Study on Know-Your-Customer Requirements for Digital Financial Services in Uganda

by Jeremiah Grossman

A healthy ecosystem for digital financial services (DFS) depends on the ability of its users to be fully registered and compliant with the know-your-customer (KYC) requirements in the market. It especially applies to a maturing DFS ecosystem wherein uptake is expected to increase from a wide variety of end-users and use cases, such as payment acquisition by small traders, merchants and schools as well as bulk disbursement to, for example, refugees.

The knowledge and conduciveness of the KYC requirements for the various stakeholders is therefore important for adoption and scale-up of DFS.

Discussions with diverse DFS stakeholders in Uganda revealed the following:

A need for more clarity around the KYC regime for the various DFS stakeholders (consumers, agents, small traders and merchants, non-corporate entities such as schools, etc.)	Discrepancies in interpretation of requirements in the KYC regime	Challenges around registration and onboarding of, for example, merchants and refugees due to strict KYC requirements and onboarding processes

To address these needs, discrepancies and challenges, United Nations Capital Development Fund (UNCDF) completed the following analyses:

An exhaustive analysis of the requirements and associated processes (either driven by regulatory authorities or by other stakeholders, such as mobile network operators and banks) for the various players in the DFS ecosystem	An assessment of the current and potential impact of these requirements as well as the interpretation and implementation thereof on the growth potential of the DFS market, particularly on the potential financial exclusion of certain end-users (people living in rural areas, traders and merchants, non-nationals, refugees, etc.)	An assessment of practices in other DFS markets that are similar to Uganda that can provide insights as to how to address the challenges and opportunities surrounding the KYC regime in order to further increase DFS uptake in Uganda

This research was in line with the goal of UNCDF to help build an inclusive DFS sector in Uganda, ensuring that a wide range of DFS are provided responsibly, at reasonable cost, by sustainable institutions in a well-regulated environment.

Existing know-your-customer regulatory framework

A number of laws and regulations address KYC requirements for opening and operating DFS accounts. They include the Financial Institutions Act, 2004 (FI Act, 2004), the *Financial Institutions (Anti-Money Laundering) Regulations, 2010* (FI (AML) Regulations, 2010), the *Mobile Money Guidelines, 2013* (MM Guidelines, 2013), the *Anti-Money Laundering Act, 2013* (AML Act, 2013), the *Anti-Money Laundering Regulations, 2015* (AML Regulations, 2015), the *Registration of Persons Act, 2015* (ROPA, 2015) and the *Anti-Money Laundering (Amendment) Act, 2017* (AML (Amendment) Act, 2017). In addition, Financial Institutions (Agent Banking) Regulations are expected to be finalized and issued in the near future.

In most cases, there is no conflict or inconsistency among the different laws, regulations and guidelines governing KYC in Uganda. One area where inconsistent requirements may exist is between the FI (AML) Regulations, 2010 (which were developed by the Bank of Uganda under the FI Act, 2004 and apply only to licensed financial institutions) and the *AML Regulations, 2015* (which were developed by the Ministry of Finance, Planning and Economic Development under the AML Act, 2013 and apply to a broad set of accountable persons). The Bank of Uganda has confirmed that, in the event of inconsistency between these two regulations, financial service providers should follow the *AML Regulations, 2015*.

Specific know-your-customer onboarding requirements for different individuals and entities

Detailed KYC onboarding requirements were examined for the following:

- Individual bank accounts
- Individual mobile money accounts (for citizens, refugees and other legal residents, and non-resident foreign nationals)
- Banking agents and mobile money agents (for individuals and legal entities)
- Mobile money merchants (for individuals with an informal or semi-formal business and legal entities with a formal business)
- Other entities such as schools, churches, mosques and non-profits

Individual bank accounts

Among other requirements included in the *AML Regulations, 2015*, individuals must now produce a national ID card, alien/refugee ID card or passport to open a bank account. Banks should apply a risk-based approach to customer due diligence, including verification of identity and immigration status.

Individual mobile money accounts

Under the *MM Guidelines, 2013*, a mobile money account could be opened with a variety of documents, such as an identity card, passport, driver permit, voter card or local administration letter. Following the passage of ROPA, 2015 and the issuance of several directives in 2017 by the Uganda Communications Commission, however, a national ID number, national ID card, alien/refugee card or valid passport is now required to register a SIM card and open a mobile money account.

