Centre for International Finance and Regulation

Towards Financial System Integrity

Research Working Paper Series

E-MONEY KNOWLEDGE PRODUCT
Trust Law Protections for E-Money Customers

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WORKING PAPER NO. 09/2014
MARCH 2014

www.cifr.edu.au

This research was supported by the Centre for International Finance and Regulation (project number E226) which is funded by the Commonwealth and NSW Governments and supported by other Consortium members (see www.cifr.edu.au).

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Acknowledgement

This knowledge product is based on work undertaken by Jonathan Greenacre and Professor Ross Buckley from the University of New South Wales to assist member institutions of the Alliance for Financial Inclusion[1] (AFI) Pacific Islands Working Group[2] (PIWG) to strengthen their respective e-money trust arrangements. The technical assistance is supported by the Pacific Financial Inclusion Programme (PFIP) which is a joint programme of the United Nations Capital Development Fund (UNCDF) and United Nations Development Programme (UNDP) with additional funding support from the Australian Agency for International Development (AusAID) and the European Union/Africa, Caribbean and Pacific Microfinance Framework Programme (EU/ACP). Mr Greenacre's and Professor Buckley's continuing contribution to this knowledge product is part of further research into the regulation of mobile money funded by the Centre for International Finance and Regulation (CIFR) with support from UNCDF and Standard Chartered Bank.

[1] The Alliance for Financial Inclusion (AFI) is a global network of financial inclusion policymaking bodies, including central banks, in developing and emerging countries: www.afi-global.org
2 The Pacific Inclusion Financial Inclusion Working Group (PIWG) was formed in 2009 at the request of the central banks of Fiji, Samoa, Solomon Islands, Vanuatu, Papua New Guinea and Timor Leste.

EXECUTIVE SUMMARY

This knowledge product examines how trusts law can be used to protect 'customers' funds'. These are funds that a customer provides to an e-money provider in exchange for electronic or 'e-money'.

The Main Risk to Customers' Funds

There are three main risks to customers' funds:

- Bankruptcy or insolvency (loss of agent or customers' funds), which can arise when the Provider is insolvent or otherwise fails, and customers' funds are used to repay the Provider's debts;
- Illiquidity (unavailability of agent or customers' funds), which can arise when the Provider uses customers' funds for its own purposes and then does not have enough funds left in its account to provide to customers when they request it;
- Operational risk, which is loss of customers' funds due to the Provider, or an employee of the Provider's fraud, theft, misuse, negligence, or poor administration.

Trusts Law Can Protect Customers' Funds

Trusts law can protect customers' funds in three ways:

- Protection 1: Fund isolation, which primarily involves ensuring the customer, not the Provider, holds the ultimate interest in the funds, and can be achieved by requiring the Provider to store customers' funds in a 'trust';
- Protection 2: Fund safeguarding, which involves liquidity, restriction on use, and diversification rules that aim to ensure the Provider always has a 1:1 ratio between issued e-money and customers' funds;
- Protection 3: Reducing operational risk, particularly in relation to theft of customer's funds, by requiring the Provider to regularly audit the trust funds, which are checked by the regulator.

The Model Trust Deed Can Help Create These Protections

A regulator can create these protections by implementing provisions from a 'Model Trust Deed', which is attached to this Knowledge Product. The Model Trust Deed contains the following three features:

Feature of Model Trust Deed	Trust Protection Created	Explanation	Clauses of Model Trust Deed
Declaration of Trust	Protection 1: Fund Isolation.	Establishes a trust relationship between customers and the Provider. It also requires that customers' funds not be mixed with the Provider's own funds.	2, 3
Customer Protection Rules	Protection 2: Fund Safeguarding.	Contains rules relating to liquidity, restrictions on use, and diversification.	4-7, 10-13
An Active Regulator	Protection 2: Fund Safeguarding. Protection 3: Reduce Operational Risk, Particularly Theft of Funds.	• Contains rules relating to auditing of accounts; and • Provides the regulator with authority to ensure the Provider complies with rules relating to: o Fund Safeguarding; and o Auditing.	8, 9.

Implementing the Model Trust Deed

A regulator should not simply cut and paste the entire Model Trust Deed for use in its jurisdiction. This report contains an implementation strategy which a regulator can use to determine which provisions, if any, of the Model Trust Deed should be implemented. All recommendations in this document are subject to obtaining legal advice on the law in individual jurisdictions.

Structure of Report

This Knowledge Product consists of the following parts:

- Part 1: The three trust protections;
- Part 2: How a regulator can implement the trust protections - in theory;
- Part 3: How a regulator can implement the trust protections - in practice; and
- Appendix: A dictionary of trust law terms used in the Knowledge Product.

PART 1: BACKGROUND OF PROJECT

At the request of the Alliance for Financial Inclusion's Pacific Islands Working Group (PIWG), the Pacific Financial Inclusion Programme (PFIP)[3] contracted Jonathan Greenacre, a consultant, to analyse the trust arrangements used by e-money issuers in the following Pacific countries: Fiji, Papua New Guinea, Samoa, Tonga, and Vanuatu (collectively termed 'Pacific focus countries' in this document).

This project was designed to focus upon customer protection mechanisms contained in the trust arrangements in each country and make recommendations on how to strengthen them. It was a remote project, and involved liaising with e-money providers and regulators in each country through email and teleconferences. The regulators included the Reserve Bank of Fiji, the Bank of Papua New Guinea, Central Bank of Samoa, the National Reserve Bank of Tonga, and the Reserve Bank of Vanuatu. The relevant e-money issuers were Digicel Fiji, Digicel Vanuatu, Digicel Samoa, Digicel Tonga, Digicel PNG, Vodafone Fiji, and Post PNG.

The project was undertaken in two separate stages: June-September 2012 and January-March 2013. This Knowledge Product and the Model Trust Deed come from insights obtained from both stages of the project.

PART 2: THE THREE TRUSTS PROTECTIONS FOR E-MONEY

1. The Main Risks to Customers' Funds

Introduction to E-money

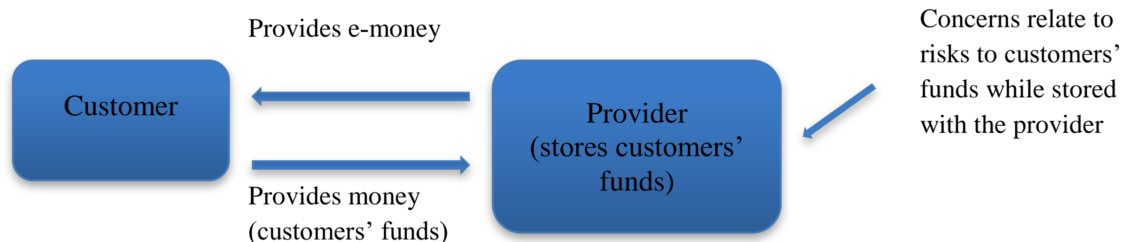
This Knowledge Product relates to electronic money or 'e-money'. While precise terminology tends to vary across countries, *e-money* is typically defined as a type of stored value instrument or product that (i) is issued on receipt of funds, (ii) consists of electronically recorded value stored on a device (such as a server, card, or mobile phone), (iii) may be accepted as a means of payment by parties other than the issuer, and (iv) is convertible back into cash.[4] The concepts of stored value and convertibility distinguish e-money from credit cards, retail gift cards, airtime, and other payment instruments that are not readily convertible.

