



ESAF Program
Expanded and Sustained
Access to Financial Services

THE FUTURE OF FINANCIAL INCLUSION THROUGH ELECTRONIC BANKING MODELS IN PALESTINE AND THE RESULTING REGULATORY IMPLICATIONS

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ACRONYMS

ATM	Automated Teller Machine
AML	Anti-Money Laundering
AML/CFT	Anti-Money Laundering & Combating the Financing of Terrorism
BIS	Bank for International Settlements
BoP	Bank of Palestine
BSC	Banking Services Company
ESAF	Expanded and Sustained Access to Financial Services
G2P	Government to People (payments)
GDP	Gross Domestic Product
ICTs	Information and Communications Technologies
KYC	Know Your Customer
MC	MasterCard
MFI	Microfinance Institution
MENA	Middle East & North Africa
MNO	Mobile Network Operator
MSEs	Micro and Small Enterprises
PIN	Personal Identification Number
PMA	Palestine Monetary Authority
PoS	Point of Sale
PSP	Payment Service Provider
SMS	Short Message Service
USAID	United States Agency for International Development

EXECUTIVE SUMMARY

This paper addresses the issue of the use of technology in enhancing the reach and cost effectiveness of delivery channels for banking and payments products and services in Palestine, drawing on the lessons of international experience.

The current infrastructure of the financial sector in Palestine remains rather a traditional one, with banks continuing to rely heavily on their branch networks. There are some encouraging signs of growth in the Automated Teller Machines (ATMs) and Point of Sales (PoS) infrastructure, while almost universal access to mobile phones may also provide an opportunity for the future.

Although access to bank accounts is widespread, significant numbers of people continue to rely on cash for savings and transactions; access to credit is very limited, particularly for micro and small enterprises. There therefore appears to be a high level of unsatisfied demand for financial services in general among individuals and enterprises in Palestine, and a high potential demand for electronic banking services in particular.

Against this background, it is possible to build a vision and action plan for the future of electronic banking in Palestine. Financial inclusion is a driver of economic growth and poverty alleviation, and the use of new technologies has enabled the financial sector to make an even greater contribution to growth and poverty reduction in many other countries.

International experience shows that by reducing costs and bringing services closer to customers, electronic financial services are reaching both underbanked and unbanked customers, and that using non-bank agents to provide access to financial services can also make a significant contribution to financial inclusion.

These technologies could have even greater advantages in the specific circumstances of Palestine. Palestine's demographics offer the potential for rapid adoption of electronic banking services, and evidence from pioneer countries demonstrates that electronic delivery channels for financial services can grow quickly. The vision for Palestine 2020 is a strong, inclusive financial sector, with Palestine becoming a regional leader in electronic banking.

To realize this ambitious vision means meeting a number of challenges, including the lack of an adequate legal framework for electronic transactions; the lack of interoperability among the different banks; the fragmentation of the market and the development of a PoS monopoly, with many banks serving a small market and only one VISA/MasterCard acquirer; the current preference of merchants and customers for the use of cash; the lack of information on the creditworthiness of potential clients; and other issues relating to the political situation of Palestine.

In tackling these challenges, it is necessary to work within the art of the possible, sequencing reforms to ensure "quick wins" in areas that can be controlled or influenced by Palestinian stakeholders and building on those quick wins to overcome the longer-term obstacles to the use of technology in enhancing the reach and cost effectiveness of financial services.

The important areas of focus in the short to medium term are:

- expanding available services outside of bank branches and offices;
- creating a national switch and an interoperable ATM and PoS network; and
- addressing information asymmetries that limit access to credit.

It will also be necessary to tackle a number of areas in which regulatory reform is required, including:

- developing the legal framework for electronic financial transactions;
- enabling agent banking through money changers and merchants;
- supporting the evolution of mobile phone-based financial services;
- establishing a banking services company; and
- widening the scope for reporting information of the creditworthiness of clients.

In the short term, the following actions are recommended:

1. **Support enactment of payment system and electronic commerce legislation;**
2. **Develop and issue E-Banking and Agent Banking Instructions;**
3. **Conduct a feasibility study of a proposed Banking Service Company;**
4. **Begin to implement the national switch; and**
5. **Address limitations to information on creditworthiness.**

These short-term actions should be followed up by the following actions in the medium term:

1. **Expand agent banking at merchants;**
2. **Expand MNOs' role in e-payment services;**
3. **Continue to develop the national switch; and**
4. **Support efforts to improve the overall business environment.**

1. INTRODUCTION

*ESAF, the Expanded and Sustained Access to Financial Services project of the United States Agency for International Development (USAID), is directed at building “a more inclusive financial sector that increases the sustainable access to financial services for Palestinian households and . . . enterprises . . . addressing weaknesses in the financial system at all levels, from banking to the financial industry to regulatory environment.”*¹

ESAF is expanding its focus on increasing access to finance more broadly to include both credit and non-credit service expansion to underserved or unserved populations and markets in the West Bank and Gaza. A key challenge is the identification of technological innovations that can be utilized by commercial banks to expand service outreach in an efficient, secure, and cost-effective manner.

In 2008, the SMART project, a precursor to ESAF, commissioned a study of the feasibility of using Information & Communications Technologies (ICTs) to expand access to financial services in Palestine.² This paper updates and expands upon the 2008 study by identifying relevant changes over the past two years and considering other ways that technology can facilitate access to finance. It is based upon a combination of desk research, telephone interviews, and face-to-face interviews during visits to Palestine in November and December 2010. The PMA is developing a ten-year vision for the future of banking in Palestine; this vision aims to cover various key themes, including the use of technology in enhancing the reach and cost-effectiveness of delivery channels for banking and payments products and services. ESAF hopes that this paper will be helpful to the PMA and other policymakers as they continue to develop this vision and an action plan for carrying it out.

The paper begins by setting out the background, with a summary analysis of access to finance in Palestine today. In the next section, a possible vision for future electronic banking is developed, starting with the benefits of electronic banking and then using international benchmarks to establish the parameters for the vision for Palestine. There are, inevitably, a number of challenges that will confront the realization of the vision. These are described in Section 4, and proposals for tackling them are set out in Section 5, including expanding available services at merchants, creating a national switch, and addressing information asymmetries that limit access to credit. The regulatory issues that will need to be addressed in this process are described in Section 6. The main conclusions and key recommendations are summarized in the final section.

¹ <http://www.aed.org/Projects/ESAF.cfm>.

² See Bruynse & Grossman, [Mobile Money Study in the West Bank & Gaza](#), FIELD Report No. 6 (2008).

2. ACCESS TO FINANCE IN PALESTINE TODAY

2.1 Infrastructure

Traditional Infrastructure

Banks are continuing to build their branch networks. As of January 2011, there were 213 bank branches, offices, and cash offices in Palestine, a 32% increase from the 161 branches and offices in mid-2008. These branches and offices cover 49 cities, towns, and villages (42 in the West Bank and 7 in the Gaza Strip).³ However, there are significant variations in access to branches. For example, there are approximately five times as many branches per working-age person in Ramallah/Al-Bireh and Jericho as in Khan Younis/Rafah.⁴ Furthermore, branches are often very limited outside of major towns and cities. For example, there are no bank branches in Ethna, a town of over 19,000 people west of Hebron, or in Bani Suhaila, a city of over 31,000 people in the southern Gaza Strip.⁵

Money changers continue to expand as well. The number of money changer outlets increased from 188 in mid-2008 to 232 as of the end of 2009.⁶ Money changers are generally available throughout Palestine, although they tend to be more concentrated in areas with significant migration and high economic activity, so there is considerable overlap with bank branches.⁷ As with bank branches, there are significant inter-governorate and intra-governorate variations. For example, Nablus has nearly five times as many outlets as Jenin/Tubas, and some towns and cities had no money changer outlets as of 2009, including Qabatiya (a West Bank town of over 20,000) and Beit Lahia (a Gaza Strip city of over 64,000).⁸

Electronic Infrastructure

Automated Teller Machines (ATMs) are becoming more widespread but are not fully interoperable. As of the end of 2009, there were 305 ATMs in Palestine,⁹ an increase of nearly 50% since mid-2008.¹⁰ However, the lack of a national switch has led to significant duplication of infrastructure, with multiple banks installing proprietary ATMs in a single location.

³ PMA statistics; Bruynse & Grossman, [Mobile Money Study: West Bank & Gaza](#), Table 3 (2008).

⁴ PMA statistics.

⁵ Bank branch data from PMA, as of Jan 2011; population statistics from Palestinian Central Bureau of Statistics, as of 2007.

⁶ Bruynse & Grossman, [Mobile Money Study: West Bank & Gaza](#), Table 3 (2008); PMA statistics.

⁷ Of the 36 cities, towns, and villages where money changer outlets were active as of the end of 2009, 30 had at least one bank branch as well. Statistics on money changer outlets and bank branches are from the PMA.

⁸ Bruynse & Grossman, [Mobile Money Study: West Bank & Gaza](#), Table 3 (2008); PMA statistics.

⁹ PMA statistics.

¹⁰ Bruynse & Grossman, [Mobile Money Study: West Bank & Gaza](#), Table 4 (2008).

