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CASH INDUSTRY REGULATION IN INDIA

Óscar Esteban | Prosegur

Recent regulatory developments in India presents an invitation to overlook the framework in which the Cash Management Companies (CMCs) and industry operates at the present, and bring light and further clarification to this situation.

Despite controversy, it is commonly established that regulation is beneficial. It is even more important and required when dealing with services or products that have a social impact and can create a systemic problem to the economy of a country, such as cash management activities. Classic benefits of regulation comprise: the protection of consumers/customers' interests; standardization (allowing a predictive outcome of services or products); enhancing quality; leaving efficiency as the main differentiator and competitive variable amongst installed players; eliminating shortcuts and ambiguity; and, in the specific case of CMC activities, diminishing risk to acceptable levels, which in this industry means reducing monetary losses and losing fewer lives. However, as one of the



The regulation of the CMC industry in India is expected to improve consumer protection and the overall quality of the industry.

disadvantages, regulation implies compliance costs. Globally the CMC industry is regulated mostly by the Ministry of Home Affairs (MHA) and subsidiarily by central banks.

The CMC industry in India comprises nine formal players and around 50-100 informal/local companies. The overall market is estimated to be around EUR 350m, with those nine formal players representing around 90% of the whole market. 12,000 secured vehicles and around 60,000 staff are employed by the CMC industry transporting an estimated equivalent amount of EUR 5,600m every day.

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The CMC industry in India is young, and its lack of regulation gave rise to an unpredictable environment not unlike the Wild West of old.

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The CMC industry in India is a young one with outsourcing from banks happening as early as 1994. Since then, the industry has been mostly unregulated, with broad operational guidelines used per each individual agreement with the banks. This meant they were not necessarily uniform. In 2005 the Private Security Agencies Regulation Act (PSARA) was created by the Ministry of Home Affairs (MHA) to regulate the private security industry and improve the standards by issuing licenses to security companies. However, its application to the CMC industry has always been an unclear and controversial matter. Beyond that, it is clearly established by all interested parties, independently of their specific positioning towards PSARA, that it offers at best just a high-level prescription for the CMC industry, without covering its operational aspects or its nature.

The demonetisation episode in November 2016 and the subsequent countrywide cash crisis showed the vital role of cash for the Indian economy and citizenship. Because of that, the Reserve Bank of India (RBI) considered the need to regulate specifically the cash management activities of banks. Accordingly, on the 6th and 12th of April 2018, RBI

launched guidelines because of “the increasing reliance of the banks on outsourced service providers and their sub-contractors in cash management logistics”. They applied “certain minimum standards for the service provider / sub-contractors who are engaged by the banks for this purpose”. The resulting cash management guidelines have two main parts: eligibility criteria and operational measures regarding physical and security infrastructure. Banks were given 90 days (so till 7th July 2018) to implement the guidelines.

The guidelines establish two criteria for being a valid service provider of cash management activities to banks: 1) a minimum net worth value equivalent at all times to EUR 12.5m; and 2) a minimum own fleet of 300 secured vehicles.

Amongst the operational parameters for minimum standards, the following ones are key:



Vehicles will need to be manned by 5 crew members, including 2 gunmen.

1) Vehicles:

Vehicles should be light commercial vehicles, especially designed and adapted, having separate passenger and cash compartments, with 1 camera each, consisting of 5 crew members, with the following composition: 1 driver, 2 cash officers (custodians) and 2 gunmen. Each cash van should be

GPS enabled and monitored live with geo-fencing. Each cash van should have tubeless tires, wireless communication and hooters.

2) Operations:

All cash movements should be carried out during daylight. Operations to ATMs should be by cassette swap instead of the present top-up replenishment system. Banks have to implement this change gradually over the next three years which allows them to better bear the costs.



Recruitment and training will take on a greater importance with the introduction of the guidelines.

3) Staff:

Staff associated with cash handling should be adequately accredited, having completed minimum hours of classroom learning and training. Character and antecedent verification of all crew members associated with cash van movement should be done meticulously. Strict background checks of the employees should include police verification of at least the last two addresses; such verification should be updated periodically and shared on a common database at the industry level.

