward regulatory framework. In Philippines, the use of e-money by RSPs is built directly into the e-money regulatory framework, with the category of "EMI-Others," i.e., e-money issuers that are non-bank RSPs. While the frameworks for remittances and e-money are more discrete in Malaysia, no e-money issuers we interviewed expressed any difficulties obtaining an RSP license.

6.3. The value of regulatory engagement

6.3.1. Engaging proactively to understand the market and regulate well

Both the BNM and BSP are viewed as open and responsive. Both regulators make substantial efforts to gather and analyze market data and trends, understand technologies and business models, as well as assist RSPs in understanding the applicable frameworks and taking the appropriate actions to comply. Clearly this approach has positive effects on the market.

Data gathering and dialogue with market participants makes for informed regulators. The BNM has been known to reach out to RSPs on its own initiative to inquire about their business, new products and challenges they face, and offer support. The BNM has a broad sense of where it wants the market to head, for example into digital channels, and it is not shy about nudging RSPs in that direction.

6.3.2. Using industry bodies to raise standards and compliance

Industry bodies can be valuable conduits for developing good practices, training and implementation of regulation, as well as feedback to policy makers and regulators. The Malaysia Association of Money Services Business (MAMSB) serves as an advocacy and self-regulatory organization for its members. However, the BNM also uses the MAMSB to improve skills and capacity in the market. For example, licensees are required to be members of the MAMSB, whose training and certification processes improve understanding, expertise and compliance of licensees with AML/CFT and other regulations. The MAMSB is critical for furthering BNM's regulatory objectives and for dialogue between the regulator and the sector it regulates.

6.3.3. Liaising with other foreign and domestic authorities

Remittance services depend on regulators trusting one another to apply and enforce appropriate regulation. However, not all countries are rigorous in their regulation of RSPs, and regulators from one jurisdiction may need to liaise with those of another to ensure common standards are met. Efforts to share expertise and sector data among regulators from different countries will strengthen the confidence among them required to allow a wide variety of players and competition in corridors. The FSB recommendations and FATF principles are useful references for such sharing.

A proper licensing or registration framework is critical for the proliferation of non-bank RSPs. However, these regulatory frameworks do not exist in a vacuum, even domestically. For example, in Philippines, a lack of coordination between the BSP's registration procedures and the approvals of municipal authorities led to delays in registrations and increased costs for RSPs. Remittance services regulators can work closely with other authorities to minimize these conflicts.