Furthermore, ATMs are largely concentrated in a limited number of governorates¹¹ and few ATMs accept deposits, so customers in most governorates still rely heavily on branches.

Point of Sale (PoS) infrastructure continues to grow, but is still very limited. The number of PoS devices has nearly doubled from 1,300 in mid-2008¹² to approximately 2,400 as of late 2010, and Bank of Palestine (BoP) plans to expand its PoS network to 4,000 in the near future. As with ATMs, however, PoS devices are clustered mostly in a few governorates, and only one bank (BoP) is currently developing a PoS network.

Access to mobile phones is becoming universal. There are approximately 2.7 million mobile phone accounts in Palestine, of which about 90% are prepaid.¹³ Given that the entire population of Palestine is just over 4 million and the productive-age population (ages 15-64) is only about 2.1 million, this suggests that virtually all households have access to at least one mobile phone account.¹⁴ While mobile phones are not currently used extensively in the provision of financial services, some limited SMS banking services are available (such as confirmation of account transactions, balance inquiry, etc.).

2.2 Use of Banking Services

Deposit Accounts

Most Palestinian adults have access to a deposit account. As of the end of 2009, over 1.2 million Palestinians held bank accounts, nearly all of which were savings, current, or time deposit accounts. Many clients held more than one account. Assuming that few of these accounts were held by children,¹⁵ over half of working-age Palestinians (ages 15-64) had at least one bank account in 2009 (see Table 1 below). However, account usage is limited; most clients primarily use accounts to receive and withdraw salaries.¹⁶

Transactions Outside of the Banking System

Significant numbers of people continue to save outside of the formal financial sector. Minimum deposit requirements and a lack of nearby branches may discourage uptake of formal banking services, particularly in villages less-served by branches.¹⁷ Even where formal services

¹¹ In particular, Ramallah/Al-Bireh, Nablus, Hebron, Bethlehem, and Gaza. See Bruynse & Grossman, [Mobile Money Study: West Bank & Gaza](#), Table 4 (2008).

¹² Bruynse & Grossman, [Mobile Money Study: West Bank & Gaza](#), Table 4 (2008).

¹³ Statistics from Jawwal.

¹⁴ Even if some individuals have more than one mobile phone and these figures include some inactive accounts, there should be at least one phone per household, given that there were an average of 5.8 people per household in Palestine in 2008. See Bruynse & Grossman, [Mobile Money Study: West Bank & Gaza](#), p7 (2008).

¹⁵ The population aged 65 or older only constitutes approximately 3% of the total population in Palestine. See CIA World Factbook, [West Bank](#) (2010); CIA World Factbook, [Gaza Strip](#) (2010).

¹⁶ See MEDA, [Savings Demand Market Research Study, West Bank and Gaza](#), p6 (2010).

¹⁷ See Bruynse & Grossman, [Mobile Money Study: West Bank & Gaza](#), pp19-21 (2008).

are readily available, however, use of cash is more prevalent than would normally be expected. Some of the reasons for this will be discussed in detail below.

Table 1. Bank Accounts, as of 31 December, 2009.

Savings Accounts	969,813
Time Deposit Accounts	104,317
Current Accounts	841,705
Other Accounts	97,542
Total Accounts	2,013,377
Total Bank Clients	1,228,414
Population, Total	4,043,218
Population, ages 15-64	2,102,473
Bank Clients as % of Population aged 15-64 (est.)	58%

Sources: PMA; World Bank, *World Development Indicators* 2009.

Credit

Access to credit is very limited, particularly for micro and small enterprises, which comprise the vast majority of businesses in Palestine. While estimates of unmet credit demand vary considerably, most stakeholders agree that micro and small businesses lack access to appropriate credit products at affordable prices, and that this is limiting business growth in Palestine.¹⁸ One estimate of access to microcredit suggests that as of the end of 2009, less than 20% of the potential market for microcredit was being served by Palestine's seven major MFIs.¹⁹

Transfers

Available data on transfers are limited to domestic transfers that go through the PMA clearinghouse. In 2009, there were 111,837 such transfers with a total value of over USD 4.3 billion.²⁰ Nearly half of all Palestinians receive some sort of money transfer from other members of the household. Of such transfers, most were received either directly from the family members themselves or through money changers.²¹

¹⁸ See Planet Finance, [Microfinance Market Survey in the West Bank and the Gaza Strip](#), p9 (June 2007); Bruynse & Grossman, [Mobile Money Study: West Bank & Gaza](#), p19 (2008).

¹⁹ See Naber, Anton, [Quick Overview of Microfinance in Palestine](#) (2010).

²⁰ PMA statistics.

²¹ Palestinian Center for Public Opinion, [Poll No. 174](#) (29 Dec. 2010).

2.3 Use of Electronic Banking Services

ATM, Debit, and Credit Cards

Of the more than 2 million bank accounts in Palestine, less than 20% are connected to electronic channels. As of the end of 2009, there were just over 285,000 debit/VISA Electron cards, 68,000 ATM (non-debit) cards, and about 29,000 credit cards.²²

ATM Transactions

Use of ATMs is growing rapidly. In 2009, over 4.6 million transactions valued at USD 867 million were conducted at ATMs. While ATM infrastructure is still limited, this represents more than a tripling of the number of ATM transactions in only two years.²³

PoS Transactions

Use of PoS networks remains low. While each of the 305 ATMs in Palestine processed an average of 15,000 transactions in 2009, the corresponding figure for the 1,745 PoS devices was only 170. Of transactions conducted at the PoS, about 90% were credit card transactions and only about 10% were debit/VISA Electron cards.²⁴

2.4 Demand for Financial Services & Electronic Banking Services

Overall Demand

There are few detailed assessments of market demand for financial services in Palestine. A 2007 study of Palestinian microentrepreneurs found high demand for insurance (particularly health insurance), credit, and savings services, with some demand for money transfer services as well.²⁵ A 2010 study found a large potential market for retirement savings and other savings services, particularly in rural areas. However, this study also found limited demand for formal savings services at present due to low incomes, lack of accessible and appropriate banking products, and lack of banking knowledge.²⁶ The fact that many people continue to save and borrow informally outside of the banking sector²⁷ suggests that current bank products and services are not meeting the needs of many Palestinians.

²² PMA statistics.

²³ PMA statistics; Bruynse & Grossman, [Mobile Money Study: West Bank & Gaza](#), p11 (2008).

²⁴ PMA statistics.

²⁵ Planet Finance, [Microfinance Market Survey in the West Bank and the Gaza Strip](#), pp9-10 (June 2007).

²⁶ See MEDA, [Savings Demand Market Research Study, West Bank and Gaza](#), pp3-4 (2010).

²⁷ See Planet Finance, [Microfinance Market Survey in the West Bank and the Gaza Strip](#), pp33-35 (June 2007); MEDA, [Savings Demand Market Research Study, West Bank and Gaza](#), pp3-4 (2010).

Demand for Electronic Banking Services

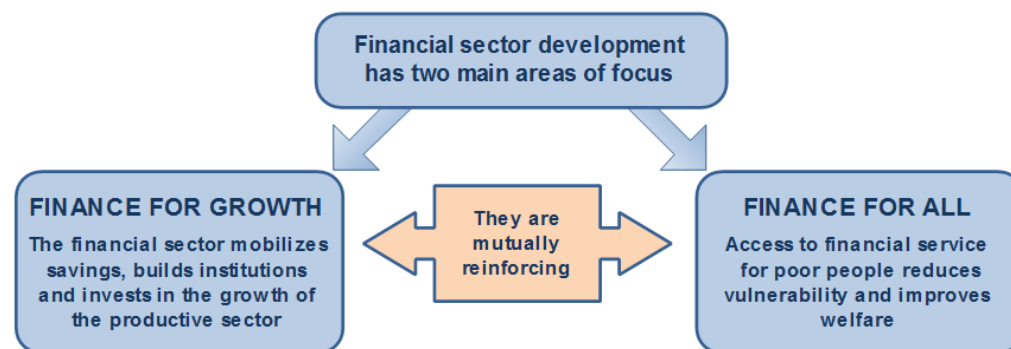
Rapid adoption of mobile phones and ATMs suggests that high potential demand could exist for e-banking services. While the Palestinian banking sector is still in the early stages of development,²⁸ the Palestinian population is young (median age of 21 years in West Bank, 18 in Gaza), literate (92% of adults), and well-educated (average of 14 years of education).²⁹ Furthermore, there appears to be growing comfort with – and demand for – electronic technologies, as evidenced by quick growth of mobile phone accounts and ATM usage. While challenges to the development of e-banking services exist (see section 4 below), a recent market demand study has indicated that greater demand for e-banking services is chiefly limited by the availability and user-friendliness of the technologies.³⁰

3. A VISION FOR FUTURE ELECTRONIC BANKING IN PALESTINE

3.1 The Benefits of Electronic Banking

It is now widely recognized that financial inclusion is a driver of economic growth and poverty alleviation. Inclusive financial sector development makes two complementary contributions to poverty alleviation: it is a driver of economic growth, which reduces poverty; and appropriate, affordable financial services improve the welfare of poor and low-income people (see Figure 1). They are complementary because financial inclusion, by empowering the excluded, enables them to contribute to economic growth, while economic growth facilitates the inclusion of more people in the economy and in the financial system.³¹

Figure 1 Inclusive financial sector development



²⁸ Occupation and conflict have hampered the development of a strong indigenous banking sector. For more information, see Bruynse & Grossman, [Mobile Money Study: West Bank & Gaza](#), Box 1 (2008).

