

E-MONEY AND ELECTRONIC PAYMENTS: FOREIGN INVESTMENT IN THE PHILIPPINE FINANCIAL TECHNOLOGY SECTOR

DEVELOPMENTS IN THE PHILIPPINE FINTECH SECTOR

The combination of low levels of financial inclusion, a steadily growing GDP and high smart phone usage has resulted in the Philippines becoming a key market in Asia for venture capital and private equity investors, as well as strategic players looking for investment or product rollout opportunities in the FinTech sector. The Philippine government has recognized the important role FinTech plays in financial inclusion and economic development and has, over the last several years, pursued several regulatory and policy initiatives to help create a cash-light society.¹

With a poor financial services infrastructure and only 28% of Filipinos having an account at a traditional bank, the FinTech sub-sectors which have seen the greatest levels of growth are electronic payments and lending.

Electronic payments continue to be the largest FinTech sector in the Philippines having tripled in volume to over Php1.1 trillion (~US\$21.4 billion) since 2013.² Although incumbent providers such as PesoPay and DragonPay continue to dominate the sector, the ability for FinTech companies to cross-sell from one industry to another broadens the opportunities for challengers to penetrate the market.

In this briefing, we focus on e-money, electronic payments and lending.

¹ Examples include: the establishment of a National Retail Payment System, the incoming electronic KYC regime, the streamlining of the registration requirements for e-money issuers and remittance companies and the regulation of virtual currency exchanges.

² <http://www.entrepreneur.com.ph/news-and-events/ph-e-money-transactions-soars-past-php1-trillion-in-2016-a00200-20170524> <last accessed: 29 January 2018>

E-MONEY AND ELECTRONIC PAYMENTS

UNDERSTANDING 'E-MONEY'

The Central Bank of the Philippines (Bangko Sentral ng Pilipinas or "BSP") has regulated e-money since March 2009 under BSP Circular No. 649 (the "Circular"). The regulation defines e-money as monetary value which is electronically stored in payment instruments/devices which consumers can use to:

- a) buy or pay for goods and services;
- b) transfer or remit funds; and/or
- c) withdraw cash or cash equivalent.

E-money has been broadly defined in the Circular to encompass cash cards, stored value cards, mobile phone wallets and "other similar products" that potentially covers any instrument which facilitates the storage and transfer of funds electronically.

Provided all funds stored in e-money instruments meet the criteria specified in the Circular, e-money issuers are excluded from the Philippine banking regulatory regime and therefore do not need to obtain a banking license and comply with the very substantial capital and regulatory burdens that otherwise would be imposed. Consequently, in order to ensure that e-money instruments are differentiated from deposits taken by a bank, they are prohibited from earning interest, rewards or other similar incentives convertible to cash for the customer and can only be redeemed at face value.

Banks and other financial institutions regulated by the BSP may also issue e-money. Based on figures provided by the BSP as of July 2017, there are only five (5) e-money issuers that are not banks or financial institutions regulated by the BSP. However, e-money issuers that are not already regulated by the BSP (because of the nature of their other businesses) are required to obtain an e-money issuer's license from the BSP.

ENTITY SETUP

Before e-money issuers are permitted to engage in e-money services, they must first incorporate a stock corporation. This is a specific form of Philippine company with shares that must have a minimum paid up capital of Php100 million (~US\$2 million). A much higher paid up capital threshold of between Php3,000,000,000 (~US\$59 million) and Php20,000,000,000 (~US\$390 million) and between Php2,000,000,000 (~US\$40 million) and Php15,000,000,000 (~US\$290 million) applies to universal banks and commercial banks, respectively, engaged in such services, depending on the number of branches it has in the jurisdiction.³

There are currently no ownership restrictions on foreign investors looking to engage in e-money services in the Philippines.

KEY LICENCES

Once incorporated, the primary licence required by a prospective provider is the e-money issuer licence (the "EMIL"). The EMIL ostensibly authorises a company to engage in e-money services. However, additional BSP approvals will be required if the prospective provider wishes to incorporate additional features beyond those envisaged under the e-money regime such as engaging in lending activities which requires a quasi-banking licence.