An e-money issuer may be a payment service provider, credit issuer, or telecommunications company. This Knowledge Product focuses on these types of 'nonbank' providers, which are labeled 'Providers' for the purposes of this paper. In particular, the Knowledge Product examines (i) *risks that arise when the Provider stores customers' funds, and (ii) the use of trust law to minimise these risks*. The basic model operates as follows and is also depicted in the diagram below. The customer deposits or 'cashes in' money ('customers' funds') with the Provider in exchange for e-money. The Provider often stores the customers' funds while the customer uses e-money to trade with other customers. Later, the customer

[3] PFIP is a joint programme of the United Nations Capital Development Fund (UNCDF) and United Nations Development Programme (UNDP) with additional funding support from the Australian Agency for International Development (AusAID) and the European Union/Africa, Caribbean and Pacific Microfinance Framework Programme (EU/ACP). The mission of the PFIP is to increase by 500,000 the number of low income and rural households, micro and small enterprises in Pacific Island Countries (PICs) that have on-going access to quality and affordable financial services by 2013.

[4] Alliance for Financial Inclusion, 'Guideline Note Mobile Financial Services: Basic Terminology' (CGAP, 2012).

'cashes out' his or her e-money. This means that the customer returns any remaining e-money that he or she has for an equivalent amount of cash from the Provider. Recently, concerns have been raised that customers' funds may not be adequately protected while they are stored with the Provider.[5]



It is easiest to understand these concerns by comparing the operation of banks and Providers.

- Regular banking: customers deposit money with banks, and the government uses 'prudential regulation' to protect such deposits. Prudential regulation, which involves a variety of tools such as limitations on leverage, aims to reduce the riskiness of banks which then helps ensure that deposits are kept safe as they are intermediated (ie lent) to borrowers;
- E-Money: Prudential regulation is not normally applied to Providers as they are not usually legally permitted to intermediate customers' funds. E-money is largely treated as 'counterparty risk', that is a temporary risk while funds are transferred electronically from one party to another. However, ever larger amounts of customers' funds are being stored as a 'float', the aggregate value of funds stored electronically. This makes it increasingly important to protect such funds.

Usually, rules that outline how a Provider must deal with customers' funds are contained in a variety of sources. These often include regulations, correspondence from a country's financial regulator to the Provider, and provisions in the Provider's contract which the customer signs when he or she begins using e-money ('non-trust documents'). This knowledge product examines how *trusts law can be used to protect customers' funds while such funds are stored with the Provider*.

Risks to be Reduced

Three main risks can arise for customers' funds while they are stored with the Provider. These are:

(i) Bankruptcy or Insolvency (Loss of customer or agent funds)

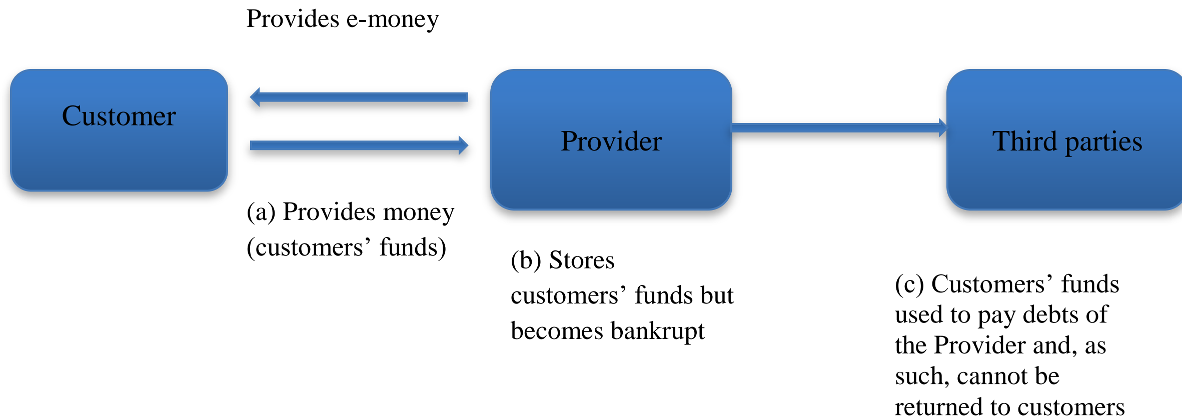
Like a bank, there is a risk that the Provider may become insolvent (cannot pay its debts), bankrupt (court determines the Provider has become insolvent) or otherwise fails. If this occurs, the Provider may use customers' funds to repay debts that it owes to other parties ('third parties'). This use of funds might be required under the bankruptcy laws if customers' funds are not held under a trust.[6] This problem may be exacerbated if the Provider uses customers' funds as collateral (ie pledged as security for repayment of a loan) to obtain loans from third parties.[7] An example of loss of customer funds is outlined from (a) to (c) below.

---

[5] See, for example, Michael Tarazi and Paul Breloff, 'Nonbank MNOs: Regulatory Approaches to Protecting Consumer Funds' (CGAP, 2012), and Kate Lauer and Michael Tarazi, 'Supervising Nonbank E-Money Issuers' (CGAP, 2012). Much of the material in this Knowledge Product is drawn from these texts.

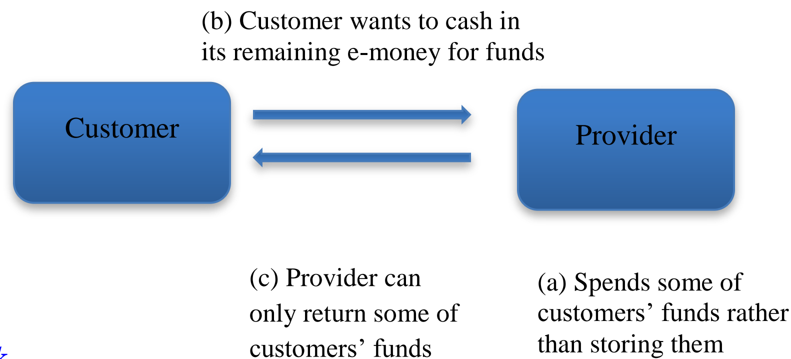
[6] Note that this use of funds may be required even if the customers funds *are* clearly distinguished. The customer may be an unsecured creditor – they will be subject to the *pari passu* rule. Their funds *will* be used to pay outstanding debts.