²⁹ See CIA World Factbook, [West Bank](#) (2010); CIA World Factbook, [Gaza Strip](#) (2010).

³⁰ Al Markaz for Development and Marketing Consultancies, [Market Demand Assessment for E-Banking Services in Palestine](#) (2009).

³¹ G20, [Innovative Financial Inclusion: Principles and Report on Innovative Financial Inclusion from the Access through Innovation Sub-Group of the G20 Financial Inclusion Experts Group](#) (May 2010).

The use of new technologies has enabled the financial sector to make an even greater contribution to growth and poverty reduction. The development of new technologies – from agency banking using PoS terminals in Latin America to mobile money transfer in the Philippines and Kenya – has greatly accelerated the widening and deepening of the financial sector. Wider and deeper financial systems have been proven to drive economic growth.³² The application of the new technologies has also enabled people, especially poor people, to access a wider range of financial services such as savings, credit, money transfer, and insurance services. The scale of these developments is indicated in the benchmarking exercise presented in the next section. Recent studies in Bangladesh, India, South Africa, and Kenya have shown that access to a range of appropriate and affordable financial services helps poor people to reduce their vulnerability to shocks, improves their welfare, and in many cases raises their income.³³

Electronic banking also has additional advantages in the specific circumstances of Palestine. As mentioned above, the West Bank and Gaza are characterized by a heavy reliance on cash. This is partly the result of the uncertainties and instability resulting from the Occupation; ironically, however, the circumstances of the Occupation also increase the dangers and difficulties of using cash and of moving it around the country. Electronic banking will facilitate a reduction in the use of cash, thus improving security for the citizens of Palestine, reducing banks' costs and thereby reducing the costs of banking services. This, together with the general increase in customer convenience, is likely to attract more customers, increase the volume of transactions, and increase economic activity in general.³⁴

3.2 International Benchmarks

Due to lower fixed and operating expenses, electronic financial services are less costly for providers than traditional financial services. As a result, providers are able to offer customers significantly less expensive services. A recent study of eight leading providers of innovative electronic financial services found that on average, their services were 19% cheaper than banks for comparable services.³⁵

³² Ross Levine, Norman Loayza and Thorsten Beck, [Financial Intermediation and Growth: Causality and Causes](#), *Journal of Monetary Economics*, (2000); Ross Levine, [Finance and Growth](#) in Aghion P. & S. N. Durlauf *Handbook of Economic Growth* (2005). Volume 1A. North Holland: Elsevier. p.82. See also Asli Demirgüç-Kunt, Thorsten Beck and Patrick Honohan, [Finance for All? Policies and Pitfalls in Expanding Access](#), World Bank, Washington DC (2008). This book complements a previous World Bank study, [Finance for Growth: Policy Changes in a Volatile World](#) (2001).

³³ Daryl Collins, Jonathan Murdoch, Stuart Rutherford and Orlanda Ruthven, *Portfolios of the Poor: How the World's Poor Live on \$2 a Day*, Princeton University Press (2009); Stuart Rutherford with Sukhwinder Arora, *The Poor and their Money*, Second Edition, Practical Action Publishing, 2009; and Robert Stone, Susan Johnson and Janet Hayes, "[Financial Sector Deepening, Kenya: Impact Assessment](#)," Oxford Policy Management for FSD Kenya (2010).

³⁴ Jenny Hoffman and Andrew Lake, [ESAF Technology Initiative: Global Regulatory Trends relating to Technology in Banking – High Level Assessment of Technology in Banking](#), Riskfrontier Consultants, edited by ShoreBank International, for AED/ESAF (2010); and Al Markaz for Development and Marketing Consultancies, [Market Demand Assessment for E-Banking Services in Palestine](#) (2009).

³⁵ These services included deposits, withdrawals, money transfers, and bill payments, among others. See McKay & Pickens, [Branchless Banking 2010: Who's Served? At What Price? What's Next?](#), p6, CGAP Focus Note 66 (2010).

By reducing costs and bringing services closer to customers, electronic financial services are reaching both underbanked and unbanked customers.³⁶ Evidence from the aforementioned study demonstrates that for these eight institutions, 63% of clients had a bank account, while 37% were unbanked.³⁷ A service that is widely adopted by both underbanked and unbanked clients would be well-suited to Palestine, where 58% of the working-age population has a bank account but most customers do not utilize a broad range of banking services, and where many people borrow or save outside of the formal financial sector.

Using merchants and other non-bank actors to provide access to financial services can make a significant contribution to financial inclusion. In Brazil, one of the earliest countries to adopt agent banking, nearly 30% of its municipalities lacked access to formal financial services in the year 2000. Three years later, every municipality in Brazil had access to formal financial services, due almost entirely to the use of “*banking correspondents*”, merchants who process financial transactions on behalf of licensed banks.³⁸ Likewise, in Colombia, the approval of agent banking in 2006 led to the rapid growth of bank-merchant networks that correlate closely with a large increase in the percentage of the population using formal financial services (see Table 2).³⁹ And in Kenya, Safaricom’s mobile phone-based electronic wallet product “M-PESA” registered over 9 million customers – over 40% of Kenya’s adult population – in less than three years.⁴⁰

Table 2. Banking Correspondents and Financial Inclusion in Colombia, 2006-2009.

Date	# of Banking Correspondents	% of Population (18 or older) using at least One Formal Financial Product	% of Population (18 or older) using more than One Formal Financial Product
July 2006	(Introduced in 2006)	29.9%	10.2%
June 2007	1,658	35.1%	12.8%
June 2008	4,331	55.5%	21.9%

³⁶ “*Underbanked*” users of innovative electronic services already have bank accounts but use them infrequently because these accounts are costly and/or inconvenient to access. “*Unbanked*” users lack any formal bank account.

³⁷ McKay & Pickens, [Branchless Banking 2010: Who’s Served? At What Price? What’s Next?](#), p3, CGAP Focus Note 66 (2010).

³⁸ Kumar et al., [Expanding Bank Outreach through Retail Partnerships: Correspondent Banking in Brazil](#), pp27-28 (2006).

³⁹ See Banca de las Oportunidades, [Growth of Non-Bank Correspondents in Colombia](#), Slide 7 (showing growth in non-bank correspondents); Maria Mercedes Cuellár, [Avances y los obstáculos de la bancarización en Colombia](#), p3, Graph 1 (showing that bank branches did not increase appreciably in 2007, while thousands of correspondents were added); and <http://www.asobancaria.com/categorias.jsp?id=227&sup=1> (detailing the increase in usage of formal financial services from 2006-2009).

⁴⁰ See <http://mobilemoneyafrica.com/?p=1572>. Other countries have also had great success with similar models of mobile money transfer, such as the Philippines with GCash and Smart, and Cambodia with Wing.

June 2009	5,162	56.7%	22.1%
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The evidence from Colombia demonstrates that agent banking was associated not only with an influx of new bank customers (“unbanked”) but also with a significant increase in usage of banking services by already-banked customers (“underbanked”).

3.3 The Vision for Palestine

Palestine’s demographics offer the potential for rapid adoption of electronic banking services. High levels of literacy and educational attainment, combined with a young, tech-savvy population, place Palestine at an advantage. When compared to countries where innovative electronic financial services have made a significant contribution to financial inclusion – including Brazil, Colombia, Kenya, and the Philippines – Palestinians are, on average, younger, more literate, and more educated.⁴¹

Evidence from other pioneer countries demonstrates that electronic delivery channels for financial services can grow quickly. In Brazil, Colombia, and Kenya, it took only two or three years to effect a dramatic increase in usage of formal financial services. If steps are taken to address the challenges affecting financial inclusion (see next section), Palestine could see similar results in a relatively short time period.

The vision for Palestine 2020: a strong, inclusive financial sector and a regional leader in electronic banking. Today, when people cite examples of financial inclusion and the use of electronic delivery mechanisms, they frequently refer to Brazil in Latin America, Kenya in Sub-Saharan Africa, and the Philippines in Asia. No developing country in the Middle East & North Africa (MENA) has emerged as a clear leader in financial inclusion through electronic channels. Through widespread adoption of e-banking, Palestine has the potential to become an example within the MENA region, using electronic delivery mechanisms to expand access to and usage of formal financial services. Banks should be able to lower costs, expand their customer bases, and increase profits. Other potential stakeholders, including mobile network operators and payment service providers, can play a supporting role in the development of a stronger and more inclusive financial sector. Most importantly, a stronger and more inclusive financial sector will intermediate more funds, and there is a positive, causal relationship between private-sector credit and GDP, particularly for developing countries.⁴²

4. CHALLENGES AFFECTING FINANCIAL INCLUSION

The vision outlined above is ambitious. It offers a picture of how e-banking has the potential to dramatically expand access to safe, flexible, and convenient formal financial services in Palestine.