The e-money issuer must register with the BSP as a remittance and transfer company in order to engage in remittance and/or money transfer facilities. Banks and financial institutions already regulated by the BSP would also need to submit an application to the BSP to obtain approval for the broadening of their financial services.

The authorisations discussed above highlight the main approvals required by the BSP. However, additional authorisations, for example to allow for forex conversions of wallet balances or cross-border peer to peer payments, may be necessary depending on the proposed functions of the e-money provider. It is key to

note that the BSP retains the discretion to request evidence that all other regulatory regimes have been considered and complied with. Consequently, a broad analysis of related financial service regulations will need to be undertaken in order to ensure regulatory compliance.

KEY CONTINUED COMPLIANCE REQUIREMENTS

Funds limit

Given the nascent nature of e-money services, the government of Philippines has placed a monthly cap of Php100,000 (~US\$ 1,950) on the aggregate amount of funds that can be loaded onto the facilities made available by a single provider to an e-money holder unless a higher amount is specifically approved by the BSP. Several e-money issuers have obtained special approval to be exempt from the monthly cap. There is at least one issuer which provides e-money with a cap of Php 1 million.

While there is no statutory maximum or minimum threshold for daily transactions by e-money providers, many banks in the Philippines limit online payments to a maximum of Php50,000 (~US\$970).

Identity checks

One area of difficulty faced by incumbent e-money providers is compliance with anti-money laundering ("AML") and know-your-client ("KYC") regulatory requirements. Unlike Indonesia, the Philippine government does not have an accessible ID database to allow for real-time customer verification. This makes the AML/KYC process cumbersome and time intensive.



In February 2017, the BSP announced that it would make AML/KYC procedures for e-money services more 'flexible' by permitting customer verification over digital platforms similar to the approach adopted by the Bank of Thailand. However, clarity as to how this will operate in practice is yet to be provided.

OTHER REGULATORY REQUIREMENTS

Providers of e-money are also required to:

- restrict the business activity of the entity to e-money or any other related activity;
- maintain complete and accurate records of each e-money holder (including their identities),

³ <http://www.bsp.gov.ph/publications/media.asp?id=3561>
<last accessed: 29 January 2018>

transaction history and such other pertinent information;

- provide suitable notification systems to evidence agreement in relation to the provision of e-money services and changes in the facility;
- demonstrate sound, secure and adequate systems to carry out e-money operations; and
- submit financial statements and any other information requested by the BSP to allow the activity of the e-money provider to be monitored.

CLIENT CASE STUDY

The relatively high capital requirement of around US\$2 million for the setup of an e-money issuer is a large up-front cost and has been a key consideration for many of our clients seeking to capitalize on opportunities in the Philippine payments sector. To alleviate the funding pressures, select clients have pursued a joint venture or partnership model with an existing banking institution to launch in the Philippines. Such strategies can help to unlock a distribution platform, payment gateways and reloading infrastructure at a lower cost than would otherwise be possible.

However, as the Philippine e-money and electronic payments sector becomes more competitive, fewer partnership opportunities may be available. New entrants may need to consider more creative solutions to deploy their capital. It is key to note that the US\$2 million only needs to be in place at incorporation and can subsequently be used for capital and/or operational expenditure. The Philippines, with its English speaking population, has been an attractive destination for business process outsourcing; some clients have considered locating regional customer services and KYC back-office processing infrastructure in the Philippines to help with the allocation of capital and to demonstrate to the BSP that there is substance to their arrangements in the Philippines which in turn may help with licensing approvals.

LENDING

In contrast to the electronic payments sector, consumer lending in the Philippines remains largely underdeveloped. The shortage of conventional data sources to verify customer suitability and the absence of a mature credit bureau have contributed to a lack of appetite from traditional financial institutions to provide credit to the unbanked majority. This has led to a large credit gap in the Philippines which is largely

served by informal lending channels on which the government has sought to clamp down.⁴

Given the high demand for credit services, the opportunities for non-bank financial institutions are significant. In order to expedite their entrance into the Philippines, there has been a growing trend for such enterprises to partner with incumbent regulated banks or non-bank financial institutions to minimise the initial regulatory burden.