[7] Note that in such case they may have a relatively weak claim (rather than an equal claim) against a secured creditor.



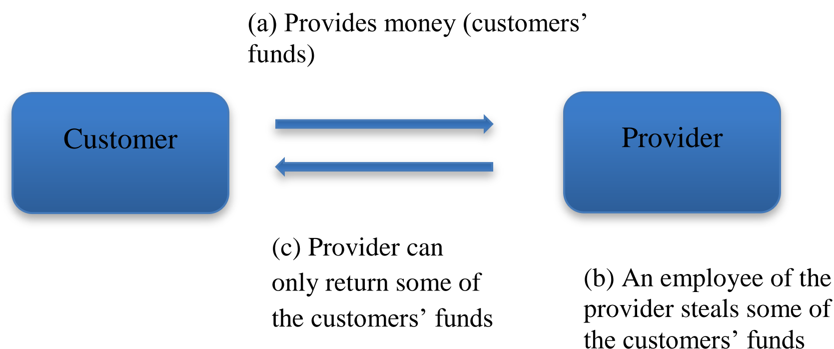
(ii) Illiquidity (Unavailability of customers' funds)

A Provider should provide only as much e-money as exists in the e-money system or 'float', which is held by customers, agents, and itself. In other words there should be a 1:1 relationship between e-money and customers' funds. However, this 1:1 relationship can be broken if the Provider spends some of the customers' funds for its own purposes. For example, the Provider may spend customers' funds to pay for its operating expenses rather than storing them. This may mean that when a customer seeks to cash in its remaining e-money, the Provider cannot return all of it. This is outlined from (a) to (c) below.



(iii) Operational Risk

Operational risk arises due to the Provider's internal activities, such as fraud, theft, misuse, negligence, or poor administration. This form of risk became prominent in May 2012, when it emerged that employees of Telco MTN Uganda had stolen around US$3.5 million from an account used to store cash which had been incorrectly sent through its e-money service. This Knowledge Product only covers fraud and theft in relation to *customers' funds that are held in the trust fund*. The process of operational risk in relation to customers' funds is outlined from (a) to (c) below.



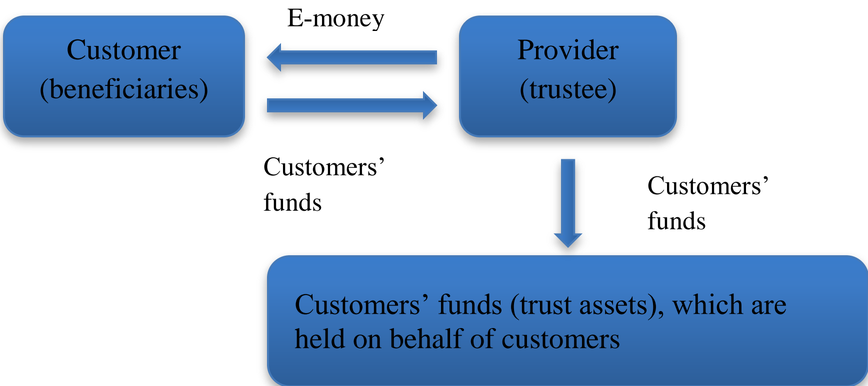
2. Using Trusts Law to Reduce Risks to Customers' Funds

The Basic Operation of Trust Law

> Trust legislation operates in many of the Pacific focus countries. This legislation helps determine the duties of the trustee. For example, the *Trustee Act* (1966) applies to trusts in Fiji.

A trust is a legal relationship between a trustee, a beneficiary and trust 'assets'. This relationship may be established by the execution of a Model Trust Deed. The trustee has power to use the trust assets. When doing so, the trustee is usually required to comply with a number of *duties* that it owes the beneficiary. An overarching duty is to use the trust assets for the benefit of the beneficiary. A number of other trustee duties are usually imposed on the trustee, such as understand and adhere to its obligations under the trust deed, exercise the skill of a 'prudent' person in the performance of duties under the trust, and not profit from the office of trustee.

The beneficiary can enforce the terms of the trust deed because he or she has certain *rights* against the trustee, as well as third parties who obtain, or claim a legal interest in trust assets. The beneficiary can enforce those rights by suing the trustee for failing to comply with the trustee duties. In relation to e-money, a trust relationship would consist of the following:



Reducing the Risk of Loss of Customers' Funds

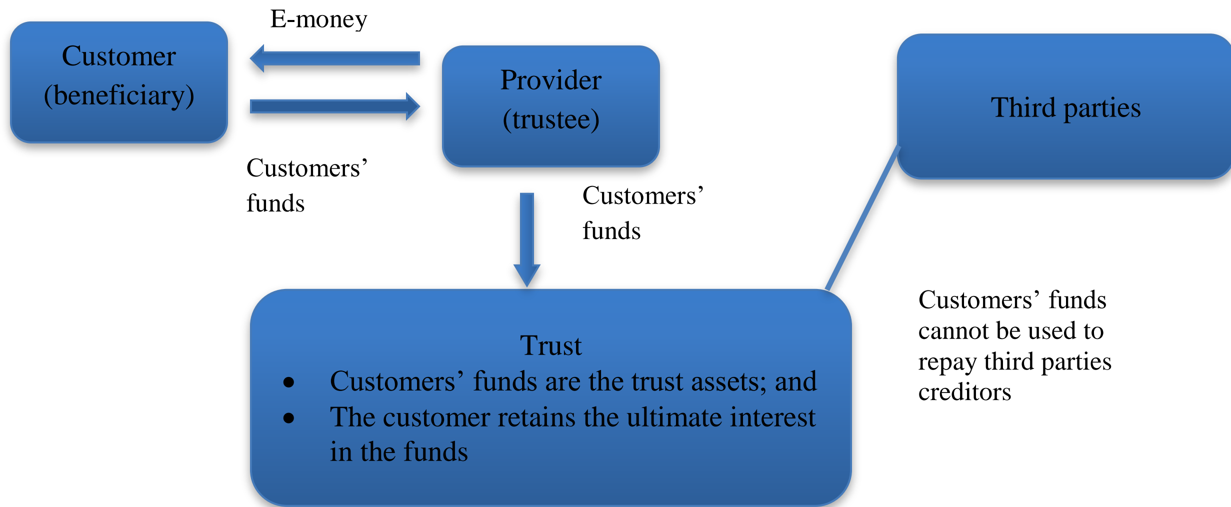
There are three main methods of reducing the risk of loss of customers' funds.