⁴¹ See CIA Factbook profiles for [Brazil](#), [Colombia](#), [Gaza Strip](#), [Kenya](#), [Philippines](#), and [West Bank](#).

⁴² See, e.g., Calderon & Lin, [The Direction of Causality between Financial Development and Economic Growth](#), p10 (2002).

To achieve this vision within the next ten years, it is critical to understand the key challenges affecting financial inclusion in general and e-banking in particular. While great potential exists for using e-banking technologies to expand access to finance, the following sub-sections discuss important issues identified by stakeholders as key factors limiting the growth of e-banking services.

4.1 Lack of Legal Framework for Electronic Transactions

No well-developed legal framework governing electronic payments exists in Palestine. Electronic signatures are not yet formally regulated, and no law specifically addresses the finality and non-repudiation of e-payments. Furthermore, there is a need to ensure that recipients of e-payments have legal priority over creditors in the event of insolvency of the payment service provider. Several stakeholders indicated that the uncertain legal environment was discouraging banks from expanding electronic payment initiatives.

Proposed payment system legislation has stalled. In 2007, the PMA's payment system department envisioned the enactment of a payment system law no later than March 2009.⁴³ However, a draft law and accompanying regulations were developed that proved to be too complex for the PMA's present needs. This document was replaced with a short framework law to establish the basic legal framework. The draft framework law could not be submitted to the Legislative Council, since it is not currently functioning.⁴⁴ Under the current legal framework in the West Bank, a law may only be issued by the President as a temporary "Law by Decision" (until the Legislative Council can reconvene), and only in an "emergency" and on issues where an "imminent need" exists.⁴⁵ Therefore, the proposed law was submitted to the President to be enacted as a Decree, but it has not yet been approved.

4.2 Lack of Interoperability

The absence of a national switch is limiting access to finance and slowing the adoption of electronic financial services. Interbank electronic transactions are processed internationally, which raises costs⁴⁶ and results in inefficient development of electronic infrastructure.

Interbank ATM transactions are costly, leading to significant duplication of infrastructure. Withdrawals at other banks' ATMs are processed through international card networks (VISA or MasterCard). As a result, these transactions are significantly more expensive than they would be if a national switch were in place. This has led to a proliferation of ATMs from different banks in overlapping locations, which is cumbersome, inefficient, and costly.

⁴³ PMA, "Vision and Action Plan for the Palestine Payment System" (Sept. 19, 2007).

⁴⁴ This is due to the dispute between Hamas (which has a majority within the Legislative Council), Fatah (which controls the Presidency), and Israel (which has arrested a number of Hamas-affiliated members of the Legislative Council). See, e.g., [Hamas Accuses Israel, Fatah of Blocking Palestinian Parliament](#) (May 7, 2009).

⁴⁵ Conversation with Muhanad Assar & Ibrahim Al-Faris, Ittqan Consulting.

⁴⁶ These costs include both switching costs and commissions paid to the ATM provider. Creating a national switch will address switching costs, while commissions may be addressed through an industry body (see Section 5.3).

Duplication of infrastructure raises costs for banks and customers alike. Currently, all banks have their own ATM controllers and are forced to expend significant resources developing proprietary ATM networks. This significantly increases both fixed and operating costs for banks, which are ultimately passed on to their customers.

4.3 Market Fragmentation & Monopoly Issues

There are many banks competing within a small market. Currently, 19 banks⁴⁷ are providing services to 1.2 million customers. Due to the lack of interoperability discussed above, banks are unable to share fixed costs for infrastructure development, particularly with respect to ATM and PoS hardware and software. Furthermore, ATM transactions are either impossible or expensive if the ATM acquirer is different from the card issuer.

Issuing and acquiring credit cards is expensive. Each bank has to buy its own hardware and software for issuing credit cards, and it is costly to produce cards due to an absence of economies of scale. As a result, fewer than half of the banks are issuing credit cards. With respect to acquisition, there is currently only one acquiring bank for VISA and MasterCard (BoP), and potential market growth is limited by the small size of the domestic market. Therefore, increased access to finance through PoS devices is wholly dependent at present upon BoP's ability to profitably expand its PoS network, which is a major limiting factor.

Stakeholders have indicated that the monopoly on VISA/MC acquisition is limiting the development of electronic channels. Since BoP must bear the full cost of developing the national PoS network, expansion will be slower than it would if more financial sector providers were sharing the cost of infrastructure development.⁴⁸ Furthermore, the combination of an underdeveloped PoS infrastructure and low usage leads to limited earnings from credit card services.

4.4 Merchants' and Customers' Preference for Cash

Some merchants prefer cash over electronic payments. Many merchants view e-payments as costly and cash as costless, despite costs associated with cash handling (such as theft, counterfeiting, and cost of collection and transport). Anecdotal evidence of merchants actively discouraging customers from paying with credit or debit cards suggests that some are not wholly convinced of the business case for facilitating e-payment transactions. Furthermore, some merchants are uncomfortable with e-payment technology, and these concerns are exacerbated by telecommunications or electricity problems that affect the performance of PoS devices.

Customers are unaccustomed to electronic banking. Customers used to transacting in branches may not immediately embrace unfamiliar electronic channels. Overall, customers trust bank branches more than mobile phones and electronic channels. The banking sector is young, and electronic financial products are a recent innovation. Consequently, e-banking infrastructure

⁴⁷ See <http://www.pma.ps/index.php?lang=en&page=1267099658205>.

⁴⁸ In practice, this cost is reduced due to donor support through the USAID/ESAF project. See http://www.usaid.gov/wbg/weekly_ach_May_24_2010.html.

and products are limited – particularly outside of wealthy or tourist-friendly areas such as Bethlehem, Jericho, and Ramallah – which reduces their appeal to customers in the short term.⁴⁹

Some customers and merchants have voiced religious objections to the use of credit and debit cards. Some customers object to using credit cards because they believe that this involves the payment of *riba*, a form of interest that is prohibited under *shari'ah* (Islamic law). Furthermore, some merchants consider *ad valorem* charges for the use of credit and debit cards to be a form of *riba* as well.⁵⁰

Despite these challenges, customers and merchants alike are beginning to embrace e-payment services. The Palestinian population is young, well-educated, and tech-savvy, and mobile phones are common, so many clients are very receptive to electronic delivery channels. ATM transactions tripled between 2007 and 2009, the number of electronic cards (ATM, debit, and credit) increased by 20% between 2008 and 2009, and the number of mobile phone subscriptions per 100 population more than doubled between Q3 2007 (31) and late 2009 (67).⁵¹ It is no surprise, then, that many banks see great potential for e-channels in the Palestinian market.

4.5 Insufficient Information on Creditworthiness of Potential Clients

Access to credit facilities is limited by a lack of objective information on creditworthiness of applicants. Historically, banks have depended upon collateral to guard against the risk of default. This risk is perceived to be particularly high for micro and small enterprises (MSEs), due to factors such as political instability and banks' inability to effectively assess MSE risk. However, many small-scale entrepreneurs lack access to collateral, particularly the forms of collateral commonly accepted by banks.⁵² As a result, MSEs – which constitute the vast majority of enterprises in Palestine – lack sufficient access to capital to grow their businesses.

The establishment of a public credit registry is an important step. The PMA established a zero-balance credit registry in April 2008.⁵³ All banks and other specialized lending institutions (including MFIs) are required to submit data on all customer obligations to the registry.⁵⁴ Since July 2010, banks have been able to access credit history information concerning individual customers. Bank lending volume and profitability increased by 25% and 54%, respectively, in the first eight months of 2010 (year-on-year vs. 2009); the PMA believes that the credit registry is largely responsible, due to a reduction in non-performing loans.⁵⁵ While these trends are

⁴⁹ The value of an electronic network to an individual user depends in large part upon the number of other users who use the network. See, e.g., <http://oz.stern.nyu.edu/io/network.html>.

⁵⁰ Hoffmann & Lake, *Policy, Regulatory and Technology Assessment of ESAF Partner Banks in Palestine*, p9.

⁵¹ See World Bank, *West Bank and Gaza Telecommunications Sector Note: Introducing Competition in the Palestinian Telecommunications Sector*, Table 1 (2008); statistics from Jawwal.

⁵² See Planet Finance, “*Microfinance Market Survey in the West Bank and the Gaza Strip*,” p33 (June 2007).

⁵³ Bruynse & Grossman, *Mobile Money Study: West Bank & Gaza*, p34 (2008).

⁵⁴ See PMA, *Instruction 2007/160*, p5 (2007).

⁵⁵ See <http://www.kippreport.com/2010/10/palestinian-credit-bureau-helps-banks-profits/>.

positive, most MSEs still lack detailed credit information, which limits the value of the credit bureau to these enterprises at present.

4.6 Other Issues

Ongoing political instability discourages banks from lending on the local market. Banks tend to be risk-averse, particularly banks headquartered outside of Palestine; much of the money collected as deposits in Palestine is invested outside the country. In response, the PMA has mandated that all banks must locally invest at least 45% of deposits captured in Palestine.⁵⁶

Challenges with collateral-based lending are aggravated by politics. Land in areas of the West Bank under Israeli civil administration (“Area C”) is subject to confiscation if inherited by a non-resident Palestinian. As a result, such land is often not formally registered for use as collateral.

