

## REACHING GEORGIA'S RURAL POOR THROUGH MOBILE REMITTANCES

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## 0. EXECUTIVE SUMMARY

This report is produced in the framework of the project “Reaching Georgia's Rural Poor through Mobile Remittances”, funded by the Financing Facility for Remittances (“FFR”) of the International Fund for Agricultural Development (“IFAD”) and co-funded by Mobile Finance Eurasia (“MFE”) and JSC MFO Crystal. It relates to the following project objective and output:

**“The overall goal of the project is to enhance the self-reliance of poor rural households through improved financial literacy and access to financial services. The project will facilitate access for remittance beneficiaries through deployment of a transformative mobile finance system, which will bring financial services to those beyond the reach of the financial industry”.**

**Project Objective A.1:** Carry out regulatory due diligence in Georgia, and Greece to: ensure clarity in legal/regulatory issues; manage regulatory risks; fine-tune a mobile remittance model to ensure compliance; and select optimum Target Corridor.

**Output A.1:** A report produced on the regulatory environment in Georgia and Greece with recommendations on the legal set up, business model and required regulatory approvals.

There have been significant outcomes identified in the course of the regulatory due diligence in Georgia and Greece. These outcomes formed the basis for the operating model. It also allowed formulation of key policies to be adopted by the mobile finance service provider. The executive summary provides a brief overview of these outcomes, which are elaborated in greater depth in the report and conclusions.

Georgia’s regulatory framework in its current form provides a basis for the establishment and execution of a mobile finance service. The most adequate legal form for this project is the “money remittance service provider”. The legislation does not adequately define the essence of e-money and e-payments, which leaves a taxation of e-payments (one of the service components) somewhat unclear. However, this does not represent a barrier for the commencement of an operation. It is noteworthy that there are various payment and e-money institutions recognized by the National Bank of Georgia which legitimately operate in Georgia for last 3-4 years without a special permit or license.

The registration of the money remittance service provider is a straightforward process. The money remittance service provider is obliged to carry out the identification of an individual performing a transaction of certain size and type.

The regulatory framework in Greece is important in the context of cross-border remittances to Georgia. The Bank of Greece aligns its regulation in this area to the EU Payment Services Directive. The acting legislation in Greece offers three options for a legal set-up, discussed in the report, which can be applied at the different stages of the project. There are minimum requirements established by the Bank of Greece for obligated entities to monitor and report transactions of a suspicious nature.

There has been an area of risk identified in the course of the due diligence related to a possible association of the mobile finance services to a deposit-taking activity. The legal team put forward a low-risk legal model, in case if the forthcoming Law on Payment Systems and the secondary legislation on e-money services is not in place for the time of a launch of the mobile finance service. Another area of legal responsibility is the protection of personal data by the service provider.

As far as the value added services, such as micro-loans, micro-insurance and micro-savings, are concerned, the regulatory due diligence confirmed the feasibility of these services being delivered via the mobile channel. The status of a microfinance organization empowers MFO Crystal to disburse and collect micro-loans as well as offer micro-insurance products on behalf of partner insurance companies registered in Georgia. For micro-saving accounts, the project is linking customers with partnering commercial banks. This has special importance for migrants living in Greece as many of them have been deprived of an opportunity to open a deposit or savings account in the bank.

**While the openness of the regulatory environment in Georgia is obvious, the predictability of legislation is to be improved. Crystal Fund is actively involved in the legislative dialogue with the National Bank of Georgia and relevant Ministries. The seminar, held on the 29th September 2010 in the frames of the IFAD FFR-funded project, became a starting point for the policy dialogue on this issue. The expected outcome of this process is a specific regulation concerning payment systems and e-money, which will ensure greater predictability and answer the open questions related to the taxation of a mobile finance service.**

## 1. INTRODUCTION

This report describes the regulatory framework for the mobile finance services in Georgia and Greece. It includes recommendations on a legal set up of the service and regulatory requirements in both jurisdictions. The report defines key terms and provides an overall description of the operating model.

The report has been composed by the legal team of MFE in close cooperation with the project team of Crystal Fund. The scope of work included a comprehensive research of the primary and secondary legislation. The issues were discussed through the series of meetings with various departments of the National Bank of Georgia, the Ministry of Finance, Georgia's National Communications Commission and with the National Bank of Greece.

In the course of the regulatory due diligence, Crystal Fund/MFE conducted a seminar on "Regulatory Environment for Electronic Remittance and Payment Systems in Georgia". This event significantly contributed towards the policy dialogue between the regulators and the stakeholders regarding an enabling environment for the development of electronic remittance and payment systems. The outcomes of the seminar, which substantially informed judgments of the project team, are available in the separate report.

The findings from the regulatory due diligence have been used to formulate the operating model and define key policies and procedures for a mobile finance service provider.

## 2. DEFINITION OF MOBILE FINANCE SERVICE AND THE ECOSYSTEM

The table below provides key definitions related to a mobile finance service using the terminology of Georgian legislation. Those terms which were not defined by Georgian legislation have been described using the terminology of the EC Payment Services Directive (PSD, 2007/64/EC) and various reports by the European Payment Council ("EPC").