Protection 1: Fund Isolation

Fund isolation rules address the problem of loss of customer or agent funds. This problem occurs because of the way laws tends to classify ownership of funds. Usually, customers' funds are stored in aggregate in one or more bank accounts in the name of the Provider, not the customers. This structure means that the *Provider is the legal owner* of the account. In the event of insolvency the Provider can use the customers' funds to pay off debts.

Fund isolation deals with this problem by requiring the provider to store customers' funds in a separate account, usually a 'trust account' in a bank. If there is a trust declared over the funds which are held in this separate bank account the *customer* retains the ultimate interest in the funds. As such, the funds

cannot be used to pay off the Provider's debts.[8] In other words, customers' funds are held separate *and* legally *isolated* from the assets of the Provider. This protection operates as follows:



Protection 2: Fund Safeguarding

(i) The Rules

Fund safeguarding rules aim to minimise both the loss of agents' or customers' funds and illiquidity risk. These rules aim to ensure the Provider always has a 1:1 ratio between e-money and the float. Maintaining this 1:1 ratio means that the provider will always have enough customers' funds to repay the customers when they want to cash in their remaining e-money. Three main categories of rules aim to achieve the 1:1 ratio:

- **Liquidity**: Liquidity rules usually require the Provider to hold 'liquid assets' (ie can be quickly converted into cash) such as bank deposits or government securities. These liquid assets should be equal to the amount of e-money that it has distributed (the 'e-float'). This is often achieved by requiring the Provider to hold customers' funds as deposits in a bank. This example below demonstrates how liquidity rules operate:

A Provider must hold an equal value of:	
E-money	Assets
Eg $10,000 worth of e-money	Eg $10,000 worth of deposits in a prudentially regulated bank

These assets operate as a form of insurance over customers' funds. Because the assets are liquid, the Provider should be able to quickly and easily convert them into regular money. This should mean that the assets are always available to return customers' funds when customers want to cash in their e-money.

[8] The distinction between beneficial owner and legal owner is an important one, and should be carefully considered.

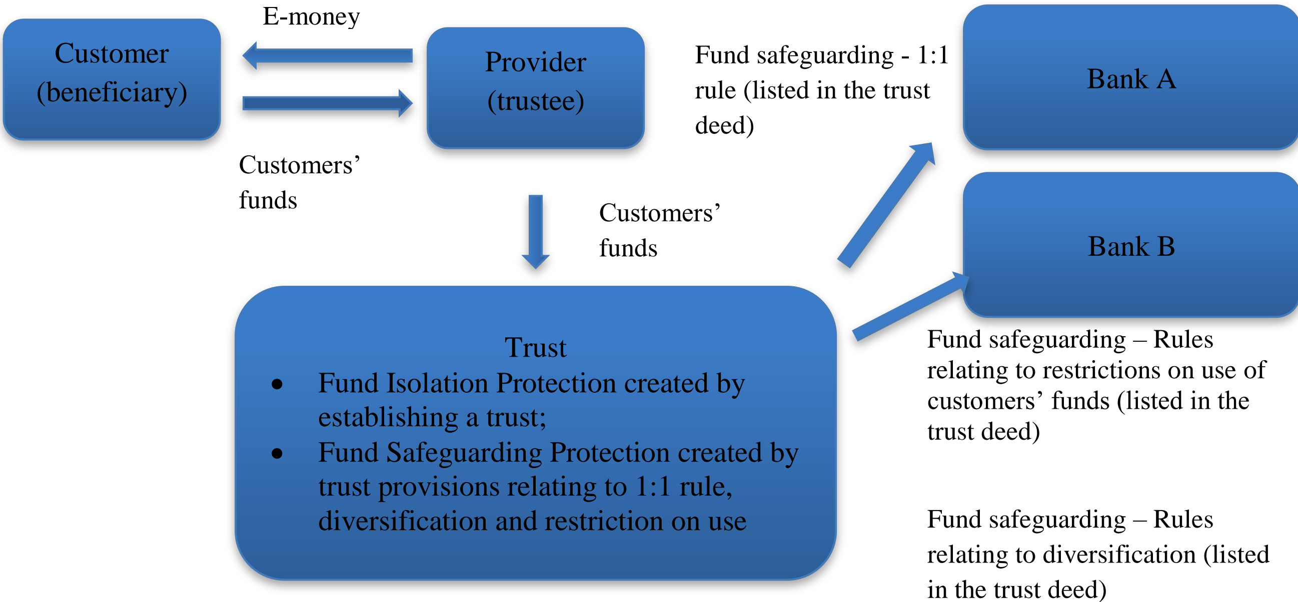
- **Restrictions on use of customers' funds**: These restrictions aim to ensure that the Provider isolates and restricts the use of customers' funds *rather than uses them for any other purpose*. When these funds are isolated, they can later be returned to customers who want to cash in their e-money. Several particularly common examples of restrictions on use of customers' funds include requirements that the Provider:
    - Cannot use customers' funds to finance its own operating expenses;
    - Can only use customers' funds to repay customers who want to cash out their remaining e-money;
    - Cannot use its customers' funds as collateral or guarantees; and
    - Cannot use customers' funds to extend credit.

- **Diversify e-float fund holdings**: As outlined above, liquidity rules often require the Provider to hold customers' funds in a bank. These assets may be lost if the bank becomes insolvent. Diversification rules aim to reduce the risk that *all* assets would be lost by requiring the Provider to hold these assets in multiple banks.

> The Pacific focus countries tend to have strong fund safeguarding rules. For example, in Fiji, rules exist in relation to liquidity and restrictions on the use of customers' funds. However, some of these rules are contained in draft guidelines only, and it should be clarified whether they apply to e-money in Fiji.

(ii) Ways in Which Trust Law Can Create Fund Safeguarding Rules

Trusts law can be used to *outline fund safeguarding rules*. These rules can take the form of 'trustee duties', which outline how the trustee (who may be the Provider) must deal with the customers' funds (the trust assets). These duties can be 'explicit', which means they are contained in the trust deed, trusts legislation and general law, or 'implied', which means the court determines that a term is required to 'fill a gap' in the trust deed. Ultimately, most fund safeguarding rules can be contained in the trust deed, so long as it is adequately drafted. The explicit and implied duties can form a 'rule book' which outline how the Provider (as trustee) must deal with customers' funds. The use of trusts to create fund safeguarding rules appears as below:



Protection 3: Reducing Operational Risk

(i) The Rules

There are a wide variety of rules relating to operational risk, such as misappropriation or negligent mismanagement of assets. This Knowledge Product has insufficient length to closely consider all of these rules. Instead, the report focuses on rules that *minimise the risk of theft of customer's funds, including through fraud*. Reducing such theft and fraud involves requiring the Provider to keep records of the account in which customers' funds are held, and ensure that these accounts can be checked by a regulator ('audited'). If accounts are being checked, there may be less opportunity for employees of a Provider to steal from customers' funds.