4) Premises:

Premises should be safe and secure and of adequate size for cash processing / handling and

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vaulting. The premises should be under electronic surveillance and monitoring round the clock. Technical specifications of vaults should not be inferior to the minimum standards for Currency Chests prescribed by the RBI. Vaults should be operated only in joint custody. All fire safety gadgets should be available and working in vaults, which should also be equipped with other standard security systems, live CCTV monitoring with recording for at least 90 days, emergency alarm, burglar alarm, hotline with the nearest police station, lighting power backup, and interlocking vault entry doors. Work area should be separate from the cash area. The premises should be under the security of armed guards whose number should have reference to the scale of operations specific to the location, but not less than five in any case.

One outstanding and interesting feature of these guidelines is the mandate given to the CMC industry to establish a Self-Regulatory Organisation (SRO) initially for staff training standards, accreditation and certification. The SRO under the name of Currency Cycle Association of India (CCA) was formally created the 17th September 2018. This step should give the CMC industry a formal, recognised and visible role within the cash management activities in India. Besides the competences named above, established initially by the guidelines themselves, CCA will have as the main responsibility the vigilance on compliance and reporting to RBI, and in the long run an advisory role for further standards evolution and development.

Since its inception in 2012 and giving the absence of standards for the cash management activities, Cash Logistics Association of India (CLA) has been working on elaborating standards and presenting and defending those to every

stakeholder, amongst them MHA. Finally, on the 8th of August 2018, MHA announced in the Gazette of India a set of model rules for transportation of valuables, very similar to those previously elaborated by CLA. The model rules by MHA are mostly identical to the RBI guidelines described above, but more technical and detailed, establishing obligations to CMCs, not to banks. MHA stipulates these model rules would be applicable after 180 days from their publication, so by the 7th of February 2019.

The model rules by MHA do not incorporate any requirement for industry access apart from the PSARA licensing obligation to CMCs if they have gunmen on staff. Specifically, the most remarkable differences and additional requirements when compared to the RBI guidelines are:

- Establish a maximum amount of cash which can be transported in a special designated and fabricated secured vehicle (EUR 625k equivalent), and the maximum amount of cash that can be transported without using a special designated and fabricated secured vehicle (13,000 EUR equivalent);
- Establish a clear timing limitation for cash operations, ranging from 4 pm till 9 pm, depending on the sort of location (from left wing extremism, so the riskiest areas, to urban areas);
- Establish the maximum allowed age for a vehicle transporting cash: 7 years;
- Incorporate the need of 2 additional cameras per vehicle, one in the front and another in the rear, with at least 5 days recording.
- Detail the contents of the training program for staff engaged in cash transportation activities; and
- Oblige ATMs to be equipped with One Time Combination (OTC) locks, to be serviced.

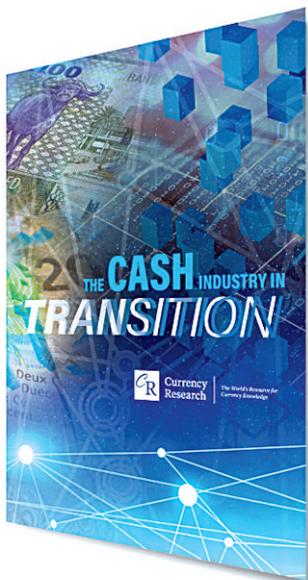
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The timing of cash operations has to be limited due to the threat of emerging left wing extremism - a feature of India's geopolitical landscape.

“
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 PRACTICES.**
 ”



The Cash Industry in Translation - a report by Currency Research

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The CMC industry in India is living in a historical moment of change; a required change to be able to catch up the backlog with this industry's mature markets, advanced economies and worldwide best practices. This evolution comes by decisively moving from a scenario of lack of regulation, where multiple operational approaches were in place compromising the service quality and risk, to a foreseeable reality of higher

levels of professionalism and recognition. The CMC industry was initially aware of that reality, having effectively pushed along the last 7 years for regulation, and having contributed along with other factors to make RBI and MHA conscious of that as well, which has crystallised on their regulation as the catalyzer for a new era. Now it is the time for the CMC industry to be at the higher level and demonstrates its capability to abide by these regulations and models.

THE CASH INDUSTRY IN TRANSITION - EXECUTIVE SUMMARY

Currency Research

While the cash industry takes some refuge in the growth of cash usage from 2008 to 2018, it is increasingly apparent that the past is not a predictor of the cash industry's future. From the unique perspective of Currency Research (CR), the only global communications, consulting, and conferencing business operating in both cash and payments, this report examines the impact of external and internal forces on the companies and government departments involved with the cash cycle as a whole.

The report concludes that cash will experience a decline globally – this will be faster than the cash industry and cash departments predict, but slower than those in the payments industry anticipate. Despite this, central banks must work to preserve cash as a societal good for a small percentage of the citizens and as a contingency in cases of natural disaster or crisis.