Term	Description (for the purposes of this report)
<b>Mobile Finance Service</b>	A system of electronic payments and remittances based on a mobile phone as a principle instrument for making transactions, where mobile (wireless) network represents a key platform for the transfer of transaction data;
<b>Mobile Finance Platform</b>	A set of software, hardware, people, policies and procedures to enable execution of secure, low-cost and convenient mobile finance transactions, such as person-to-person remittances (P2P), cross-border remittances, bill payments, merchant payments (P2M and M2M), air-time top-up and currency conversion;
<b>Stored Value Account (SVA)</b>	A virtual account held in the name of one or more customers, which is used for the execution of payment and remittance transactions; each SVA can include sub-accounts supporting foreign currency transactions; SVA is frequently mentioned as "mobile wallet";
<b>E-Money</b>	An electronic surrogate for coins and banknotes, which is used for making payments and remittances in limited amount and not as means

	of saving, stored on the hard memory of the service provider's mobile finance platform;
<b>Service Provider</b>	Legal person registered by the National Bank of Georgia as "money remittance service provider" providing and executing mobile finance services (mobile remittances and payments) throughout Georgia;
<b>Customer</b>	A natural person duly identified and registered by service provider, who is using the mobile finance service for the purposes other than trading, business or profession; acting on the basis of a contract with a service provider regarding the provision of remittance, payment and currency conversion services;
<b>Agent</b>	A natural person hired by a service provider (or a legal entity duly registered by the NBG and contracted by a service provider), who is providing cash-in and cash-out services for customers, by converting customers' cash to the electronic value on customer's SVA (stored value account) and, vice versa, converting the electronic value from SVA to cash;
<b>Merchant (provider/supplier of goods and/or services)</b>	A legal entity, electronically integrated to the service provider's mobile finance platform, using the mobile payment system to collect the payments for supplied goods and/or services; when merchant can be any legal person operating in accordance to the Georgian legislation i.e. small corner shop, service outlet, utility company, mobile network operator etc.;
<b>Mobile Network Operator ("MNO")</b>	The operator of a mobile (wireless) network which has legal agreement with a service provider regulating an access to functional elements/resources of the wireless network;
<b>Existing Payment Infrastructure</b>	Companies operating according to the Georgian legislation, providing instant payment service, acting on the basis of a contract with Service Provider and electronically integrated to the m-finance platform in order to provide customers with cash-in services;
<b>Correspondent Entity</b>	An overseas legal entity registered by a national regulator (e.g. the Bank of Greece) to carry out cross-border remittance services, electronically integrated to the m-finance platform, managing the network of agents in a given jurisdiction, carrying out analytical transactions with service provider, followed by a periodic settlements of netted funds through commercial banks;
<b>Partner Bank</b>	A commercial bank in Georgia, which services the special current account of the Service Provider, used by agents to deposit cash in order to get corresponding electronic value for further distribution down the system; the balance on the bank account (so called "float") is equal to the amount of electronic money in circulation; the special accounts with partner banks are used for settlement transactions with agents, merchants, existing financial infrastructure, correspondent entity as well

as banking and finance institutions;

**Banking and financial institution**

Entity described by the clause 2.a of the Organic Law on the National Bank of Georgia (commercial banks, micro-finance institutions etc), which are electronically integrated to the mobile finance platform in order to facilitate a simplified access to services for their customers using the mobile finance platform;

All transactions within the mobile finance platform take place only between duly registered users (customers, agents and merchants), who should have an access to the following:

- A working mobile phone connected to the wireless network;
- An appropriate software (operating system and the application) written to the hard memory of the phone or an access to mobile web or SMS;

Users should know the following:

- How to use the mobile (or web) interface;
- Unique pin-code, known only to a user, necessary for authorization of transactions.

### **3. LEGAL FRAMEWORK FOR THE ESTABLISHMENT OF THE MOBILE FINANCE SERVICES IN GEORGIA**

#### **3.1 Licensing for the Mobile Finance Services**

The services envisaged by Crystal Fund’s project would be best defined in legal terms as e-money service, executed via mobile channel, with elements of domestic and cross-border remittances. Hence, the mobile finance service would fall under the e-money regulation of a respective jurisdiction.

However, there is neither definition nor special regulation related to e-money in Georgia. There are number of companies operating with e-money model in Georgia (E-money.ge, Web-Money, loyalty schemes of pharmacy networks etc.) neither restricted not regulated in any form.

Nevertheless, the cross-border remittance component of the service could potentially fall under the supervision of the National Bank of Georgia when it comes to the remittances of a certain size and type. Therefore, the legal team has explored all legal forms available in legislation which could fit the operating model.

**Based on a comprehensive research and analysis of the acting legislation of Georgia and taking into consideration the suite of services of the mobile finance operator (“service provider”), the most adequate legal form for the establishment and execution of mobile finance services was identified “money remittance service provider”. This legal form is defined by the Order of the Head of the Financial Supervision Agency N17 from February 9, 2009 “On approval of Rules on regulation of money remittance service provider”.**

As far as the specific corporate form is concerned, the service provider can be set up as an entity of any type envisaged by the Law of Georgia “On Entrepreneurship”, with exception to a “cooperative”.

The legal team analyzed existing definitions which would best correspond to the nature of a mobile finance service. In result, CF/MFE arrived at three core services, which could potentially require licensing from the financial sector regulator. They are:

- 1) Remittances
- 2) Payments
- 3) Currency conversion

### **3.2 Remittances**

According to the Article 3(1)(a) of the Order of the Head of the Financial Supervision Agency N17 as of February 9, 2009 “On approval of Rules on regulation of money remittance service provider”, the money remittance service provider has the right to perform money remittance activities by means of any system and is empowered to carry out other additional activities after fulfilling the relevant regulatory requirements, should such exist.

**This clause provides a clear legal basis for operation of in-country and cross border remittances. However, it does not explicitly “cater” for payment services.**

### **3.3 Payments**

Based on the above-mentioned formulation (“other additional activities”) and taking into consideration the general principle of the civil law “anything not explicitly prohibited by law is allowed”, the money remittance service provider has the right to carry out payment services on the basis of a service agreement with a merchant, as there are no restrictions in the Georgian legislation to perform such services.

This argument is strengthened by the fact that there are payment service providers, such as instant payment kiosk operators (Nova Technology, TBC Pay, OSMP) and the mentioned e-money operators, which legitimately operate in Georgia for last 3-4 years with no license or registration.