(ii) Ways in Which Trust Law Can Create Rules that Minimise Operational Risk

Trust law can create rules that minimise operational risk in relation to customers' funds in two ways:

(a) Auditing

The trust deed can contain clauses that outline when the Provider must audit the trust accounts, and describe how this auditing should take place. This auditing process can help ensure the integrity of the system.[9] These rules can be in the form of trustee duties, like with the duties in relation to fund safeguarding rules (outlined above).

(b) *Monitoring*

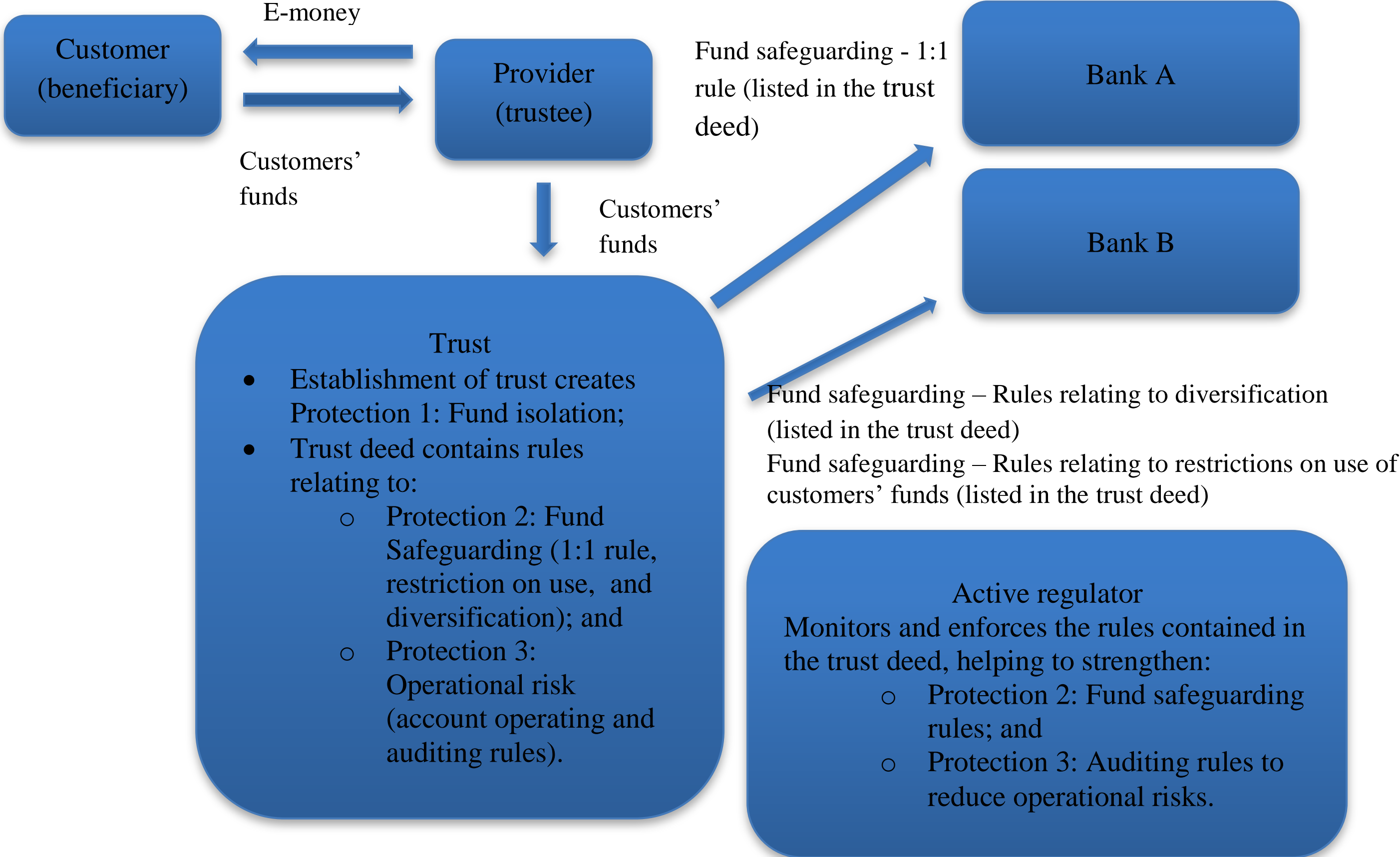
It is advisable that there is a person who is provided with powers to ensure that the Provider is actually auditing the trust account and (more importantly) that trust funds are safe, and that the Provider is complying with the terms of the trust. Normally in trust law the beneficiaries or their designate would do the auditing. This is because, as outlined above, the customers (as beneficiaries in the trust), have the power to enforce the terms of the trust by suing the Provider (as trustee) for breaches of the trust's terms. This means that regulators usually take a largely *passive* approach to monitoring trust accounts adopted by regulatory bodies.

However, this traditional approach to monitoring the Provider's actions may not be feasible in relation to e-money. For many customers, e-money is their first sustained interaction with formal financial services, and they may not be educated and experienced in relation to trust related rules and principles.[10] This lack of practical oversight may enable the Provider to avoid complying with the trust deed, increasing operational risk.

> Regulators in Fiji, Samoa, and Vanuatu already take a quasi-active supervisory approach by requiring e-money providers to produce financial reports.
>
> However, the rules around reports are piece-meal and these regulators appear yet to determine an *overall regulatory approach* to e-money. Determining such an approach may help the regulators to design a coherent set of rules for e-money.

[9] Michael Klein and Colin Mayer, 'Mobile Banking and Financial Inclusion: The Regulatory Lessons' (World Bank, 2011), 13.
[10] Denise Dias and Katharine McKee, 'Protecting Branchless Banking Consumers: Policy Objectives and Regulatory Options' (CGAP, 2012).

In this instance the country's e-money regulator should take an *active approach* that involves monitoring and enforcing the terms of the trust *on behalf of* the customers. This approach is used in other areas of trust law, such as in off-shore jurisdictions where investors are concerned about the trustworthiness of trustee companies who held funds on their behalf. This role would operate as follows.



As outlined above in Part 1, in many countries, some, or all of these protections are contained in non-trust documents. Furthermore, regulators could impose these rules through non-trust law regulation, such as legislation. A more long-term solution to protecting customers' funds may come through legislation.

> In several Pacific focus countries customer protection provisions may be contained in a variety of non-trust documents. For example, in Samoa, these documents include the *Trustee Act* (1975), *Trustee Companies Act* (1988), and Digicel Samoa's Mobile Money Operations Manual.