There is not an enabling business environment for access to credit. In particular, secured transactions law limits permissible forms of collateral and the types of security interests that may be created.⁵⁷ In addition, leasing has not yet developed in Palestine; only now are regulations being introduced. Furthermore, the costs associated with starting a formal business are among the world’s highest, which is a disincentive for formalization.⁵⁸

⁵⁶ See PMA, *Instruction 2008/5*, Part 7/5, pp30-31 (2008).

⁵⁷ See <http://www.doingbusiness.org/data/exploreconomies/west-bank-and-gaza#getting-credit>.

⁵⁸ See <http://www.doingbusiness.org/data/exploreconomies/west-bank-and-gaza#starting-a-business>.

5. TACKLING THE KEY CHALLENGES

5.1 Working with the Art of the Possible

Some of the challenges faced by the financial sector in Palestine have deep exogenous roots that cannot be addressed by the PMA or by financial service providers. The most obvious of these is the Occupation and the accompanying restrictions on trade and movement within Palestine and between Palestine and the rest of the world, as well as the security situation in general. Other issues are less obvious but also create serious obstacles to electronic banking, such as limitations on the use of mobile technology, including on the frequency spectrum.

Some other challenges are endogenous to Palestine but will be difficult to overcome in the short to medium term. For example, new legislation is required to create a sound legal and regulatory infrastructure for e-banking, but as pointed out in sub-section 4.1 above, new laws cannot be passed in the absence of a Legislative Council, resulting in a serious backlog of new legislative instruments. The establishment of an appropriate framework for collateral for bank loans is another major difficulty – exacerbated by the rules on the inheritance of land in Area C – which will take a very long time to overcome.

It is therefore necessary to establish a reform program that begins with matters over which the PMA has control. Fortunately, there are a number of areas in which progress can be made. Furthermore, these areas address issues that should be dealt with at an early stage in the sequencing of reforms in Palestine in order to foster success in expanding access to financial services.

Handled effectively, these areas can yield “quick wins” in the reform process, thus mitigating the impact of the longer-term challenges. The key areas that could be tackled in this context are expanding available services at merchants, creating a national switch, addressing information asymmetries that limit access to credit, and developing an appropriate regulatory framework. The first three areas are dealt with in the rest of this section, while the regulatory framework is addressed in Section 6.

5.2 Expanding Available Services Outside of Bank Branches & Offices

Currently, formal financial services available outside of bank branches and offices are fairly limited. Customers can withdraw funds from ATMs (and deposit funds at select ATMs), make purchases at PoS devices, and transfer and exchange funds at money changers. However, other services – including deposits (outside of a few ATMs) and loan disbursement/repayment – must take place within branches.

Expanding available services outside of bank branches would foster financial inclusion. Currently, there are about 19,000 Palestinians per bank branch. To reduce this to 10,000:1,⁵⁹ the

⁵⁹ This number was recommended by Maurice Girgis based upon comparable regional figures. See Girgis, Maurice, [Mobilization of Savings in the West Bank and Gaza](#), p21. FIELD Report No. 5 (2008).

number of service points offering banking services would have to expand from 213 to about 400. As it would not be cost-effective to do this in the near future through bank branches and offices alone, this could only be achieved by taking advantage of existing infrastructure, such as money changers and merchants equipped with PoS devices.

Expansion of services at money changers and merchants would benefit banks, non-banks (money changers and merchants), customers, and the financial sector as a whole. Table 3 depicts some of the potential benefits accruing to each actor in the financial services value chain, including other potential actors.

Table 3. Potential benefits from expanded access to electronic services at merchants

Banks	<ol style="list-style-type: none"> 1. Reduction in costs by providing services outside of branches. 2. Increased customer base by reaching previously unbanked clients. 3. Increased revenue by increasing financial activity among underbanked clients.
Non-Bank Agents (Money Changers, Merchants, etc.)	<ol style="list-style-type: none"> 1. Revenue from commission for serving bank's customers. 2. Increased foot traffic results in greater customer utilization of primary service offering (money transfer/exchange, purchase of goods, etc.).
Customers	<ol style="list-style-type: none"> 1. Ability to access financial services locally reduces expenses and opportunity costs associated with accessing bank infrastructure. 2. Greater access to safer, formal financial services reduces risk of loss of savings. 3. Banks' cost reductions may allow them to offer more attractive rates/services.
Payment Service Providers (PSPs)	<ol style="list-style-type: none"> 1. Revenue from commission for serving bank's customers. 2. Expansion of available services leads to network effects that result in greater use of PSP services.
Government	<ol style="list-style-type: none"> 1. Lower costs for disbursement of salaries/benefits to citizens. 2. Greater financial inclusion. 3. Reduction of use of cash and checks. 4. Reduction of informal financial transactions/greater ability to track financial transactions.
Mobile Network Operators (MNOs)	<ol style="list-style-type: none"> 1. Revenue from commission for serving bank customers. 2. Value-added service to encourage new customers to join and old customers to stay. 3. Lower costs for airtime top-up.

A wide variety of financial services can be safely offered through non-bank agents. In other countries where agent banking is permitted, non-bank agents offer services such as:

- Deposits
- Withdrawals
- Bill payments (utilities, telecommunications, mortgage, insurance, etc.)

- Purchase of goods and services
- Money transfer (domestic and/or international)
- Loan disbursement
- Loan repayment
- Salary disbursement
- Government to People (G2P) payments such as pensions, welfare, or other social cash transfers

Historically, money changers have provided a wide variety of financial services. Currently, money changers are allowed to offer domestic and international money transfers as well as currency exchange. In the past, however, particularly when the banking sector was just developing, money changers informally provided a number of other services, including (unauthorized) deposit-taking and lending.⁶⁰ While money changers are no longer offering deposit-taking and lending on their own behalf, they are trusted by the community and are experienced with cash management. Allowing money changers to act as banks' agents to provide deposit and lending services could help to expand access to formal financial services.

Currently, many merchants question the value proposition for e-banking services. PoS devices are underutilized, and merchants sometimes encourage customers to pay with cash rather than electronically. Allowing merchants to provide a wider range of services – especially services for which they receive a commission – should significantly increase the appeal of electronic service provision. Doing so could lead to a paradigm shift, with merchants viewing e-banking services as a “profit center” rather than as a “cost center”.

Mobile network operators (MNOs) should also be allowed to play a role. Some of the most successful examples of financial inclusion through technology have been developed using mobile phones. Worldwide, there are already 95 mobile money initiatives, with another 94 in the planning stages.⁶¹ Both Jawwal and Wataniya are familiar with global mobile money projects, and they are eager to participate in technology-enabled financial inclusion. To mitigate risk, the PMA can follow international best practice, which recognizes banks' comparative advantage with respect to license acquisition and regulatory compliance, while allowing banks to harness MNOs' strengths through collaborative initiatives.⁶² The PMA could adopt a phased approach to MNO involvement in electronic banking services, requiring MNOs to play a supporting role to banks initially (with the possibility of taking a more independent role in the future when the model is well-established).

⁶⁰ For background on the history of money changers and the banking sector in Palestine, see Bruynse & Grossman, [Mobile Money Study in the West Bank & Gaza](#), p12 & Box 1, FIELD Report No. 6 (2008).

⁶¹ See <http://www.wirelessintelligence.com/mobile-money/>.

⁶² See Davidson, Neil, [ng and Effectively Structuring Operator-Bank Relationships to Offer Mobile Money for the Unbanked](#), Mobile Money for the Unbanked Program (2011).

5.3 Creating a National Switch/Interoperable ATM and PoS Network

A national switch would bring great benefits to Palestine. Linking banks, MFIs, utility companies, MNOs, and other financial sector actors is critical for realizing the potential benefits of electronic banking. A national switch would foster competition, improve transaction security, attract new customers, increase financial services revenue, and facilitate international transactions. By furthering the development of an efficient financial sector, this should also drive overall market growth. The switch could support a vast array of financial services, including the following:

- Traditional card payment transactions (ATM withdrawals/deposits, purchase of goods & services at PoS).
- E-banking financial services at ATM or PoS (deposit, withdrawal, money transfer, airtime top-up, bill/loan payment).
- A connection to international payment systems such as VISA, MasterCard, and American Express (allowing banks connected to the switch to accept these cards).
- Mobile payment financial services (allowing users to transfer funds to customers on a different mobile network).
- G2P payments (salaries, pensions, social benefits, etc.)
- Internet banking and electronic commerce.

There is strong support for developing a national switch and for sharing infrastructure. The PMA, most banks, and other stakeholders recognize the need for a local, interoperable system to connect banks and electronic payment systems. Furthermore, most stakeholders agree that given the size of the Palestinian market, it would not be cost-effective for each bank to develop its own PoS and ATM infrastructure for electronic financial services. The idea of a Banking Services Company (BSC) that would allow banks to share infrastructure costs is supported by the PMA, the Association of Banks in Palestine, and many banks. The BSC would be funded by institutions using the switch, with each institution's contribution depending upon metrics such as the number of customers using the switch and the number of transactions per customer.