#### **Important Considerations (discussed later in greater detail):**

<b>AML/CTF:</b>	While existing providers operate payment services with no obligation to authenticate users and report about transactions, the money remittance service providers – in contrast – are required to get registered as “obligated entities” and abide by the national KYC (Know Your Customer) regulations related to the Anti-Money Laundering and Countering Terrorism Financing rules;
<b>Tax Implications:</b>	Absence of a definition and a respective regulation concerning e-money/e-payment <u>may</u> have certain tax implications, which should be taken into account while designing the operating model.

### **3.4 Currency Conversion**

The same logic applies to a currency conversion/currency exchange service. The service provider will carry out such transactions using the same status of a “money remittance service provider”.

The Georgian Law does not restrict electronic transactions related to currency exchange. There is a rule for registration of the currency conversion/exchange bureaus (*Order N344 of the President of the National Bank of Georgia on “Approving Rule of Registering and Regulating Foreign Exchange Bureaus” as of December 31, 2007*), which establishes the basic framework and requirements for natural persons or legal entities to operate the cash-based currency conversion service. The Order addresses the risks associated with the foreign currency bank-notes and physical conditions where such operations can be performed.

There is no definition of a cashless or electronic currency conversion which, by its nature, eliminates the need for operators to deal with cash (bank-notes, coins). Taking into consideration that neither the

service provider nor its agents will have any contact with foreign currency cash<sup>1</sup>, they will not be required to register as “foreign exchange bureaus”. The electronic currency conversion service will be offered to customers on the basis of a service agreement.

### **3.5 Issues related to deposit-taking activity**

According to different definitions of various legal acts of Georgia, a “deposit” is the money received by commercial banks or non-bank deposit organizations. Bank deposits are often called “accounts” (“angariSi”) and non-bank deposits (“anabari”), synonym of an “account”. However, it seems that this is only the distinction in wording, without the substantial difference in meaning.

The “account” is defined as “money or other means of payment received by (i) commercial banks or (ii) non-bank deposit organizations, which become the owners of the money or other means of payment.”

**Today there is no legal act in Georgia, which states that the issuance of electronic money does not constitute a deposit-taking activity.**

For example, in the EU E-Money Directive this provision is expressly mentioned: “the issuance of electronic money does not constitute a deposit-taking activity, in view of its specific character as an electronic surrogate for coins and banknotes, which is to be used for making payments”.

Furthermore, e-money is different from pre-paid services offered by i.e. mobile network operators in Georgia, because pre-paid instrument implies that money was paid in advance for the provision of specific service and funds therefore cannot be retrieved or cashed-out. In fact, the mentioned prepaid service is undoubtedly a subject to VAT.

Taking account of the lack of clear definition of e-money, there is a potential risk the National Bank of Georgia to view a mobile finance service as a deposit-taking activity, which is a subject to its prudential regulation. This may not be an issue at the moment, but it can become relevant on the later stage when mobile finance system attracts larger number of customers transacting in high volumes.

In result, the following options have been identified:

1. In the course of in-depth consultation with the National Bank of Georgia, they suggested two options:
  - a. launch the service as a money remittance service provider, because accepting funds for remittances and payments does not falls under the legal definition of a deposit; furthermore, this practice is already in place with several institutions operating with e-money models and the National Bank of Georgia does not perceive them as significant risk to the public interest, leaving these institutions beyond its supervision;
  - b. in result of the seminar conducted under the auspices of the IFAD-funded project and active communication from CF/MFE legal team, the National Bank of Georgia has accelerated its new draft law on “Payment Systems” and secondary legislation concerning e-money, which would “catch up”, according to the National Bank, with current and future e-money operators; CF/MFE has been asked to provide their feedback to the early draft when it is released;
2. To eliminate any theoretical risk associated with deposits, the service provider can construct its legal model differently. There have been number of solutions presented by the legal team, but

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<sup>1</sup> All cash-in and cash-out transactions at agent locations will take place in Georgian Lari (“GEL”); customers will be contractually provided with the right to cash-out a foreign currency from their SVAs, but in this case they should visit one of the branches of the service provider’s partner bank.

the most rigorous and risk-free solution is to mirror every SVA opened by Service Provider with a customer's personal bank account in the partner bank.

Commercial banks are highly interested in this option as this is a way of acquiring large number of new account-holders. The critical element brought forward by Crystal Fund is the technology which enables a cost-effective relationship (registration and transactions) between banks and e.g. a client from a remote rural area. The level of client identification for registration purposes suggested in this report is in full compliance with the requirements of commercial banks. In addition to a mobile finance service contract, customers will be given a choice of several banks (2-3 partner banks are planned for integration at the beginning). So a customer will choose a bank in order to open a special account linked to SVA.

In this option, the balance on the mobile wallet will be mirrored by the balance on the personal bank account. All transactions happen electronically [instantly] using the mobile finance platform, whereas settlement of funds between customers, or between a customer and a merchant, will be implemented via the bank transfer between respective bank accounts. This model does not alter technological or operational framework developed by CF/MFE.

### **3.6 Forthcoming Legislation**

CF/MFE conducted a seminar "Regulatory Environment for Electronic Remittance and Payment Systems in Georgia", which contributed towards the policy dialogue between the regulators and the stakeholders regarding an enabling environment for the development of electronic remittance and payment systems.

This event was used as a starting point for the discussion on the forthcoming e-money legislation by the National Bank of Georgia. Questions raised by CF/MFE legal team as well as other industry representatives have been fed into the legal drafting process.

The National Bank will be initiating this new legislation by the end of 2010. A forthcoming Law on "Payment Systems" and the secondary legislation concerning e-money will introduce the notion of electronic payments and provide clear legal basis for current and future operators. The draft is mainly based on the modalities of EU Directives, but the intention is to introduce a light-touch regulation, typical for Georgia's "deregulatory approach". One of the key recommendations from the seminar was an inclusion of amendments in the *clause 19 of the Tax Code of Georgia*.