Historically there were three barriers to a totally cashless society: technological, financial, and political. As this report points out, the first two barriers have

been mostly overcome or are very close to resolution. It is therefore the third, political, barrier that will increasingly come to the forefront.

By comparing cash and payments to the horse and automobile marketplace of the early 1920s, CR makes the argument that the next decade, 2019 to 2029, will be one of dramatic worldwide change, much as 1919 to 1929 was to the horse and auto industries. We then outline the internal factors influencing this change, such as more durable and secure banknotes, more efficient sorting solutions, and regulations that affect cash circulation. External factors driving change within the cash industry include the socialisation of payments, contactless payments, smartphones and e-wallets, and billions of dollars in investments for new digital payments initiatives.

We then examine disruption psychology and the history of previous disruptors to draw conclusions about where the cash industry may be headed. In a previously released report, 2014's

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The Case for Cash Part 1: Myths Dispelled, we concluded with the following observation on the fate of cash:

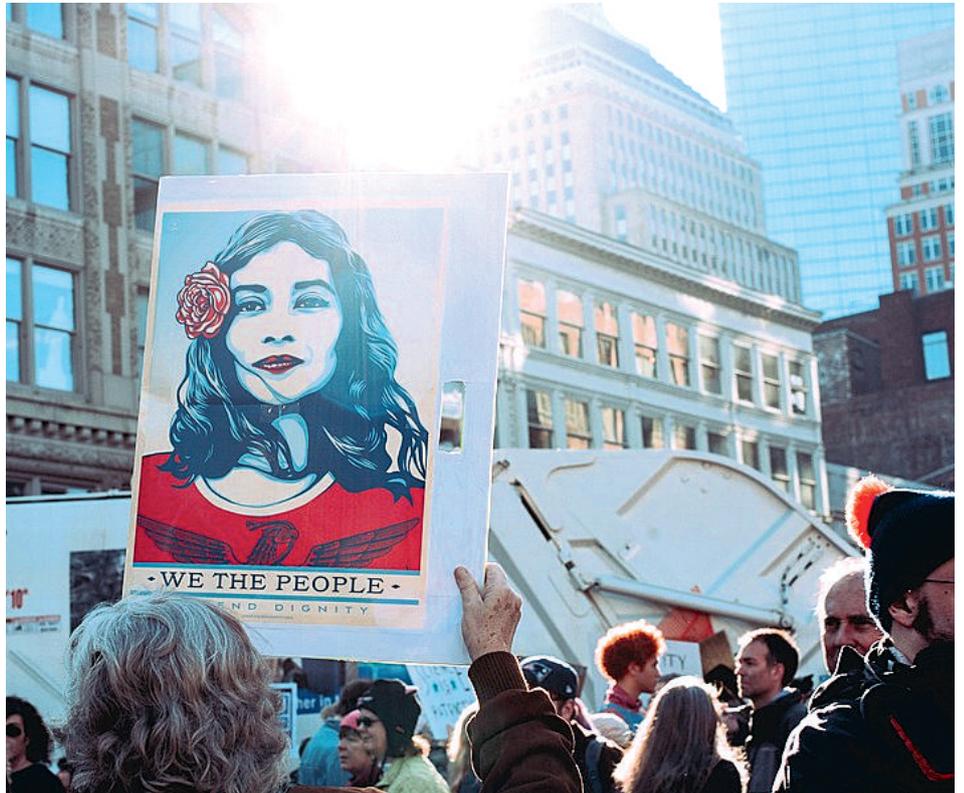
At a recent seminar on alternative methods of payment, almost every new payment scheme was compared to cash. It seems that whenever a new payment method is introduced, people continue to recognize that if of necessity must be “as good as cash.”

“I have developed a new payment system, it is:

- As easy to use as,
 - As flexible as,
 - As secure as,
 - As confidential as,
 - As fast as,
 - As universally accepted as,
 - As reliable as,
 - As high tech as,
 - As unquestionable as,
 - As identifiable as,
 - As reconcilable as,
 - As immediate as,
 - As irreversible as,
 - And probably most importantly,
 - As trusted as cash.
- It will have billions of users instantly and it will revolutionize the world.”
- But right now, it is cash.

This Cash Industry in Transition report concludes that in many countries, in many different ways, digital solutions and systems have been or are being developed that will meet all of the above criteria and much more. The technological and financial barriers are solved.