To determine the services that the BSC should provide, a full financial feasibility study is necessary. BSC models vary by country, depending upon the needs that they are designed to meet (see Annex 3 for a comparison of different services offered by BSCs in selected countries). Only by conducting a full feasibility study will the PMA and member banks be able to determine which services can be offered cost-effectively through a BSC in Palestine. Some of the issues that should be addressed by the feasibility study include the following:

- Ownership: How should ownership be structured to ensure that services will be sustainable and competitively priced?
- Governance: Issues related to governance, decision-making, and standard setting need to be addressed.

- Optimal architecture of the switch: Some criteria that should be considered include independence from existing private networks, interoperability, and ease of expansion to address future needs.
- Current and projected use: What are the current ATM, cash-in/cash-out, and PoS traffic at year zero, and what is expected over the next 5 years? How much of this traffic is domestic and how much is international?
- Hardware investment requirements: How much investment in hardware (servers, telecom lines, buildings) will be required to support the infrastructure? How will the investment costs be funded or shared between the banks and the PMA? Will PoS terminals and other hardware be owned or rented, and how shall they be maintained?
- Business model for BSC: What is the business model for the company operating the switch in terms of revenues (assessment fees per card, transaction fees, etc.) versus costs (salaries, telecom costs, etc.)? When is the break-even point likely to be reached, and how will the initial loss be funded or shared between the banks and the PMA?
- Business model for acquirers, issuers, and non-bank agents: Are the transaction fees paid by non-bank agents for PoS transactions high enough to encourage banks to issue cards, yet low enough to encourage non-bank agents to offer electronic services? Are commissions earned by non-bank agents sufficient to encourage them to offer additional banking services, such as cash-in and cash-out (if permitted)?
- Clearing and Settlement: Should clearing and settlement be supported by the BSC or by another institution?
- Appropriate Technology: What technologies are required to conduct secure transactions using ATMs, PoS devices, and/or mobile channels?

5.4 Addressing Information Asymmetries that Limit Access to Credit

While the nascent credit registry will expand access to finance, many potential customers still lack credit histories. The microfinance market is meeting only a fraction of potential demand, while many small enterprises fall into the “missing middle” – they are too big for microfinance, but they lack the collateral required by banks. The current system of reporting does not capture information about those who have not borrowed from banks or MFIs. This creates a “Catch-22”⁶³ – potential borrowers cannot borrow without having a history of borrowing to prove that they are reliable credit risks.

Including data on payment of other obligations would help lenders to assess creditworthiness of potential clients with little or no credit history. Evidence from the United States demonstrates that including information on payment of utility and telecommunications bills allows more customers to receive credit scores and access credit. Furthermore, such data improve the credit scoring system’s ability to predict whether a particular client would be a good credit risk, particularly for clients whose credit files previously lacked

⁶³ A “Catch-22” is a colloquial expression referring to a situation in which a person requires something that is only available to people who are not in that person’s situation. See generally http://en.wikipedia.org/wiki/Catch-22_%28logic%29.

sufficient information to develop a reliable credit score.⁶⁴ The PMA has indicated that it is working with utility and telecommunications providers to enable them to submit data to the registry, which they hope will begin in 2011. This would be particularly useful for utility company data, as most Palestinians have postpaid utility bills, but most telecommunications accounts are prepaid and therefore could not be reported to a credit bureau.

In addition, new psychometric⁶⁵ techniques are being developed that might offer potential for more effectively evaluating creditworthiness of potential clients. For example, Harvard University's *Entrepreneurial Finance Lab* has developed an automated test that lenders can use to measure an entrepreneur's psychological profile, business skills, intelligence, and ethics. Preliminary results from pilot studies indicate that lenders are able to use such a test to predict creditworthiness at least as well as they can using traditional methods (such as credit scoring and analysis of financial statements). Furthermore, this test can be used with clients who lack credit scores or professional financial statements, thereby reducing the information asymmetries that lead banks to limit lending to micro, small, and medium enterprises.⁶⁶

6. REGULATORY ISSUES

6.1 Develop the Legal Framework for Electronic Financial Transactions

The lack of a well-developed legal framework for electronic transactions is a barrier to the expansion of electronic banking. Currently, commercial disputes regarding electronic payments and other banking transactions are governed by the Law of Commerce.⁶⁷ The law instructs judges to apply the following considerations when settling such disputes:⁶⁸ (i) legal rules; (ii) business custom in the industry in question; (iii) legal precedent; and (iv) principles of justice and equity. In the absence of clear legal rules for electronic commerce, financial sector actors interested in offering electronic services are forced to rely upon business custom and principles of justice and equity in the event of a legal dispute. This creates uncertainty, which increases risk.

The new Banking Law attempts to partially address this legal issue by defining e-banking transactions. The law defines "*electronic banking transactions*" as the use of electronic means to perform banking transactions. Such transactions are deemed to be legal, and acts resulting from such transactions are deemed to be binding upon the participants.⁶⁹ While the legal import of this definition has not yet been tested, this language clearly attempts to establish the legality and non-repudiability of such transactions. However, it remains to be seen whether this

⁶⁴ See The Brookings Institution, [Giving Credit Where Credit is Due: Increasing Access to Affordable Mainstream Credit using Alternative Data](#), pp24-27.

⁶⁵ "*Psychometrics*" refers to the use of quantitative tests to assess psychological variables such as aptitude, intelligence, and personality. See <http://www.thefreedictionary.com/psychometric>.

⁶⁶ See http://www.efinlab.com/index.php?option=com_content&view=article&id=8.

⁶⁷ *Law of Commerce*, Art. 6 (per conversation with Muhanad Assar & Ibrahim Al-Faris, Ittqan Consulting).

⁶⁸ *Law of Commerce*, Art. 4 (per conversation with Muhanad Assar & Ibrahim Al-Faris, Ittqan Consulting).

⁶⁹ [Banking Law 2010](#) (per conversation with Muhanad Assar & Ibrahim Al-Faris, Ittqan Consulting).

definition alone will offer financial institutions enough comfort to proceed with ambitious e-banking initiatives.

6.2 Agent Banking

The PMA has developed clear guidelines for outsourcing by banks. A 2009 Instruction defines outsourcing and lists requirements for outsourcing, including prior PMA approval, a feasibility study, a Board-approved internal policy on outsourcing, contingency plans, contractual requirements, and other measures to mitigate outsourcing risk.⁷⁰ These measures closely follow the Bank for International Settlements' (BIS) recommendations regarding financial services outsourcing.⁷¹

In addition, the Anti-Money Laundering Law addresses key agent banking AML concerns. Money changers are required to abide by the provisions of the AML Law.⁷² In addition, the law applies to “*financial institutions*”, which the Law defines broadly to encompass any entity engaged in a wide variety of financial activities, including accepting deposits and transferring funds. It therefore appears from the text of the law that it would apply directly even to institutions acting on behalf of other financial institutions (such as agents acting on behalf of banks).⁷³

However, other aspects of an enabling regulatory framework for agent banking are not yet in place. As discussed above, there are no regulations governing electronic payments or electronic banking. In addition, regulations addressing risks specific to using retail agents to facilitate electronic financial transactions have not been developed. Based upon international experience, the use of retail agents poses a number of risks, including credit, legal, liquidity, operational, and reputation risk.

Prior to authorizing agent banking, the PMA should develop an Instruction on Electronic Banking and an Instruction on Agent Banking. With respect to e-banking, the BIS has developed a set of risk management principles that can be used as a guide, much like the BIS outsourcing principles that form the basis for the PMA's *Instruction on Outsourcing*.⁷⁴ With respect to agent banking, the Instruction should include most or all of the following recommended risk-mitigating measures:⁷⁵

1. Banks held responsible for actions of agents on their behalf
2. Customer has right of recourse directly to bank
3. Central Bank has right to review agent records
4. Agents prohibited from offering services on their own behalf

⁷⁰ *Instruction 2009/8* (per conversation with Muhanad Assar & Ibrahim Al-Faris, Ittqan Consulting).

⁷¹ See Bank for International Settlements, [Outsourcing in Financial Services](#) (2005).

⁷² See <http://www.pma.ps/index.php?lang=en&page=1247572503202>.

⁷³ See [Anti-Money Laundering Decree Law of 2007](#), p2 (definition of “financial institution”) and Annex 1.

⁷⁴ See Bank for International Settlements, [Risk Management Principles for Electronic Banking](#) (2003).

⁷⁵ See Grossman, Jeremiah, [My Agent, My Bank](#) (forthcoming).