**It was suggested to add "the issuance and execution of e-money" to the list of financial services provided in the Tax Code, which would avoid uncertainties regarding the taxation of a mobile payment service.**

## **4. PRECONDITIONS FOR THE REGISTRATION OF A MONEY REMITTANCE SERVICE PROVIDER**

*The article 17(2) of Order of the Head of the Financial Supervision Agency N17 as of February 9, 2009 "On approval of Rules on regulation of money remittance service provider" sets out the conditions precedent to registration of a money remittance service provider. These are the following:*

- Availability of relevant operational space (the place where the documentation required to be kept according to the "Law of Georgia on Facilitation of Prevention of Legalization of Illicit Income" and the legal acts of Head of Financial Monitoring Service of Georgia);
- Computer;

- Printer and photocopying machine; and
- Special software to maintain money transfer transaction data.

The mentioned requirements are defined in accordance to the “*Law of Georgia on Facilitation of Prevention of Legalization of Illicit Income*” (dated 6 June 2003) and aim to ensure fulfillment of Georgia’s international obligations regarding AML & CTF.

The registration process includes notifying in writing the National Bank of Georgia about the new money remittance service provider (company or natural person) and his/her address. Within 10 days from registration a money remittance service provider by the registrar of the National Bank of Georgia, the company is obliged to get enrolled as an “obligated entity” in the Financial Monitoring Service of Georgia, the key national agency, facilitating prevention of illicit income legalization and terrorism financing.

## 5. ANTI-MONEY LAUNDERING AND COUNTERING TERRORISM FINANCING

According to the Article 6 of the Order N1 of the Head of the Financial Monitoring Service of Georgia as of February 17, 2009 “On approval of the rules on elaboration, systematization, analysis and reporting to the Financial Monitoring Service of Georgia of the information by the money remittance service providers”, the money remittance service provider is obliged to perform the identification of the individual engaged in business relationship with the money remittance service provider, in cases when the amount of the transaction/operation performed by means of such money remittance service provider exceeds 1,500 GEL<sup>2</sup> or if such transaction is “suspicious”<sup>3</sup>. The Order provides a very detailed description of the types of transactions, which are defined as suspicious and should be monitored and reported by obligated entities.

When performing the local or international money remittance transactions it is required to keep the following information regarding the individual carrying out money remittance transaction:

- Name/Surname;
- Account number (if such exists) or the unique code of the individual;
- Address of the individual;

The required documents for the identification process are as follows:

*If individual is Georgian citizen*

- ID or passport or any other identification document, which equals abovementioned according to the Georgian legislation;

*If individual is foreign citizen*

- the passport issued by the relevant country or other document that equals the above said according to the Georgian legislation.

Following data shall be gathered during the identification process:

- Name/surname;

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<sup>2</sup> Currency exchange rates in September 2010 were in average US\$ 1.8325 and EUR 2.3865 to one Georgian Lari.

<sup>3</sup> A transaction supported by a grounded supposition that it had been made or implemented for the purpose of legalizing illicit income (it does not provide verified economic (commercial) content, or clear lawful purpose, is not consistent with an ordinary business activity of the person involved in it, the person’s identification or the origin of relevant amount cannot be ascertained), or the person involved in the transaction is likely to be connected with terrorist or terrorism-supporting persons;

- Citizenship;
- Date of birth;
- Place of residence;
- ID (passport) number and the personal number of an individual based on ID or passport;
- If individual is registered as a sole entrepreneur, the fiscal identification number.

The money remittance service provider is obliged to keep the copies of identification data (copies of such documents) of its clients (or their representatives) in electronic or paper form , and keep the information (documentation) regarding the performed transactions for at least 6 years from the date of such a transaction.

## 6. TAX IMPLICATIONS

There have been two issues identified in the course of the due diligence which required comprehensive analysis from the viewpoint of taxation. They are:

- Value Added Tax (“VAT”) – whether or not all or part of the services performed by service provider are subject to VAT;
- Profit Tax [in case if customer fund related to SVA is kept at service provider’s special account rather than customer’s personal bank account] – whether or not the benefit that could be derived from cash balance on the bank account should be accrued as an income for the purposes of profit (corporate) tax.

According to the *Tax Code of Georgia, Section 230.1.a*, financial operations and/or financial services are exempt from VAT. Financial services include transactions related to “financial instruments”. The Tax Code provides definitions of financial instrument, financial operation and financial services. It is therefore important to establish that the mobile finance services fall under the broad definition of “financial services”. However, this is not straightforward because legislation does not explicitly mention e-money and mobile financial services. CF/MFE looked into the following definitions:

- (a) The *section 19.1 of the Tax Code of Georgia* defines the notion of financial instrument, mentioning money in cash or cashless form as a financial instrument. *The section 230.1.a of the Tax Code of Georgia* states that the financial services, which include transactions related to financial instrument – in this case money in cash or cashless form, are exempt of VAT. Therefore, domestic or cross-border remittances can be clearly regarded as transactions related to the financial instrument. Hence they are not subject to VAT. This conclusion is strengthened by existing practice, according to which the remittance service operators, of any legal form, are not subject to VAT.

Furthermore, according to Article 1(2) of the *“Rules on Non-cash transactions in Georgia”, approved by the Order of the President of the National Bank of Georgia as of June 26, 2007*, money remittance is understood as a method for transferring funds, including in foreign currency, between the natural persons by means of a bank transaction, and such transfer of funds shall not result from the delivery of goods and services [by a vendor/supplier/merchant].

At the same time *the clause 19.1 of the Tax Code of Georgia* defines that any agreement between two counteragents can be regarded as financial instrument unless this agreement envisages provision of goods and/or services.

It is obvious that for VAT purposes, the Tax Code clearly distinguishes financial instrument from a compensation for the provision of goods and services.