However, until such legislation is drafted, it may be advisable to implement the trust protections contained in the Model Trust Deed. The benefit of implementing a trust deed which contains the relevant provisions is that an effective trust deed can simultaneously create the fund isolation, fund safeguarding, and operational risk protections. Furthermore, a trust deed can be used as a 'stop-gap' measure until a country's e-money market develops, and a regulatory framework becomes necessary.

However, trusts law has some important limitations which need to be considered. The recognition of the trust law principles outlined in this Knowledge Product is largely limited to jurisdictions which have a 'Common Law' legal system. This system, which is based upon the English legal system, is used by a

large number of countries, such as Fiji, Kenya, Papua New Guinea, and Uganda. The recommendations in this Knowledge Product will not be directly applicable to non-Common Law countries, such as Civil Law countries.[11]

PART 3: HOW A REGULATOR CAN IMPLEMENT THE THREE TRUST PROTECTIONS – IN THEORY

A country's regulator can create the three trust protections (fund isolation, fund protection, operational risk) by implementing clauses taken from the Model Trust Deed. This document is attached to this Knowledge Product and contains three main features:

Feature of the Model Trust Deed	Trust Protection Created	Explanation
Declaration of Trust	Protection 1: Fund Isolation.	Establish a trust relationship between customers and the Provider.
Customer Protection Rules	Protection 2: Fund Safeguarding.	Model Trust Deed contains rules relating to liquidity, restrictions on use.
An Active Regulator	Protection 2: Fund Safeguarding. Protection 3: Reduce Operational Risk.	Model Trust Deed: • Contains rules relating to auditing of accounts; and • Provides the regulator has authority to ensure the Provider complies with rules relating to: o Fund Safeguarding; and o Auditing.

This report does *not* recommend that a regulator necessarily adopt all of the clauses of the Model Trust Deed. Each regulator should consider which of clauses are appropriate, using the implementation principles listed in Part 3 of this Knowledge Product. A regulator may decide that certain terms of the Model Trust Deed are not appropriate in the context of their jurisdiction and/or the commercial context in which the Provider operates.

Feature 1 – Implement a Trust Deed Which Contains a Declaration of Trust

As outlined above in Part 1, the fund isolation protection can protect customers' funds if there is a trust relationship between the customer and Provider. Usually, to establish such a relationship, there must be *sufficient evidence of an intention to form a trust relationship.*

> In Papua New Guinea, Digicel PNG and Post PNG use trust deeds, each of which contains a declaration of trust. This demonstrates a clear intention to form a trust relationship between the customer and the Provider.

The strongest evidence of such an intention comes from the following:

[11] An additional limitation of trust law is the traditional difficulty of suing a trustee. For example, if a trustee steals customers' funds and uses such funds to purchases an asset (e.g. a car), the beneficiaries cannot sue the car dealer; *unless* the car dealer was dishonest (e.g. they knew the money was stolen). This is a technical avenue of law.

- *Implementing a trust deed*: This is a legal document that outlines how the trust relationship between the Provider and customers will operate; and
- *A declaration of trust*: The trust deed should contain a trust declaration, in which the Provider (who is the individual establishing the trust, otherwise known as the 'settlor') declares that it holds the customers' funds ('trust assets') on behalf of the customers (the 'beneficiaries').

The following clauses of the Model Trust Deed demonstrate a clear intention to establish that a trust relationship exists between the parties: [12]

Clause in Trust Deed	Explanation of How Clause Demonstrates an Intention to Establish a Trust Relationship
Use of trust deed	Demonstrates an intention to operate the relationship through a trust deed and ultimately trust law, rather than as regular relationship established through use of a contract.
Clause 3	Declares that a trust relationship exists between the parties.

Feature 2 – Include Fund Safeguarding Rules in the Model Trust Deed

As outlined above in Part 1, the trust deed can contain trustee duties which can be used as rules that require the provider to deal with customers' funds in certain ways. The Model Trust Deed contains clauses that have this effect. At the outset, it is important to note that there is no international 'best practice' on a number of important customer protection provisions contained in the Model Trust, such as interest payments.[13] Regulators will need to determine the position they will take on such provisions.

> Any fund safeguarding rules that are imposed will need to be consistent with other regulation in each country. For example, in Vanuatu, the *Trustee Company Act* (1971) may impose obligations upon a trustee that contradict those contained in the Model Trust Deed.

The table below outlines the trust protections listed in the Model Trust Deed.

Aspect of Fund Safeguard	Clause in Model Trust Deed	Explanation of How Provision Provides Fund Safeguarding Protection
Liquidity	Clause 4	Requires the Provider to pay all customers' funds into an account or accounts at a prudentially regulated banking institution.[14]
	Clause 5	Maintains a 1:1 ratio between e-money and customers' funds requiring that the Provider ensures the amount of money in the trust fund is at least equal to the amount of e-money it has issued.[15]

[12] Note that the Provider is the trustee in the Model Trust Deed. Other individuals could be the trustee, and there are no set rules about who should serve in this position. However, given that the trustee holds a position of considerable responsibility and power, and is subject to a variety of duties which require competence and diligence, such a person should generally be competent, reliable and have integrity. In many circumstances this may involve a lawyer, a trustworthy member of the community, or a company of good standing who assumes trustee duties. The regulator would not normally serve as trustee. However, the regulator does have an active role under the Model Trust Deed.

[13] See, eg, Tilman Ehrbeck and Michael Tarazi 'Putting the Banking in Branchless Banking: Regulation and the Case for Interest-Bearing and Insured E‐ money Savings Accounts' (World Economic Forum, 2011).

[14] See similarities with other jurisdictions, for example, Indonesia: Bank Indonesia Regulation Concerning Electronic Money, No. 11/12/PBI/2009, 13 April 2009; and Circular Letter Concerning E-Money, No. 11/11/DASP, 13; see Malaysia also (Guideline on Electronic Money BNM/RH/GL -16-3, July 2008).

[15] See Philippines (Circular 649, 9 March 2009).