5. Clear customer disclosure requirements
6. Limitations on size of transactions and balances held
7. Agent banking subject to money laundering/terrorist financing laws
8. Stricter due diligence for agents that engage in core banking activities
9. Transactions conducted in real time
10. Agents required to maintain float at bank
11. Contractual agreements clarify agents' and banks' rights and responsibilities
12. Electronic audit trails to minimize fraud risk
13. Proper agent due diligence, training, and oversight
14. Service agreements provide benchmarks and include business continuity provisions
15. Multi-factor authentication (and training customers on PIN protection)

Further detail regarding these regulatory measures is included in Annex 2. In addition, the PMA can learn from countries such as Pakistan and Kenya that have already developed detailed guidelines for mitigating agent banking risk.⁷⁶

6.3 Mobile Financial Services

Mobile network operators (MNOs) should be allowed to play a role in fostering financial inclusion. The near-ubiquity of mobile phones in Palestine presents an enormous opportunity to harness this infrastructure to expand access to finance quickly and inexpensively. Completely excluding MNOs from participation in e-banking would be neither advisable nor necessary from a risk management perspective. Both banks and MNOs have comparative advantages that they can bring to schemes aimed at expanding access to finance. Banks' strengths typically lie in risk mitigation, regulatory compliance, fraud deterrence, liquidity management, and financial product development. MNOs complement these through strengths of their own, including building and managing third-party distribution networks, branding and advertising products to the mass market, and quickly developing value-added services.⁷⁷

MNOs' participation in providing electronic financial services should proceed in phases. Initially, MNOs should provide services only to banks and customers who already have bank accounts. MNOs could either enter into joint-venture agreements with banks (as described in the previous paragraph) or merely agree to act as an electronic delivery channel for e-banking services. In either case, the bank would be held entirely responsible to the customer (and to the PMA) for the services in question.

In the future, MNOs' role could be expanded. Depending upon the success of the models described above, the PMA could consider whether to permit MNOs to operate more independent schemes, such as electronic wallets in which banks are only used as a safe place to store customer funds. Pakistan has adopted such an approach, initially approving only "bank-led"

⁷⁶ See State Bank of Pakistan, [Branchless Banking Regulations](#) (2008); Central Bank of Kenya, [Guideline on Agent Banking](#) (2010).

⁷⁷ See Davidson, Neil, [Mapping and Effectively Structuring Bank-Operator Relationships to Offer Mobile Money to the Unbanked](#), p7 (2011).

schemes and indicating that “nonbank-led” schemes possibly could be introduced in the future once e-banking schemes are better-developed.⁷⁸

6.4 Establishing a Banking Services Company

The recommended legal form for the Banking Services Company (BSC) will depend upon the findings of the feasibility study. Different countries use different legal entities, ranging from a limited liability company jointly owned by 10 banks and VISA International in Jordan⁷⁹ to a cooperative jointly owned by over 25,000 banks and merchants in Finland.⁸⁰ The feasibility study should include an assessment of the different possible legal entities and offer recommendations.

A variety of legal forms are available for consideration. Traditional legal entities include Ordinary Companies (2-20 members), Public Shareholding Companies (minimum of 7 shareholders), and Private Shareholding Companies (2-50 shareholders).⁸¹ In addition, a new Cooperative Law was enacted in June 2010,⁸² so cooperative entities could be explored as well.

6.5 Information on Creditworthiness

Currently, the credit registry cannot obtain information from private-sector entities such as utilities and telecommunications companies. Under the current instructions, only banks and specialized lending institutions are to provide data to the registry.⁸³ These instructions would have to be amended to address the sharing of information between the credit registry and the private sector.

In addition, utility and telecommunications regulations may need to explicitly permit sharing of customer data. The PMA will have to coordinate with regulators in the utilities and telecommunications sectors to avoid potential conflicts. In the United States, regulatory uncertainty with respect to utility companies’ rights and responsibilities has led some providers to decline to submit customer data to the credit bureaus.⁸⁴ However, the PMA is aware of these concerns and the need to address them.

7. CONCLUSION & RECOMMENDATIONS

Palestine has the potential to become a regional leader in electronic banking, thus expanding financial inclusion as a driver for economic growth and poverty alleviation. The banking system is sound and well-established, though it still relies heavily on the traditional infrastructure of

⁷⁸ State Bank of Pakistan, *Branchless Banking Regulations*, Section 3 (2008).

⁷⁹ See <http://www.visajordan.com/About.html>.

⁸⁰ See <http://www.luottokunta.fi/en/luottokunta/organisation>.

⁸¹ See <http://www.pipa.gov.ps/structurs.asp>.

⁸² See http://www.ilo.org/public/english/region/arpro/beirut/downloads/events/coop2010/exec_sum_en.pdf.

⁸³ *Instruction 2007/160*, p5.

⁸⁴ Burr & Carlson, *Utility Payments as Alternative Credit Data: A Reality Check*, p7, 14 (2007).

branch networks. Several factors would favor the introduction of new technologies in banking in this context, including: the large unsatisfied demand for financial services; the demographics of Palestine, where the population is young, literate, well-educated, and relatively tech-savvy; and the widespread use of mobile phones.

The challenges to the realization of this vision of Palestine with a strong, inclusive financial sector are described in Section 4. A number of measures needed to tackle these challenges are proposed in Sections 5 and 6. To realize the vision for Palestine 2020, the following actions are recommended – they are presented as a Gantt Chart in Annex 4:

Short-Term Recommendations

- 1. Support enactment of payment system and electronic commerce legislation:** The lack of an enabling legal framework for electronic transactions increases uncertainty and discourages stakeholders from expanding e-banking services.
- 2. Develop and issue E-Banking and Agent Banking Instructions:** In the short term, the Agent Banking instruction should permit banks to engage money changers to offer a variety of banking services, including real-time deposits and withdrawals, domestic and international money transfers, and bill payments. The instruction should also allow banks to develop pilot projects with other merchants to offer a more limited number of banking services, including acceptance of deposits but not including money transfer services. In addition, MNOs should be permitted to play a role in agent banking, either as a delivery channel or through a joint venture with a bank.
- 3. Conduct feasibility study of Banking Service Company:** There is broad consensus that some form of BSC would benefit the banking sector by connecting banks' infrastructure and facilitating cost-sharing. However, the details of how such a scheme would be structured to ensure sustainability and competitiveness have not been elucidated. A detailed feasibility study would address these issues and provide guidance for moving forward.
- 4. Begin to implement national switch:** While full development of a national switch will take time, traditional card payment transactions such as ATM withdrawals and purchase of goods and services at the PoS should be facilitated early on. This will provide revenue to ensure the viability of the payment switch.
- 5. Address limitations to information on creditworthiness:** While the establishment of a credit bureau is already beginning to reap dividends, many individuals and organizations – particularly MSEs – have little or no credit history. Including data on payment of other obligations such as utility and telecommunications bills would help to include many of these currently-excluded parties. In addition, the PMA and financial institutions could explore alternative methods for assessing creditworthiness of micro, small, and medium enterprises, such as psychometric analysis.

Medium-Term Recommendations

- 1. Expand agent banking at merchants:** Assuming that pilot projects with merchants are successful, the PMA may wish to revise the Instructions on Agent Banking to allow banks to contract merchants to provide a wide variety of banking services on their behalf.
- 2. Expand MNOs' role in e-payment services:** Assuming that initial collaborations between MNOs and banks are successful, the PMA may wish to consider revising the Instructions on Agent Banking to permit MNOs to develop more independent e-payment schemes.
- 3. Continue to develop the national switch:** Other services can be added to the national switch in the medium term, such as interoperable Internet banking and mobile payments.
- 4. Support efforts to improve the overall business environment:** Business environment issues indirectly – but often significantly – affect access to finance. The PMA and the financial sector can play a role in advocating for key business environment improvements, such as collateral law and business registration reform. In addition, the PMA can work with financial institutions to develop leasing in Palestine.

ANNEX 1: LIST OF PEOPLE INTERVIEWED

NAME	ORGANIZATION
Abu Diab, Nabil	Association of Banks in Palestine
Al-Faris, Ibrahim	Ittqan Consulting
Assaf, Muhanad	Ittqan Consulting
Atari, Hamdi	Cairo Amman Bank
Awwad, Riyadh	PMA Payment System Department
Bleidi, Assaf	Al-Rafah Microfinance Bank
Bruynse, Dirk	MTN
Eid, Ahmad	Wataniya
Faroun, Ali	PMA Supervision & Inspection Department
Hoffmann, Jenny	Riskfrontier Consultants, Ltd.
Horani, Jamal	Arab Bank
Hubbab, Hussein	Al-Quds Bank
Ilsley, Robert	Riskfrontier Consultants, Ltd.
Isawi, Asem	Wataniya
Izz, Ruba	Jawwal
Kamal, Amer	Wataniya
Katbeh-Touqan, Lubnah	PMA Legal Department
Muzher, Marwan	Al-Rafah Microfinance Bank
Qumsieh, Iyad	PCNC
Sesalem, Ashraf	Bank of Palestine
Shabaneh, Mohamed	Wataniya
Titik, Alaa	Al-Quds Bank

ANNEX 2: RISK MANAGEMENT PRINCIPLES FOR THE USE OF RETAIL AGENTS⁸⁵

While agent banking offers great potential for fostering financial inclusion, it also presents certain risks. These risks must be effectively mitigated prior to approving agent banking schemes.