At the same time, CR’s follow-up report, The Case for Cash Part 2: The Justification, outlined the many positive social contributions of cash. Unlike other payment methods, cash is not subject to private, profit-oriented objectives; rather, it is a



Cash is not subject to profit-oriented interests and thus is able to serve the citizens themselves and protect public interest.

social and public good that serves wider interests. Governments, through their central banks, maintain monetary stability in markets by issuing cash. Furthermore, cash is an inclusive method of payment that facilitates economic transactions for all members of society. The central bank’s support and issuance of cash is fundamental to a nation’s economic and social systems.

Banknotes and coins are key to a central bank’s role and mandate. They provide a safe, efficient, and trusted means of payment and store of value to citizens, and are not subject to commercial interests. They support the central bank’s monetary independence from the government by providing a source of revenue to fund its operations. If central banks had to seek budgetary appropriations from governments, they would potentially be less independent. With a distinct national and economic identity, banknotes and coins are among the most important symbols of a sovereign nation, which is a

significant justification for governments and central banks to continue issuing physical currency.

The Cash Industry in Transition report concludes that central banks are in the difficult position of receiving criticism if they express support for cash but also criticised if they support the move away from cash. They are navigating through truly uncharted territory and must be pragmatic in planning and preparing for a less-cash future.

The cash industry must also hasten its planning for a less-cash society while maintaining a robust cash industry – not an easy task.

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From America, with love - much of the current terminology employed by CIT companies is tailored for a US environment - making it less than ideal in other countries.

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SINCE 1994 THE LSW 633 PROPOSAL AND THE LSW 630/632 FORMS HAVE BEEN THE STANDARD FORMS USED BY THE INSURANCE INDUSTRY TO ASSESS THE NATURE OF THE CIT EXPOSURES AND PROVIDE THE RESULTING INSURANCE COVER.
”

WHY SECURITY MANAGEMENT (CIT) COMPANIES SHOULD BE CAREFUL WHICH INSURANCE WORDING THEY USE TO PROTECT THE VALUABLES IN THEIR CARE

Steven Cole | Marsh Ltd

Every day, CIT organisations all over the world face many different challenges, as fraudsters and criminals deploy more innovative methods to steal the valuables under their protection. This increasing threat requires CIT companies to review and understand the nature of their insurance cover, to ensure they have adequate protection in place to adapt to the rapidly changing risk environment.

Since 1994 the LSW 633 proposal and the LSW 630/632 forms have been the standard forms used by the insurance industry to assess the nature of the CIT exposures and provide the resulting insurance cover. Whilst these market wordings have been updated over the years to reflect the changing nature of the exposures to CIT companies, the base form still remains the same today, necessitating careful consideration where used.

Both the LSW 633 and LSW 630 were designed to assess and provide an insurance solution for CIT companies in the US. Therefore, these forms contain terms and conditions tailored for US CIT entities which are unlikely to be relevant to policy holders situated outside of the US; for example, references to UL rating and Federal runs, "official US public holidays" and "service of suit" provisions.

Caution needs to be given to ensure that the forms are tailored to the CIT company's specific circumstances. In some cases, such base forms have been adopted as the market standard wording. For example:

- The LSW 633 proposal form contains what would have been considered to

be a 'basis of contract' clause under the Laws of England and Wales. Previously these clauses converted the insured's pre contractual representations, including answers on a proposal form, into warranties. If the information was inaccurate, resulting in a breach of warranty, insurers were permanently and automatically off risk from the date of the breach, even if the breach was irrelevant to the loss that occurred or the breach had been remedied.

This was clearly a very harsh remedy. Fortunately, the Insurance Act 2015 abolished the use of 'basis of contract' clauses. However, if the LSW 633 is used in jurisdictions where the Insurance Act 2015 does not apply, it could still have a detrimental effect and put coverage at risk, depending upon the remedies available to an insurer under the appropriate choice of law in the event that some of the information within the LSW 633 is inaccurate.

- The LSW 633 also provides insurers with the remedy of avoidance in the event of a non-disclosure or misrepresentation of a material fact; this is in addition to the basis of contract clause. The Insurance Act 2015 also updates insurers' remedies for material non-disclosures and misrepresentations, so that avoidance is only available where the insured's failure to make a fair presentation of the risk is deliberate or reckless, or where not deliberate or reckless in circumstances where the underwriter

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can show that they would not have entered into the contract on any terms had full disclosure been given. The LSW 633 is inconsistent with these changes under the laws of England and Wales and thus detrimental. Consideration should also be given to insurers' remedies for a breach of a pre-inception duty of disclosure under the laws of other countries, to understand the scope of insurers' remedies in the event of a breach.