Aspect of Fund Safeguard	Clause in Model Trust Deed	Explanation of How Provision Provides Fund Safeguarding Protection
Restriction on the use of customers' funds	Sub-clauses 4.2 and 4.3	The Provider can only *invest* customers' funds into the bank accounts approved under the terms of the Model Trust Deed, and so the Provider: • Cannot use the customer deposits to finance its own business operations, except in so far as funds can pay the trustee's reasonable remuneration and expenses; • Can only use the funds the customer deposits to repay customers who want to cash out their remaining e-money; • Cannot use customers' funds to extend credit.[16]
	Clause 6	Requires the Provider to use surplus interest earned on the customers' funds in the bank account(s) for the following payments in order of priority: • Operating expenses of the trust fund, including any bank fees; • Reasonable remuneration of the trustee; and • For any remaining balance, to the Provider.[17]
	Clause 7	Requires the Provider to cash in e-money for customers' funds when the customer is entitled to such funds, and includes provisions for unclaimed monies.
	Clause 10	Prevents the Provider from changing the trust terms to get access to customers' funds.
	Clause 11	Obliges the trustee to pay customers' funds to customers if the trust is terminated.
	Clause 12	Aims to ensure only reliable and trustworthy persons ('fit and proper') become trustee.
	Clause 13	Enables the regulator to remove a trustee if the regulator believes the trustee: • Is not complying with the terms of the trust deed or any other duties according to law; and/or; • Is not a 'fit and proper' person or under the control of people who are fit and proper.
Diversification	Clause 4.1(b)	Enables the Provider to open a deposit account at multiple prudentially regulated banks, but does *not* oblige it to do so. This is because (i) few regulators require Providers to open deposits at a variety of prudentially regulated banks, and (ii) banks are usually regulated in a manner which provides extensive protection for the deposits, which often makes diversification unnecessary.[18]

[16] See Indonesia (Circular Letter Concerning E-Money, No. 11/11/DASP, 13 April 2009).
[17] Note the international disagreement about whether interest should be payable to customers. See, eg, Tilman Ehrbeck and Michael Tarazi 'Putting the Banking in Branchless Banking: Regulation and the Case for Interest-Bearing and Insured E- money Savings Accounts' (World Economic Forum, 2011).
[18] This approach is used in Afghanistan (Amendment to the Money Service Providers Regulation to Extend Regulatory Oversight to E-Money Institutions, 25 November 2009) and Kenya.

Feature 3 – Provide the Regulator with Active Powers

As outlined in Part 1, an active regulator can monitor the way in which the Provider complies with the trust deed, which can help strengthen the fund safeguarding rules (protection 2) and auditing rules (protection 3). The Model Trust Deed describes the regulator as a 'Protector', and provides the institution with the following authority, powers, and responsibilities to this end:

Regulators in Tonga and Vanuatu suggested they may not have legislative authority to regulate e-money. Establishing such authority will be required to take an active approach.

Provision in Model Trust Deed	Explanation of How Clause Provides Clear Authority, Powers and Responsibilities
Clause 8.1	Determines which of a country's regulators has authority to take an active role in relation to the trust fund.
Clause 8.2	Outlines the duties of the regulator, particularly to operate in the interests of the customers.
Clauses 8.3 and 8.4	Lists the power of the regulator, such as: • Demand additional audits of accounts; • Refuse to agree to the Provider's application to amend the trust deed; • Refuse to provide consent to the Provider's proposed application to terminate or wind up the trust deed; • Refuse to provide consent to the Provider's proposed application to appoint a new person as a new trustee; • Remove a Provider; and • Sue the Provider on behalf of the customers. These powers ensure that the trust account is operated in the interests of customers.
Clause 9	Enables the regulator to review the audits of the trust fund, which reduces the opportunity for the Provider, or the employees of the Provider, to engage in theft or fraud. This monitoring process can be done in conjunction with the banks in which the Provider has deposited customer funds.[19]

PART 4: HOW A REGULATOR CAN IMPLEMENT THE THREE TRUST PROTECTIONS – IN PRACTICE

As outlined above in Part 2, regulators should not simply transplant the provisions of the Model Trust Deed into their jurisdictions. Experiences from other jurisdictions, particularly Kenya, suggest that regulators should be cautious and careful in designing regulation for e-money. Several steps, outlined below, may help regulators to ensure that regulation adequately minimises risks, while also permitting e-money to develop.[20]

[19] Section 6.2 of Sri Lanka's Mobile Payment Guidelines No. 2 (2011) for Custodian Account Based Mobile Payment Services.
[20] See, in particular, the experience of the Central Bank of Kenya in designing regulation for M-Pesa (Mwangi S. Kimenyi and Njuguna S. Ndung'u, 'Expanding the Financial Services Frontier: Lessons From Mobile Phone Banking in Kenya (Brookings, 2009)).

Step 1: Determine Regulatory Authority and Capacity

In many countries, regulators do not have clear authority to supervise e-money. This is often because regulatory authority is shared between a country's central bank, bank regulator, and telecommunications authority.[21] Providing a regulator (or multiple regulators) with sufficient authority to regulate e-money is the first step in implementing the trust protections.

It is also crucial to ensure the regulator has sufficient capacity to regulate e-money. This is a new and rapidly developing form of financial service, and many regulators are still growing their understanding of the risks in this market, and the technical regulatory approaches of dealing with them. Furthermore, the law of trusts often interacts with a variety of legislation including unit trusts and trustee companies, perpetuities, banking, and bankruptcy. Regulators should only implement regulation that they have sufficient technical understanding to supervise effectively.

Step 2: Use Implementation Principles to Determine Which Clauses of the Model Trust Deed to Use

As outlined above in Part 2, the Model Trust Deed should not be 'cut and pasted' into any country. Regulators should follow three 'implementation principles' to determine which aspects of the Model Trust Deed are appropriate for their home jurisdiction and the specific commercial context of the Provider.

Approach E-money Regulation Holistically

Regulators should aim to use trusts law as part of a wider regulatory framework for e-money. There are various issues which cannot be adequately addressed through the implementation of a trust deed (e.g. limits on the amounts of e-money which can be held by a customer, operational and verification issues and competition concerns), all of which are important for customer protection and the wider development of the e-money market. Implementing the Model Trust Deed without addressing those other issues may create regulatory gaps that distort the operation of the market.[22]

Use a Consultative Approach

Countries with the most advanced e-money markets tend to have a consultative regulatory model, in which the regulator, Providers, and banks work together to design effective regulation. By obtaining input from the private sector, regulators tend to be better able to design regulation that protects customers but is also commercially viable and ultimately enables the e-money market to grow.[23] Furthermore, and as outlined in Part 2, regulators will need to decide upon their policy for important aspects of customer protection. A consultative approach with the private sector will enable regulators to determine policy that protects customers but can still enable Providers to continue developing their products.

Likely Effectiveness: Consider Local Circumstances

Each country requires a customised approach. Important issues such as domestic legal principles and rules, culture, politics and corruption levels, will determine whether clauses from the Model Trust Deed are likely to operate effectively (e.g. whether there is legislation which impacts upon the operation of a

[21] In Kenya, the financial supervisor has established its authority through written agreements with the Provider.
[22] For an overview of those issues, see Claire Alexandre, Ignacio Mas, and Daniel Radcliffe, 'Regulating New Banking Models to Bring Financial Services to All' (2011) 54 *Challenge*, no. 3.
[23] See again, the policy and practice of the Central Bank of Kenya as discussed in Kimenyi and Ndung'u, note 17 above.

trust deed). Furthermore, while some guidance from other countries may assist this process, regulators should not try to mimic other jurisdictions too closely. This is because the regulatory objectives and approach to achieving these objectives will differ from country to country, according to, amongst other things, the types of models and services being offered, the prudential framework, and the level of financial system development.[24] Consequently, during the consultative process, regulators should be mindful of which aspects, if any, of the clauses of the Model Trust Deed can operate effectively their home country.