Banks are already familiar with most risks inherent in agent banking. For example, the use of electronic delivery channels creates e-banking risks, while the use of third parties creates outsourcing risks. Banks have used electronic channels and have outsourced services for many years, and internationally accepted guidelines on mitigating e-banking and outsourcing risks have been developed.⁸⁶

However, agent banking also presents banks with less-familiar risks. The use of retail agents – particularly non-money changer agents that are not already regulated as financial institutions – raises new issues with which banks may be less familiar. These risks may include credit, operational, legal (compliance), liquidity, reputation, consumer protection, and AML/CFT risks, all of which must be effectively mitigated. Specific risks may include some or all of the following:

Credit Risk

- *Risk that customer's funds do not reach bank account or intended recipient.*
- *Risk that agent is not reimbursed by bank.*
- *Risk that bank is not reimbursed by agent for deposits or payments credited to customer's account.*

Operational Risk

- *Fraud committed by customer.*
- *Fraud committed by agent.*
- *Fraud committed by outside party.*
- *Theft of bank's equipment from agent's premises.*
- *Theft of customer deposits or payments from agent's premises.*

Legal (Compliance) Risk

⁸⁵ Adapted from Grossman, Jeremiah, *My Agent, My Bank* (forthcoming).

⁸⁶ See Bank for International Settlements, [Risk Management Principles for Electronic Banking](#) (2003); Bank for International Settlements, [Outsourcing in Financial Services](#) (2005).

- *Bank held liable for agent's failure to comply with legal mandates (such as disclosure requirements, customer identification requirements, guidelines regarding storage of records and protection of customer data, etc.).*
- *Bank unable to comply with reporting requirements due to inability to access information held by agent (on servers, in shops, etc.).*
- *Regulator unable to review data or records held at agent.*

Liquidity Risk

- *Agent unable to meet customer requests for withdrawals due to insufficient cash on hand.*
- *Agent unable to process deposits or payments due to insufficient funds in bank account/float.*

Reputational Risk

- *Poor performance by agent leads to negative opinion of bank.*
- *Poor performance of electronic channel leads to negative opinion of bank.*
- *Violation of customer data privacy or confidentiality leads to negative opinion of bank.*
- *Inability of agent to meet withdrawal requests causes customers to believe that bank lacks funds, leading to possible loss of confidence and "run" on deposits.*

Consumer Protection Risk

- *Customer defrauded by agent (funds do not reach customer's bank account or intended payee, customer overcharged, etc.).*
- *Customer not satisfied by agent's or bank's resolution of issue.*
- *Fraudster impersonating agent defrauds customer (accepts deposits or payments despite lack of relationship with bank).*

Anti-Money Laundering & Combating the Financing of Terrorism (AML/CFT) Risk

- *Customers not properly identified at agent.*
- *Misuse of electronic channels for money laundering or terrorist financing.*

Since agent banking is a relatively new development, the Basel Committee on Banking Supervision has yet to develop a guidance document for addressing these risks. However, national regulators and international stakeholders such as CGAP and the Gates Foundation have

produced documents aimed at helping regulators to consider how best to address these risks.⁸⁷ In addition, every country that permits agent banking has put in place certain requirements to mitigate the inherent risks in outsourcing banking transactions to retail agents. Certain measures have been adopted by most countries that allow agent banking, including the following:

1. **Banks held responsible for actions of agents on their behalf:** By holding banks completely responsible – both to customers and to the central bank – for actions taken by their agents when working on their behalf, central banks can ensure that banks have strong incentives both to engage in careful due diligence prior to selecting an agent and to monitor their agents’ activities.
2. **Customer has right of recourse directly to bank:** Allowing a customer to bring complaints directly to the bank reinforces the bank’s responsibility to the customer and ensures that the customer will be able to address any problems with the agent banking experience.
3. **Central Bank has right to review agent records:** Allowing the Central Bank to directly inspect all agent banking-related records, data, or other relevant information in an agent’s possession provides the regulator with a secondary means of supervising agent banking business, particularly if the regulator might otherwise be unable to properly supervise the regulated institution.
4. **Agent prohibited from offering services on its own behalf:** In order to clarify that only banks are permitted to engage in deposit-taking and other banking business, many countries specifically prohibit agents from providing such services on their own behalf. Some countries require agents to have signs specifying that they are providing these services on behalf of a licensed financial institution.
5. **Clear customer disclosure requirements:** To reduce the risk of fraud or other forms of customer abuse, many regulators provide detailed customer disclosure requirements, which may include some or all of the following: clarification of roles and responsibilities of bank and agent; clear description of costs of services; and information on how to resolve problems and file complaints.
6. **Limitations on size of transactions and balances held:** Some countries limit the size and frequency of transactions by an individual customer or at a particular agent (on a daily, monthly, and/or annual basis). Such measures may help to mitigate fraud risk, money laundering risk, and the risk of insufficient agent liquidity to meet customer demand.
7. **Agent banking subject to AML/CFT laws:** In order to ensure that agents are not misused to circumvent AML/CFT laws, some country regulations specify that agents are subject to

⁸⁷ See, e.g., Lyman et al., [Regulating Transformational Branchless Banking: Mobile Phones and Other Technology to Increase Access to Finance](#), CGAP Focus Note 43 (January 2008); Alexandre et al., [Regulating New Banking Models that can Bring Financial Services to All](#), Gates Foundation (August 2010).

these laws, either directly (as providers of financial services) or indirectly (as agents of banks that are directly subject to the laws).

8. **Stricter due diligence for agents that engage in core banking activities:** Some countries require central bank approval or more detailed agent due diligence (both initial and ongoing) for agents that will be engaged in activities that are perceived as riskier, such as conducting KYC, opening accounts on behalf of the bank, or taking deposits.
9. **Requirement for real-time transactions:** In order to limit the risk of fraud or error, most countries require that all transactions be conducted in real time.
10. **Stipulation of required provisions in contracts and service agreements:** Regulators may require that agent banking contracts and service agreements contain provisions addressing the rights and responsibilities of the parties, performance benchmarks, termination and business continuity clauses, and other provisions aimed at mitigating risks.
11. **Proper agent due diligence, training, and oversight:** Banks are generally required to carefully screen, train, and monitor their agents. Some regulators have prescribed specific measures that must be taken by banks when conducting agent due diligence.
12. **Minimizing electronic fraud risk:** Regulators may prescribe measures to reduce the risk of fraud, such as multifactor authentication, customer education on protection of PINs and passwords, and electronic audit trails.

ANNEX 3. BANKING SERVICE COMPANIES IN SELECTED COUNTRIES⁸⁸

SERVICES	Jordan (Visa Jordan Card Services)	France (Cartes Bancaires)	UK (Link)
Ownership structure	LLC owned by 10 banks & Visa Intl.	“Economic Interest Group” (a legal entity formed to support the primary activities of its members) with 133 member banks and other financial institutions.	LINK is an unincorporated association. All UK banks with ATMs are members.
Connect ATMs to switch?	YES	YES	YES
Support cash withdrawal and balance inquiry?	YES	YES	YES
Support PoS transactions?	YES	YES	NO
Clearing & settlement between member banks?	YES	YES	YES
Operating regulations?	YES	YES	YES
Log switched transactions?	YES	YES	YES
Calculate fees?	YES	YES	YES
Unified standard of interfacing?	YES	YES	YES
Recruiting, approving and/or training merchants for accepting cards?	YES	NO	NO
Purchase and deployment of PoS terminals?	YES	NO	NO
Certification of terminals?	YES	YES	YES (for ATMs)
PoS customer service?	YES	NO	NO
Mobile phone payments?	YES	NO	NO

⁸⁸ See <http://www.visajordan.com/>; <http://www.cartes-bancaires.com/>; <http://www.link.co.uk/Pages/Home.aspx>.

ANNEX 4. PROVISIONAL TIMETABLE FOR PALESTINE FINANCIAL SECTOR VISION 2020

Issues & Proposed Actions	Short Term (approx. 2011- 2012)	Medium Term (approx. 2013- 2015)	Long Term (approx. 2016-2020)
Electronic Banking – Regulation			
<i>Enact payment system/e-commerce legislation</i>			
<i>Develop and issue Instructions on E-Banking & Agent Banking</i>			
<i>Revise Instructions to allow MNOs to lead e-payment schemes</i>			
Agent Banking – Money Changers			
<i>Allow banks to engage money changers to offer a wide variety of banking services.</i>			
Agent Banking – Merchants			
<i>Allow banks to engage merchants to offer limited banking services (not including money transfer) through pilot projects.</i>			
<i>Allow banks to engage merchants to offer a wide variety of banking services.</i>			
Agent Banking – MNOs			
<i>Allow banks to engage MNOs in joint ventures or as delivery channels for e-banking services.</i>			
<i>Allow MNOs to lead e-payment schemes</i>			
National Switch			
<i>Conduct feasibility study of Banking Service Company</i>			
<i>Establish Banking Service Company and implement national switch</i>			
Information on Creditworthiness			
<i>Amend Credit Bureau Instructions to allow PMA to collect data from utility and telecommunications companies.</i>			

Issues & Proposed Actions	Short Term (approx. 2011-2012)	Medium Term (approx. 2013-2015)	Long Term (approx. 2016-2020)
<i>Liaise with utility/telecommunications regulators to ensure permissibility of submitting customer data to credit bureau.</i>			
<i>Explore alternative methods for assessing creditworthiness of MSEs with limited credit histories.</i>			
Business Environment			
<i>Support the development of the leasing industry.</i>			
<i>Support efforts to amend collateral law.</i>			
<i>Support efforts to streamline business registration process.</i>			