- The LSW633 proposal form is outdated and fails to ask the right questions about the operations of a CIT company, which can have a negative impact on the underwriter's understanding of the exposure and terms offered. For example, a question on the 'average and maximum values in each premises is limited to coins rather than covering all valuables present on the premises. Insurers will charge a premium on the premises' limits unless they know the average values of all valuables at risk.
- The scope of cover available



Words get in the way - The current wording used by CIT companies can result in restrictions and limitations as well as unneeded risk.

under the LSW 630 is restrictive and excludes loss and damage directly or indirectly caused by, resulting from or contributed to by the dishonesty or collusion of any owner, director, officer or employee of the Assured. This is a broad exclusion which removes one of the major risks faced by CIT companies.

- Even where the LSW 632 Fidelity Rider is included to bring back cover against the physical loss or physical damage directly or indirectly caused by the dishonesty or collusion of an employee, it only provides cover on narrow terms where the loss or damage is discovered within 72 hours of its occurrence. Insurers may agree to amend the discovery time period to 7, 14 or sometimes 30 days from the occurrence of the loss.

However, this time frame is still unrealistic for CIT companies to achieve, in particular taking into account the operations of many CIT companies especially in developing countries.

Many CIT companies, such as banks or MSPs, do not reconcile cash within such short time frames and losses may not be discovered for around 60 days. In circumstances where a time frame is imposed it should start to run from the 'discovery of the loss' by the insured and not 'the occurrence' of the loss or damage. Many insurers may resist this change, arguing that this exposes them to potential losses if an infidelity isn't discovered quickly.

Therefore, insureds will have to demonstrate that they have good procedures in place to monitor and reconcile the cash on a regular basis to achieve such a change in terms.

- The LSW 630 wording also insists that only armoured vehicles should

be used in transit and if an unarmoured vehicle is to be used, then there needs to be an additional armed guard but only in the event of accident and breakdown of the armoured vehicle. This doesn't reflect the advancements in use today where many CIT operations use unarmoured vehicles that rely on technology to enhance the security procedures.



The current LSW 630 wording requires that armoured vehicles be used in transit - a precaution which is less relevant today due to technological enhancements to security procedures.

These are only a few examples of the exclusions and limitations found in the LSW 633, LSW 630 and LSW 632 documents that limit the scope of cover for CIT companies, or put a CIT company at risk in its entirety. The wordings may also be inconsistent with local laws and certainly don't reflect the exposures that CIT companies face today. Some of the terms and conditions impose controls and restrictions on insureds that impede their progress and distract them from doing their business.

CIT companies looking to obtain appropriate insurance cover to meet the challenges they face today should be wary of accepting standard market clauses and seek a broader wording without such exclusions and limitations.

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Marsh has developed a proposal form that asks the right questions to enable us to provide full information to (Re)insurers. Importantly, it also has removed the 'basis of contract' clause.

If you need any assistance in this regard please contact either;

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UPCOMING EVENTS

Asia Cash Cycle Seminar (ICCOS)

23-26 September, 2019

Shangri-La Hotel, Colombo, Sri Lanka

www.asia.iccos.com

ACMA AGM at the Asia Cash Cycle Seminar

23 September, 2019

12 pm - 2 pm

Shangri-La Hotel, Colombo, Sri Lanka

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23 September, 2019

2 pm - 4:30 pm

Shangri-La Hotel, Colombo, Sri Lanka

Topic: Legislation/Regulation vs Self-Regulation and the Impact on the Security of Cash

Fees: USD 250 (for non ACMA members)

USD 125 (for ACMA members)

asia.iccos.com/workshops

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www.atmia.com/conferences/asia/

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Feb 2020

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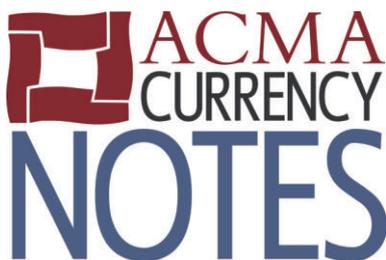
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To provide a platform for Cash Management Companies (CMCs) in Asia, Africa and Australia & Oceania to raise their professional reputation and standing in the Cash Handling and Cash Management Industry, and to act as a representative with the appropriate authorities on issues of common interest.

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