Therefore, while it is clear that remittances are treated as a financial service, it is questionable whether merchant payments, which include an element of provision of goods and/or services, can be equally regarded as a financial service. Hence it is not clear whether or not the payment service is a subject to VAT.

(b) However, the section 19.2.a of the Tax Code of Georgia defines the notion of “financial operation”, offering *inter alia* the term “payment instrument”.

The legislation does not specify whether the mobile payment (from customer to merchant) falls under the definition of a “payment instrument”. The *clause 1.a of the Regulation on Plastic Cards approved by the President of the National Bank of Georgia N 70 dated 15 March 2007*, defines plastic card as a payment instrument. Using the analogy with plastic cards, mobile payment can be defined as a payment instrument, due to the technological and operational similarities of both products and the fact that the settlement of funds between customer and merchant accounts happens through the bank transfer.

**In spite these arguments, the legal team recommended to include VAT for merchant payments in the financial projections, given that it is not going to have a substantial impact on the cost of service for customers. It would neither have significant implications on overall financial results of the service provider. At the same time, it was suggested to write a letter to the Revenue Service of Georgia with a view of clarifying these issues. Finally, the forthcoming legislative amendments should include an amendment to the Tax Code of Georgia, which will define e-money and transactions related to e-money as a financial service. This would avoid uncertainty in respect to VAT.**

As far as profit tax is concerned, the tax object, which was assessed by legal team, was the cash float kept on the bank account of the service provider. This cash in bank corresponds to the balances on a customer’s SVA. The question was raised on whether this fund can be treated by tax authorities as an interest-free loan from a customer to a service provider. If yes, the interest, which could be earned by this amount, can be treated as a “benefit” and accrued as the revenue. This will result in increase of the company’s profit and a subsequent increase of the amount of profit (corporate) tax.

**The legal team recommended clarifying this issue with the Revenue Service of Georgia. It is likely that the mentioned benefit will be regarded as the revenue which can result in higher profit tax. The service provider should either include this tax in its financial projections or opt out for the operating models suggested earlier. In that model the float corresponding to customer SVAs is kept on the customers’ personal bank accounts linked to their SVAs. The forthcoming legislation of Payment Systems is also going to resolve this issue.**

## **7. REGULATION FOR CROSS-BORDER REMITTANCES IN GREECE**

The *Payment Services Directive (PSD, 2007/64/EC)* is a regulatory initiative from the European Commission (Directorate General Internal Market) which regulates payment services and payment service providers (as defined in the Directive) throughout the European Union (EU) and European Economic Area (EEA).

This Directive has been transposed into national legislation by all EU (and EEA) Member States by 1 November 2009. This has changed the regulatory framework in Greece and allowed a creation of new

type of entities Payment Institutions (“PIs”). The capital requirements for PI is from EUR 50,000, whereas Money Transfer Intermediaries (“MTIs”) were requested at least EUR 150,000 and Electronic Money Institutions (“EMIs”) are still requested as much as EUR 3 M for the initial capital. According to Bank of Greece, the latter requirement will be revised in 2012 bringing down the initial capital for EMI to EUR 350,000.

According to the Payment Services Directive, organizations that are not credit institutions or EMIs, can apply for an authorisation as PI (certain capital and risk management requirements apply) in any EU country of their choice (where they are established) and then passport their payment services into other Member States across the EU without additional PI authorization requirements. This means, PI registered with e.g. Financial Services Authority in the United Kingdom, can use their passport in any member state, including Greece. The same applies to EMIs.

This opens a range of option for Service Provider from Georgia:

- 1) To register as a Payment Institution in one of the EU countries, which requires the establishment of a company (in Greece it should be *Société Anonyme*) with minimum capital of EUR 50,000;
- 2) To integrate with already existing money transfer intermediary in Greece/EU without a need of securing any license of registration; this option offers a range of PIs from relatively expensive international payment systems such as Western Union, Money Gram etc., to more inexpensive and dynamically growing Greek agent networks, some of which act as agents to larger international payment systems;
- 3) To integrate with EMI in Greece. While there are no EMIs registered in Greece due to the hefty initial capital requirement, there are number of well-developed EMIs registered in the UK and operating throughout Greece. These EMIs can be a desirable alternative to MTIs because they have much wider agent distribution networks.

According to the AML&CTF rules, the following documents should be presented by individual who wants to remit funds from Greece to e.g. Georgia.

For every transaction, the money transfer intermediary shall issue a transaction slip, delivered to its customer and including at least the following information:

- Name and address of the originator;
- The transacted amount;
- Name and address of the beneficiary;
- Date of the transaction;
- Place of payment.

For the purposes of the “Greek Law on Money Laundering”, sender should claim the evidence of the identity of contracting or the transacting person. For the evidence a police identity card or a passport or another official document is required. This obligation exists for every transaction the amount of which is equal to EUR 1,500 at least either performed with one transaction or by more, which take place in the same day or refer to the same legal relationship.

The intermediary shall keep records of its operations for at least five (5) years.

According to market research conducted by CF/MFE, the overall majority of Georgian migrants will be able to comply with these identification requirements.

## 8. PROTECTION OF PERSONAL DATA

Another area of legal risk identified in the course of the regulatory due diligence is a protection of personal data. According to the *Civil Code of Georgia (clause 18<sup>1</sup> of 13.03.2008 N 5919)*, any individual is entitled to get information about his/her personal details and financial/property data; at the same time an entity is obliged to ensure the confidentiality of personal information. Furthermore, there is a draft law on “the Protection of Personal Data” under consideration in the Parliament of Georgia.

## 9. VALUE ADDED SERVICES

The “Reaching Georgia’s Rural Poor through Mobile Remittances” project envisages the provision of value added services, such as micro-loans, micro-insurance and micro-savings, to customers of the mobile finance service. The legal team assessed the legal aspects of this project component and made several suggestions.