Adopt a 'Proportional' and 'Light Touch' Approach to Implementing the Recommendations

Regulators should remember that *more extensive implementation of the Model Trust Deed may better protect customers but will also impose increased regulatory costs on the Provider and the regulator*. This point is outlined in the 'implementation spectrum', below:

Features of Knowledge Product	Level of implementation of Model Trust Deed		
	Limited	Moderate	Extensive
Declaration of Trust	• No trust documents; and • No declaration of trust.	Declaration of trust in a non-trust document, such as a consumer contract.	• Use of trust deed; and • Trust deed contains a declaration of trust.
Customer Protection Rules	Implement few provisions of the Model Trust Deed, if any.	Implement some of the Model Trust Deed.	Implement many or all of the provisions of the Model Trust Deed.
An Active Regulator	Limited regulatory powers.	Moderate regulatory powers.	Strong regulatory powers.

Increased customer protection *and* regulatory costs

Increased regulatory costs has important consequences for two key players in the regulatory landscape:

- The Provider: increased regulatory costs reduce its ability to experiment with e-money products that can meet the needs of unbanked or underbanked populations; and
- Regulator: increased regulatory costs require greater expertise and resources in order to implement more complex trust law.

In determining which terms of the Model Trust Deed to implement, regulators should be guided by the 'proportionality principle'. This approach requires the regulator to:
(**i**) understand the risks presented by e-money; and
(**ii**) design regulation and supervision such that the costs to the regulator, the Provider, and customers are proportionate to the risks that relate to customers' funds.

In relation to trust law and e-money, the proportionality principle should result in a 'light touch' approach to regulation, for the following reasons:

- *Non-regulatory incentives*: Providers tend to have strong non-regulatory incentives to protect

[24] See Dias and McKee, note 7 above.

consumers' funds. E-money is still new in many jurisdictions, and many Providers are eager to demonstrate reliability in order to gain credibility with customers and regulators.

- *Experimentation is still required*: The recent introduction of e-money also means that Providers require a high degree of regulatory freedom in order to experiment and develop products that meet the needs of 'unbanked' or 'underbanked' populations.

- *Existing protection*: Many e-money schemes will already have at least some of the protections listed in this report in a variety of non-trusts documents, such as the contract between customers and the Provider.

- *Regulatory Expertise*: Many regulators are still developing expertise in relation to e-money, making it unwise to expect such institutions to implement complex regulation.

Step 3: Consult with Providers to bring Contractual Terms into the Model Trust Deed

Many of the terms of the Model Trust Deed may already be contained in the contract that exists between the Provider and customer. It may be most efficient to transpose modified versions of those contractual terms into the Model Trust Deed, so long as they achieve the same goals as the original clauses in the Model Trust Deed.

Step 4: Develop Additional Regulation If and When Required

As outlined above, this Knowledge Product focuses on using trusts law to target the most pressing regulatory issues in relation to customers' funds. Regulators should also monitor other issues that are increasingly featuring in discussions about the future direction of e-money, such as competition issues, maximum limits on e-money accounts, and maximum transaction volumes between customers.

APPENDIX 1: DICTIONARY OF TERMS[25]

Agent: A third party acting on behalf of the Provider. This may be pursuant to a services agreement, joint venture agreement, or other contractual arrangement. This agent *may* conduct cash in/cash out services and is described as an agent with a **cash merchant function**.

Beneficiary: Is the person or persons entitled to the benefit of the trust assets. In relation to e-money, the beneficiary is the e-money customer (or the holder of the **e-money account**).

E-float: The total outstanding amount of e-money issued by the Provider.

E-money account: An e-money holder's account that is held with the Provider. In some jurisdictions, e-money accounts may resemble conventional bank accounts, but are treated differently under the regulatory framework because they are used for different purposes (for example, as a surrogate for cash or a stored value that is used to facilitate transactional services).

Electronic Money (e-money): A type of monetary value electronically recorded and generally understood to have the following attributes: (i) issued upon receipt of funds in an amount no less in value than the value of the e-money issued; (ii) stored on an electronic device (e.g. a chip, prepaid card, mobile phone, or computer system); (iii) accepted as a means of payment by parties other than the issuer; and (iv) convertible into cash.

Fund Isolation: Measures aimed at isolating consumer funds (i.e. funds received against equal value of e-money) from other funds that may be claimed by the issuer or the issuer's creditors.

Fund Safeguarding: 'Measures aimed at ensuring that funds are available to meet consumer demand for cashing out electronic value. Such measures typically include: (i) restrictions on the use of such funds; (ii) requirements that such funds be placed in their entirety in bank accounts or government debt; and (iii) diversification of floats across several financial institutions.'[26]

Implied terms: Trusts legislation and/or courts can imply certain terms into a trust deed if they are absent or unclear in the trust deed, and are not expressly negated by the trust. These terms can include that a trustee must:

- Act in the best interests of the beneficiary;
- Ensure that trust money is retained in a separate account from the trustee's own bank account, or the account of a third party;
- Exercise powers under trust in a manner which is impartial between the beneficiaries;
- Exercise the skill of a 'prudent' person in performing its duties under the trust;
- Invest the trust fund;
- Not profit from the office of trustee;

[25] Many of the definitions used in this section have been adopted from the AFI, 'Guideline Note, Mobile Financial Services: Basic Terminology' (2012). This is to ensure consistency across the literature.
[26] It has been noted that fund safeguarding and fund isolation protect customer funds in a nonbank-based model.

- Record accounts *and* provide access to relevant trust documents; and
- Understand and adhere to its obligations under the trust deed.

Settlor: The person who settles or declares that certain assets are to be held on trust for the benefit of the beneficiaries. This person may declare themselves (or a related entity) the trustee of the assets.

The Trust: A legal relationship between a trustee and a beneficiary which pertains to certain trust assets. The recognition of this relationship impacts upon the rights of third parties to the trust assets.

Trustee: The person who holds trust assets for the benefit of the beneficiary. There may be more than one trustee. In the e-money context, this individual will often be the Provider (or a related entity).

Trust Deed (sometimes described as a 'Trust Deed' or 'Settlement'): A formal legal declaration by the settlor that is used to create a trust. The terms of the trust deed will specify the trust 'assets', the trustee and the beneficiary. It will also specify various aspects of the trust relationship (e.g. provision for the appointment of a new trustee).