The *AML Regulations, 2015* would appear to apply to mobile money service providers, implying that all of the requirements for opening individual bank accounts should apply to opening individual mobile money accounts as well. However, it does not appear to have been put into practice.

Individual banking agents

Sole proprietorships would appear to be subject to the same KYC requirements described in the *AML Regulations, 2015* for individuals. Partnerships would have to provide additional information such as registration information and KYC information on each partner and any other controlling person.

In addition, specific agent due diligence requirements are included in the Financial Institutions (Agent Banking) Regulations. These provisions would require banks to confirm that the sole proprietor or partnership has a bank account, is registered and licensed, has a physical address with adequate and secure premises, and has been engaged in commercial activity for at least 12 months. Furthermore, banks would need to conduct a suitability assessment that considers factors such as credit history, criminal record, experience and reputation.

Legal entity banking agents

Legal entities seeking to serve as banking agents would appear to be subject to the KYC requirements described in the *AML Regulations, 2015* for 'local entities and other bodies.' Among other pieces of information, legal entities must provide proof of registration or incorporation, information on the natural persons managing, controlling or owning the entity, financial statements and a tax ID number. Incorporation documents should be verified with the Registrar of Companies, the location and contact details of the head office or other location should be physically verified, and information regarding directors, officers and others who are authorized to establish an agent banking relationship should be independently verified.

Legal entities would also be subject to the same agent due diligence requirements in the Financial Institutions (Agent Banking) Regulations as for individuals, which are described above.

Individual and legal entity mobile money agents

The *MM Guidelines, 2013* require that mobile money agents be registered businesses with a physical address and an account in a licensed financial institution. In addition, mobile money service providers are required to 'put in place an effective agent selection process and carry out due diligence on [their] agents'.

The *AML Regulations, 2015* would appear to apply to mobile money service providers, implying that all of the requirements for opening individual accounts should apply to opening individual mobile money agent accounts and all of the requirements for opening accounts as a legal entity should apply to opening legal entity mobile money agent accounts. In the absence of a stated requirement to comply with the *AML Regulations, 2015*, however, the application of these Regulations to mobile money agents remains unclear in practice.

Informal, semi-formal and formal mobile money merchants

The *MM Guidelines, 2013* are silent regarding KYC requirements for mobile money merchants; the Guidelines only address KYC requirements for agents and individual customers. The *AML Regulations, 2015* address individuals and legal entities, but they do not address individuals operating informal or semi-formal merchant businesses. Furthermore, it does not appear that the Regulations are currently being applied to individual mobile money customers and mobile money agents, so it is unclear whether the Bank of Uganda expects the Regulations to apply to formal mobile money merchants. In the absence of specific requirements in the Guidelines and certainty regarding application of the Regulations, there is a lack of clarity regarding appropriate KYC requirements for informal, semi-formal and formal mobile money merchants.

Schools, churches, mosques and other non-profit entities

The *MM Guidelines, 2013* are silent regarding KYC requirements for non-profit entities such as schools, churches, mosques and others that wish to accept mobile money payments; the Guidelines only address KYC requirements for agents and individual customers. The *AML Regulations, 2015* and the *FI (AML) Regulations, 2010* have clear KYC requirements that could apply, but it does not appear that the Regulations are being applied currently to individual mobile money customers and mobile money agents. In the absence of specific requirements in the Guidelines and certainty regarding application of the Regulations, there is a lack of clarity regarding appropriate KYC requirements for schools, churches, mosques and other non-profit entities that wish to accept mobile money payments.

How are financial service providers interpreting and implementing know-your-customer requirements?

Individual bank accounts

Currently, both the *FI (AML) Regulations, 2010* and the *AML Regulations, 2015* remain in force. While the Bank of Uganda has indicated that the *AML Regulations, 2015* should be followed in the event of inconsistency, the F*I (AML) Regulations, 2010* have not been repealed and have not been amended to match the 2015 regulations. As a result, some banks continue to follow the *FI (AML) Regulations, 2010* in practice, particularly with respect to identifying clients.

With respect to refugees, while laws and regulations do not explicitly address KYC requirements for them, the gap is not creating a barrier in practice. Banks and mobile money service providers have interpreted the *AML Regulations, 2015* and the *FI (AML) Regulations, 2010* to allow them to accept the refugee ID card as sufficient proof of identity.