The service provider will not be offering value-added financial services to its customers on its own. Instead, the customers will be given a chance to choose a provider of a financial service they wish to sign-up to. At the initial stage of the project the list of financial providers will be limited with two-three banks and the microfinance institution MFO Crystal. In the future, the use of mobile finance service will be offered to all banks and microfinance institutions who would be willing to integrate with the platform.

The status of a microfinance organization provides a sound legal basis for MFO Crystal to disburse and collect micro-loans as well as collect insurance premium on behalf of partner insurance companies. This will be implemented on the basis of a service contract between the service provider and MFO Crystal. Micro-insurance policies will be offered by Crystal on behalf of an insurance company which is being identified. If MFO Crystal decides to offer the range of products from different insurance companies, taking more active role in product definition, branding and management, MFO Crystal will require an additional license of an insurance broker<sup>4</sup>.

For micro-saving accounts, the regulatory due diligence confirmed that MFO Crystal would be restricted to accept deposits and it is unlikely that the regulation would be changed in the near future. This does not put under risk the fulfillment of a project output related to micro-saving accounts, because one of the partner banks - TBC Bank has already confirmed their interest to offer saving and deposit accounts to the mobile finance customers.

The legal team has studied a practice of several Georgian microfinance institutions, which use different financial instruments, such as a loan or bond to attract funds from public thus offer individuals saving/investment opportunities. The National Bank of Georgia does not perceive this as an area of risk to public interest and also has no legal ground to restrict this activity. MFO Crystal will be working on the product design to pilot a product similar to micro-savings account. This product is perceived as strategically important for MFO Crystal to develop long-term local funding. This offers an opportunity to make a case for regulators on advantages of offering low-value saving accounts to low-income

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<sup>4</sup> In order to explore the legal and operational aspects of the micro-insurance service and establish a feasibility of MFO Crystal’s strategic involvement in micro-insurance activities, in September Crystal Fund and MFO Crystal hosted a delegation of ILO Micro Insurance Facility and Micro Insurance Association of Netherlands.

individuals. The issue of savings and deposits has special importance for migrants living in Greece as many of them have been deprived of an opportunity to open a deposit and savings account in the bank.

## **10. OPERATING MODEL ALIGNED TO THE REGULATORY FRAMEWORK**

The following operating model and procedures are based on the requirements of Georgian and Greece/EU regulation.

### **10.1 Registration and Operation of Agents**

Service Provider will recruit agents on the basis of their professional background and their credit history, in order to avoid hiring the individuals with criminal experience and with a poor credit record. The agents will be hired across the country offering employment opportunities to hundreds of rural people. To avoid a credit risk with agents, the service provider will allocate electronic value within the limit of the deposit made by an agent at the service provider's special account in the partner bank(s). In Georgia the majority of agents, especially those operating in rural areas will be natural persons. There will be agent companies recruited for the same task and in this case they should get registered with the National Bank of Georgia as a money remittance service provider. This involves simply writing a notification to the National Bank of Georgia. In Greece, the service provider will have one or more commercial relationships with existing Payment Institutions which employ well-developed networks of branches and points of presence.

To fulfill cash-in and cash-out transactions, the agents will be equipped with the mobile phones and POS terminals as well as special agent applications allowing execution of transactions in a secure and fast manner. Agent's mobile phone or POS terminal will be connected by Virtual Private Network to the central server of the mobile finance platform using secure protocols and data encryption, which satisfies the highest standards of the payment industry.

In result, any transaction will take place in real time between accounts (account to account), assigned unique number and entire flow will be logged in the data base and available for on-going and historical analysis.

### **10.2 Registration of Customers**

Customers will be authorized to conduct remittances and cash-out services only after full identification and registration. The registration process results in opening of the Stored Value Account ("SVA") one the name of a customer. This is a virtual account and does not require the customer to have a bank account. Alternatively, SVA can be mirrored by a personal bank account of customer, should service provider choose a respective legal model. SVAs will be identified by the Mobile Subscriber Integrated Services Digital Network Number ("MSISDN") of the customer. The registration process includes the following steps:

- Agent will take a picture of an ID using the camera built in the mobile phone or alternatively makes a photocopy;
- Customer will fill the application with necessary identification and contact information;
- Agent will transmit the personal identification to the central registrar of the Service Provider, where this information will be verified on the basis of:
  - The UN Consolidated List of terrorists and terrorism-supporting persons
  - The data base of the Civil Registry of the Ministry of Justice of Georgia using the personal number, which will allow elimination of the identity fraud;
- Following verification, the registration will be completed which will be confirmed to a customer via SMS;

- It will be necessary to update the customer registration data in case if they change their passport or ID, in this case they will be asked to submit a copy of the new identity document;
- The same procedure will be accomplished in Greece and other countries of operation.

The registration details and personal/commercial information of users will be securely protected in the multi-layered and encrypted data base for the period of at least 6 years defined by Law. This will allow generation of detailed electronic transaction history reports should such requirement be made by the Financial Monitoring Service. Unless the cases defined by Law, the service provider will ensure the non-disclosure, safety and confidentiality of the personal data.

### **10.3 Suite of Services**

The platform will facilitate a range of transactions, including but not limited to:

- Cash-in/loading mobile wallet or Stored Value Account (“SVA”) at agent locations, through the instant payment kiosks and from the bank account held by partner banks;
- Cash out at agents and partner banks (at the later stage from ATMs);
- Cross-border remittances;
- Utility/bill payments either through an established Payment Gateway, or through a new dedicated Gateway established for the purpose of this project;
- Person to Person (in-country) remittances between registered customers with SVA;
- Air-time top-up;
- Electronic currency conversion for customer to convert float from foreign currency SVA (EUR, USD and Russian Ruble) to a local currency SVA (Georgian Lari);
- Merchant payments via the transfer from the customer’s SVA to a merchant’s SVA (optional - contactless payments at merchant location using a static chip, NFC or other technology).