LENDING COMPANY

The most common way for non-bank enterprises to engage in such services is to establish a lending company. The Republic Act No. 9474 (otherwise referred to as the Lending Company Regulation Act of 2007) defines a 'lending company' as a corporation that engages in the granting of loans from its own capital funds or those sourced from no more than nineteen (19) persons.⁵ The regulation expressly excludes traditional financial institutions such as investment houses and loan associations as such enterprises are governed under separate legislation.

In order to incorporate a lending corporation, the prospective enterprise must submit an application to the Securities and Exchange Commission (the "SEC") which governs the consumer lending sector alongside the BSP and the Bureau of Internal Revenue. The application typically takes thirty (30) days from the submission of complete documentary requirements for the SEC to approve, subject to any additional information requests it may have.

Once approved, the non-bank financial institution must then obtain a Certificate of Authority which acts as the licence to operate. This will require the prospective enterprise to submit various statements about the business, its directors, its commercial plans and its internal compliance policies. Due to the detailed nature of the information requested by the SEC, this process typically takes thirty (30) days from the submission of complete documentary requirements.

Lending companies are required to maintain a minimum paid up capital of Php1,000,000 (~US\$20,000) which the SEC has the discretion to increase if it deems it necessary depending on the functions and size of the relevant credit provider. The majority of the paid-up capital must be used for lending purposes and any additional investments made by the enterprise cannot exceed twenty-five per cent (25%) of its paid up capital. The relatively low capital

⁴ <http://www.sec.gov.ph/wp-content/uploads/2016/10/2016PressReleaseInformalLenders.pdf> <last accessed: 29 January 2018>

⁵ Section 3 of the Republic Act No. 9474

requirements reflect the government's expectation that such companies will only be engaging in micro-lending. If the provider were to grow significantly, the SEC may require it to apply for a full banking licence which will impose additional capital and compliance requirements.

A lending company may grant loans in such amounts with reasonable interest rates and charges as may be agreed between the lending company and the borrower. However, the agreement must comply with the provisions of Republic Act No. 3765, otherwise known as the "Truth in Lending Act" and Republic Act 7394, otherwise known as the "Consumer Act of the Philippines". Furthermore, the Monetary Board, in consultation with the SEC and the lending industry, may prescribe maximum interest rates taking into account prevailing economic and social conditions.

Every lending company is required to maintain books of accounts and records as may be required by the SEC and prescribed by the Bureau of Internal Revenue and other government agencies. If a lending company engages in other businesses, it is required to maintain separate books of accounts for such businesses.

FOREIGN OWNERSHIP RULES

Previously, Republic Act No. 9474 required that the majority of the voting capital of the prospective lending company must be owned by citizens of the Philippines.⁶ However, Republic Act No. 10881 has removed this requirement. A lending company may now be owned up to one hundred per cent (100%) by foreign nationals.⁷

CLIENT CASE STUDY

The absence of quality and reliable credit scoring data is one of the key holdbacks for clients looking to develop business in the Philippine lending sector. In this area, we are seeing clients bring innovative solutions to the problem using smartphone usage and application analytics. Peer to peer lenders from other jurisdictions are also considering white-labelling or deploying their algorithms and infrastructure to the Philippines to help assess and score credit risk across a broad spectrum of the Philippine society.

Ultimately, the technological solutions being developed by clients for credit scoring and lending in the Philippines may also be deployed in other markets across the region. Such flexibility should be planned for as part of the terms of any new commercial partnership in this sector.

MOFO FINTECH PRACTICE

At Morrison & Foerster we have significant experience advising clients on FinTech related matters (including investments by Financial Institutions, Tech and VC investors as well as roll outs of products regionally) and we would be delighted to discuss any matters touching on this sector with you.

This briefing has been prepared with the kind input of SyCip Salazar Hernandez & Gatmaitan, one of the leading full-service law firms, and our preferred corporate counsel, in the Philippines.

Because of the generality of the briefing, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.

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The information contained in this document does not constitute legal advice and is accurate as at March 2018.

⁶ At least 51 per cent.

⁷ Section 5 of Republic Act No. 10881