Individual mobile money agents

In practice, most agents are unable to meet all of the requirements in the *MM Guidelines, 2013*. Most have neither a trading licence nor a bank account, some have a trading licence but no bank account, and only a small percentage of agents are fully registered businesses with a bank account and a physical address.

Informal and semi-formal mobile money merchants

Currently, mobile money merchant acquisition in Uganda is being driven by aggregators rather than mobile money service providers. In the absence of clear legal guidance, aggregators are adopting a tiered approach on an ad hoc basis. Typically, informal and semi-formal businesses can open a mobile money merchant account with an aggregator by providing a national ID. Some aggregators even accept other documents if the prospective merchant lacks a national ID, such as a local council letter.

Legal entity mobile money merchants

In practice, when mobile money service providers or aggregators onboard legal entities as merchants, they apply requirements that are similar to the requirements for 'local entities and other bodies' under the *AML Regulations, 2015*.

Schools, churches, mosques and non-profit entities

As noted earlier, there is no clear set of KYC requirements for schools, churches, mosques and other non-profit entities interested in accessing mobile money services, as these entities are not specifically addressed in the *MM Guidelines, 2013*. In practice, mobile money service providers take different approaches to KYC requirements for such entities, although all interviewed providers required copies of certain documents such as a certificate of registration, constitution (or equivalent) and identity documents of at least two directors or other executives.

How are know-your-customer requirements impacting adoption of digital financial services?

Challenges with customer identification

Historically, the lack of a universal identification system and an effective system for electronic verification of national ID numbers and cards has limited financial inclusion. Recently, however, access to the national ID card and refugee ID card has increased dramatically. As of April 2017, about 90 percent of the adult population had received a national ID number and had or should soon receive a national ID card, while as of 1 May 2017, 81 percent of refugees and asylum-seekers had been biometrically registered.[1]

In addition, the National Information Technology Authority is developing an electronic payments gateway to facilitate digital KYC, which will enable financial service providers to access identity information for KYC purposes. This system offers the potential to further foster financial inclusion by expanding access to information while lowering the cost of conducting customer due diligence.

Difficulty onboarding informal and semi-formal merchants and agents

While the *MM Guidelines, 2013* and the Financial Institutions (Agent Banking) Regulations require agents to be formal businesses, the vast majority of Ugandan businesses are informal and cannot meet the stated requirements. Given the predominance of informal businesses in the country, adherence to strict rules requiring agents and merchants to be registered and/or licensed would hamper DFS ecosystem development. On the positive side, the Bank of Uganda understands these challenges and is open to proposals for addressing them—such as the application of simplified due diligence to informal and semi-formal mobile money merchants—to the extent permitted by law.

Lack of risk-based know-your-customer approach

To date, banks, mobile money service providers and other financial service providers have faced challenges in developing a risk-based KYC approach due to the lack of data on national, sectoral, and customer- and product-specific money laundering and terrorist financing risks. For example, informal and semi-formal businesses seeking to serve as merchants cannot comply with all of the KYC requirements for legal entities, yet the risk presented by these businesses has not been adequately explored.

Uganda completed a national anti-money laundering and countering financing of terrorism (AML/CFT) risk assessment in April 2017 that has been approved by the Cabinet and is expected to be published in the near future. In the coming months, the Uganda Communications Commission and the Bank of Uganda are expected to coordinate sector-specific risk assessments on behalf of the mobile telecommunications sector and the banking sector, respectively. Providers of mobile money services (mobile money service providers and their partner banks) and agent banking services will then be able to develop risk-based AML/CFT approaches that are grounded in the results of the national and sector-specific assessments.

This research, commissioned by UNCDF MM4P was conducted by BFA

[1]Interview with Dr. Tumubweinee Twinemanzi, Director of Industry Affairs and Content, Uganda Communications Commission.

How can sector stakeholders address know-your-customer challenges to foster growth and uptake of digital financial services?

Sector stakeholders can address KYC challenges that are limiting DFS growth and uptake by taking the following steps:

1. Maximize the positive impact of efforts to improve identification of Ugandan citizens and refugees
2. Promote the development of a tiered regulatory framework for merchant and agent acquisition
3. Conduct sector-specific risk assessments to better understand DFS risks and enable development of proportionate AML/CFT approaches