### **10.4 Technology**

The platform will be scalable and designed in a manner allowing gradual integration with an existing payment infrastructure (i.e. instant payment kiosks). The mobile finance solution will be based on the use of multiple access methods, such as SMS, USSD, WAP, IVR and/or others. The use of multiple channels increases the service accessibility and significantly reduces the risk of fraud.

The platform will provide an adequate level of transaction security satisfying the ISO 8583 standard. The solution will include agent, merchant administration, fraud management and other modules. All system interactions and transactions will be recorded and available for data processing and analysis.

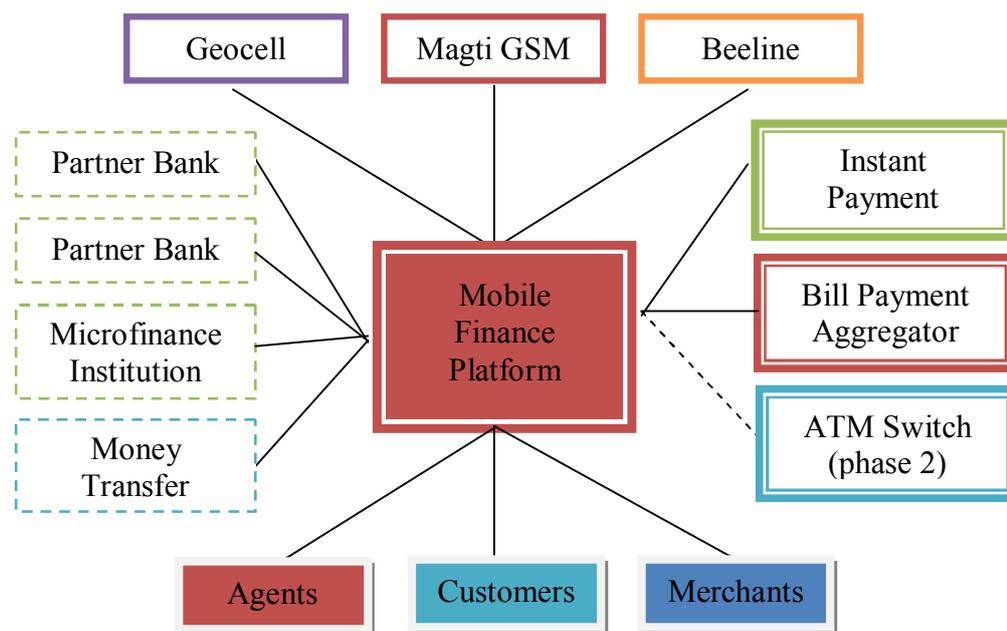
The user interfaces will be designed in the manner which is user-friendly and minimizes the probability of mistakes. Every transaction will require authorization by PIN-code and SMS notification will be sent to both parties of a transaction.

A service provider will ensure high quality and high availability Tier 1 and Tier 2 customer support.

The integration effort will be staged and initially include the following participants (see exhibit 1 below):

- MNOs (maximum 3 MNOs, the number depends on a platform features);
- With money transfer institution/system in Greece;
- Two partner banks;
- A microfinance institution;
- A network of the Instant Payment Kiosks;
- Bill payment aggregator;
- ATM switch (will be implemented later)

Exhibit 1: high level design of the mobile finance ecosystem:



## 11. OPERATING MODEL FOR CROSS-BORDER REMITTANCES

The project aims to establish a remittance corridor between Greece and Georgia by deploying either an (a) agent-to-mobile and/or (b) mobile-to-mobile model, subject to negotiations with counterparts in Greece.

The mobile finance solution will be able to support both models, so customers will remit funds from Greece either (a) from agent locations to customers holding SVAs in Georgia or (b) by topping-up SVAs held by migrants in Greece and sending money from their SVA to the SVAs of their relatives in Georgia.

Both models, but especially the second one, allow migrants to control their funds much better compared to traditional remittance services. An improved control of funds will encourage the use of revenues for saving, productive activities and investment.

The project team has established communication lines with the range of financial institution (MTIs and EMIs) in Greece, which are interested to connect to a new mobile finance system. Crystal Fund presumes the most rational strategy to be a partnership with a local MTI and an EU-registered EMI. This would offer Georgian migrant living in Greece possibilities of: (a) implement remittances with the help of agents to the SVAs of their families in Georgia or (b) top-up their SVA in Greece through the extensive network of agents and manage remittance and payment transactions from their phone. The speed of a customer adaption to new technology will define the demand on both models, but ultimately – due to the convenience, time needed and qualitatively better control of funds, the second option (mobile-to-mobile) should quickly become more popular and sustainable.

## 12. CONCLUSIONS

- Georgia’s regulatory framework in its current form provides a basis for a launch and execution of a mobile finance service. The current regulation does not adequately define the essence of e-money and e-payments, which leaves the taxation of e-payment somewhat unclear. However, this is not a barrier for the commencement of mobile finance operation;
- The most adequate legal form for the establishment and execution of mobile finance services is the “money remittance service provider”;
- This legal form will enable the service provider to offer (a) cross-border and domestic remittances as well as electronic/mobile (b) payment and (c) currency conversion services; while remittances are explicitly defined by legislation and duly regulated by the National Bank of Georgia for AML & CTF purposes, the electronic payments and currency conversion services can be carried out by service provider on the basis that there is no restrictions or regulation for this service. In essence, any legal person is entitled to operate such a service, provided they meet with tax obligations. It is noteworthy that there are various payment and e-money institutions recognized by the National Bank of Georgia, which legitimately operate in Georgia for last 3-4 years without a special permit or license;
- The registration of money remittance service provider is simple and straightforward which includes a written notification of the registrar in the National Bank of Georgia about the name and address(es) of the money remittance service provider. Within 10 days following the registration, the service provider is obliged to get duly enrolled as an “obligated entity” in the Financial Monitoring Service of Georgia, the key national agency facilitating prevention of illicit income legalization and terrorism financing;
- The money remittance service provider is obliged to perform the identification of the individual engaged in business relationship with the money remittance service provider, in cases when the amount of a transaction/operation performed by means of such money remittance service provider exceeds 1,500 GEL<sup>5</sup> or if such transaction is “suspicious”<sup>6</sup>
- A tax treatment of the payment transactions for the purposes of VAT is not clear and straightforward because legislation does not explicitly define e-money and e-payment and this service is not included in the list of financial services, which are VAT exempt according to the Tax Code Georgia. Although, the service provider can argue that the payment service may fall under the definition of “payment instrument”, the legal team recommends to obtain an explicit clarification from the Revenue Service on this issue or include VAT in pricing model, until the desired legislative amendments are ratified;
- A regulatory framework affecting cross-border remittances is set up by the Bank of Greece which aligns its regulation in this area to the EU Payment Services Directive (PSD, 2007/64/EC);

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<sup>5</sup> Currency exchange rates in September 2010 were in average US\$ 1.8325 and EUR 2.3865 to one Georgian Lari.

<sup>6</sup> A transaction supported by a grounded supposition that it had been made or implemented for the purpose of legalizing illicit income (it does not provide verified economic (commercial) content, or clear lawful purpose, is not consistent with an ordinary business activity of the person involved in it, the person’s identification or the origin of relevant amount cannot be ascertained), or the person involved in the transaction is likely to be connected with terrorist or terrorism-supporting persons;

this provides a service provider with three options, which can be applied at different stages of the project: (i) to register as a Payment Institution in one of the EU countries; (ii) to integrate with already existing money transfer intermediary in Greece/EU without a need to secure any license or registration and (iii) to integrate with e-money institution with adequate agent distribution network in Greece;

- There are minimum requirements established by the Bank of Greece for obligated entities to monitor and report suspicious transactions; these personal identification details can be satisfied by overwhelming majority of Georgian migrants living in Greece;
- Other areas of risk identified in the course of the due diligence include the issue of possible association of the mobile finance services to a deposit-taking activity. The National Bank of Georgia has been vigorously consulted with on this matter and the reassurances have given to CF/MFE. However the legal team has offered a low-risk legal model in case if the forthcoming Law on Payment Systems and the secondary legislation on e-money is not in place for the time of launch of the mobile finance service;
- Other area of legal responsibility is the protection of personal data by service provider. According to the Civil Code of Georgia, the service provider will be obliged to protect confidentiality of personal information. CF/MFE should monitor the progress of a draft law under consideration by the Parliament of Georgia on “the Protection of Personal Data”;
- Taking account of the key outcomes from the regulatory due diligence, the project team formulated an operating model and key legal policies to be followed by the service provider in its operations;
- While the openness of the regulatory environment in Georgia is obvious, the predictability of the legislation is to be improved. Crystal Fund is actively involved in the legislative dialogue with the National Bank of Georgia and relevant Ministries. The seminar conducted on the 29<sup>th</sup> of September 2010 in the framework of the IFAD FFR-funded project became a starting point for the policy dialogue. The expected outcome of this process is an adoption of a specific legislation and regulation concerning payment systems and e-money, which will subsequently offer greater predictability and resolve open issues related to the taxation a mobile finance service.

## LIST OF LEGISLATIVE ACTS USED IN THE PROCESS OF REGULATORY DUE DILIGENCE:

### *Georgia*

- Organic Law of Georgia on the National Bank of Georgia
- Law of Georgia on Activity of a Commercial Bank
- Tax Code of Georgia
- The Civil Code of Georgia
- Law of Georgia on “Facilitating the Prevention of Illicit Income Legalization”
- Law of Georgia on “ Electronic signature and Electronic documents”
- Order of the Head of the Financial Supervision Agency N17 as of February 9, 2009 “On approval of Rules on regulation of money remittance service provider”
- Order N1 of the Head of the Financial Monitoring Service of Georgia as of February 17, 2009 “On approval of the rules on elaboration, systematization, analysis and reporting to the Financial Monitoring Service of Georgia of the information by the money remittance service providers”
- Order N166 of the President of the National Bank of Georgia on “Rules on Non-cash transactions in Georgia” as of June 26, 2007
- Order N344 of the President of the National Bank of Georgia on “Approving Rule of Registering and Regulating Foreign Exchange Bureaus” as of December 31, 2007

### *Greece*

- DIRECTIVE 2007/64/EC on payment services in the internal market.
- DIRECTIVE 2009/110/EC on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending.
- REGULATION (EC) No 2560/2001 on cross-border payments in euro.
- Bank of Greece governors ACT No 2501/31 October 2002 credit institutions’ disclosure requirements to retail customers with respect to terms and conditions governing the provision of bank services.
- Bank of Greece Governor’s Act 2526/8 December 2003 concerning the terms and conditions for licensing the establishment of a credit institution in Greece.
- GOVERNOR’S ACT No. 2527/8.12.2003 rules for the prudential supervision of electronic money institutions by the Bank of Greece.
- ACT OF THE GOVERNOR No. 2536/4.2.2004 requirements for granting authorization to, and rules for the supervision of, money transfer intermediaries.
- Law 1266/2.7.1982 authorities responsible for the conduct of monetary, credit and exchange rate policies, and other provisions.
- Law No. 2331/24 August 1995 prevention and combating of the legalization of income from criminal activities.
- LAW 3148/2003 accounting Standardization and Audit Committee, replacement and supplementation of the provisions on electronic money institutions, and other provisions.
- LAW 3691/2008 prevention and suppression of money laundering and terrorist financing and other provisions.
- Law 5076/1931 on Sociétés Anonymes and Banks.
- MONETARY POLICY COUNCIL ACT No. 50/31.7.2002 establishment of a framework for the oversight of payment systems.