CURRENT SITUATION OF LOW-VALUE PAYMENT SYSTEMS IN LATIN AMERICA AND THE CARIBBEAN

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Introduction

Clearing and settlement payment systems (payment systems) are an essential part of a country’s financial infrastructure, allowing the smooth functioning of its financial markets. Such systems consist of instruments, rules, procedures and participants, which together allow the efficient and secure flow of the money and information involved in all financial system transactions. The absence of proper regulatory and oversight mechanisms in these systems, as well as the failure of such mechanisms, can result in disturbances affecting the proper functioning of the financial system. Structural weaknesses can also directly expose markets to different risks, some of which might be sources of financial tensions. The smooth functioning of this infrastructure is therefore crucial for the security, efficiency and reliability of each transaction as well as for financial system as a whole.

A retail payments system processes relatively low-value transactions which are typically periodic, non-urgent, and cleared and settled in high volumes. These systems are a vital part of the financial infrastructure as they contribute to the efficiency, access and stability of the financial system via their role in individuals and firms’ transactions. In retail payment systems individuals transfer money through various payment media, including checks, debit cards, electronic transfers, etc. In the case of other types of payments, such as those of high-value, financial institutions make large, urgent fund transfers in real time. These payments are usually associated with the interbank market.

The recent performance and development of low-value payment services has made them particularly relevant for the authorities in charge of the financial infrastructure. Several events corroborate this, including: 1) the growing use of electronic media and technological innovation in low-value payment services, making markets more efficient; 2) the gradual substitution of cash and paper based payment instruments in general; 3) the entrance of new payment service providers other than banking and financial institutions, generating increased competition in payment service offerings; and 4) end users’ gradual acceptance of these new instruments.

Unfortunately, unlike other regions, in Latin America and the Caribbean (LAC) obstacles still exist for the full development of instruments and mechanisms making up retail payment systems, and for their use to be leveraged as a catalyst for access to the financial system. It is therefore essential that the region’s financial authorities clearly identify the policies that could be key to the smooth development of their retail payment markets.

This essay was prepared in order to highlight some relevant aspects of low-value payment systems in Latin America and the Caribbean. It does not purport to be a detailed study and is more intended to encourage the consideration and discussion of certain topics during the First Regional Workshop on Payment Systems in Latin America and the Caribbean, jointly organized by the Central Bank of Trinidad and Tobago, the Bank for International Settlements and the Center for Latin American Monetary Studies.

Low-value payment systems in LAC

Financial globalization, as well as the requirements of firms, individuals and financial institutions, have made the need for more secure and efficient settlement and payment systems increasingly evident in both advanced and emerging economies. Under this context, in December 1999, the BIS Committee on Payment and Settlement Systems (CPSS) published its Core Principles for Systemically Important Payment Systems. The main objective of this document is to provide a benchmark of best practices for payment systems in the new global context.

Based on this framework, and faced with increased international financial flows resulting from globalization, different international institutions took actions to bolster financial infrastructure in their regions. In the case of Latin America and the Caribbean, central banks have implemented reforms to improve –and in some cases develop– national payment systems. As could be expected, different degrees of progress have been observed. Thus, while some countries have focused on the implementation of modern platforms capable of real time electronic transfer of high value transactions (and/or in developing a legal framework defining the attributes,
regulations, instruments and mechanisms for system participants), others have not given high priority to this area. Progress after several years of reforms can be summarized as follows: a) the implementation of real time gross settlement systems (RTGS) and automated clearing houses (ACH); b) the issuing of laws and regulations governing the operations of settlement and payment systems, and, to a lesser extent, c) greater acceptance and use of new payment instruments other than cash or checks. Such efforts undoubtedly represent significant progress, particularly in high-value settlement and payment systems, where the weaknesses of traditional systems constituted a potential risk for the smooth functioning of clearing and settlement payment transactions.

Despite progress made over the last decade, significant margins still exist for improving the efficiency and security of payment systems in Latin America and the Caribbean. For instance, in recent years the international community has recognized that besides providing a sound payments system, it is also necessary to pay attention to the way individuals—other than the same financial institutions—use such systems. In this respect, the region’s central banks continue with an unresolved program in the area of low-value payment systems, mainly concerning financial access and depth, factors essential for strengthening the market economy.

This essay reviews two key factors the author believes are currently relevant for ensuring the smooth development of retail payment services in the region: the structure of payment media use (what instruments and the way they are used) and the role of the participants (users, providers and regulators).

Retail payment system use and access

One current challenge, related to the way individuals use and access retail payment services, is to encourage the use of payment media other than cash and checks, and which also provide the user with certainty and improve low-value transactions, i.e. provide a financial infrastructure capable of simplifying and encouraging its use. This is closely linked with agents’ preferences for making transactions, given that individuals and firms’ financial habits and culture are determining factors in the use of non-paper based payment instruments. Although this is yet another challenge, a solution could be found through actions to change financial culture and encourage the use of innovative payment instruments. Nevertheless, due to the fact that the authorities do not have control over how individuals respond, this factor takes longer than other actions which might also foster the use of retail payment media other than cash. Thus, one of the most direct way authorities and the private sector can encourage the use of retail payment instruments is to broaden physical infrastructure by increasing the number of access points (ATM and EFTPOS) and providing more accessible and well known online banking platforms, among others.

Using information from 16 countries in the region who are members of the Western Hemisphere Payments and Securities Settlement Forum (WHF)\(^2\), Graph 1 shows how the population’s use of available payment systems has evolved. As can be seen, the use of payment instruments such as electronic transfers (credit transfers), payment cards and direct debits has grown significantly in comparison with the use of checks, that in fact has been stagnant in recent years.

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\(^2\) The WHF is a joint initiative of the Center for Latin American Monetary Studies and the World Bank, designed to provide a framework for technical collaboration in the region to improve payment and securities settlement systems. The WHF is composed of 19 central banks from the 33 countries in Latin America and the Caribbean. In this case, statistical information collected by the WHF in October 2010 includes information from the following countries: Argentina, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Guatemala, Honduras, Cayman Islands, Mexico, Paraguay, Peru, Trinidad and Tobago, Uruguay and Venezuela.
Graph 1 also illustrates the use of cards (debit and credit) in the region. Their growing utilization reveals the gradual acceptance of this payment instrument among individuals. The publicity and marketing campaigns carried out by financial institutions, businesses and international card networks have played an important role in the progress made to date. It is also important to point out that money in circulation (bills and coins held by the public) is growing at rates similar to those observed in previous years. This reflects the strong preference that still exists in the region for cash as the main payment instrument.

**Graph 1. Money in circulation ($M_0$), checks paid, card payments and electronic transfers (1999-2009)**

Money in circulation (bills and coins) operations with checks, payment cards and credit transfers (in billions of USD)

Although these figures are not conclusive, they suggest a progressive substitution of some payment media by other more efficient and modern instruments. As financial institutions allow and encourage the use of non-paper based retail payment media, the opportunities for expanding access to the financial system will also increase.

A comparison of the current situation in the region with that observed in developed countries, reveals there is still a lag in the utilization of retail payment instruments in LAC. For instance, information from several CPSS countries\(^3\) shows that the use of electronic transfers and cards is much higher in developed countries than in LAC. In 2009, 143 card operations per capita were carried out in developed countries, while an average of just 13 operations per capita were made in LAC. As for electronic transfers, 34 operations per capita were made on average in the former countries and only 2.2 in LAC. Finally, between 2005 and 2009, the use of checks declined 22% in developed countries and 18% in LAC, suggesting a larger substitution by other instruments in the former case.

The installed capacity of financial infrastructure in Latin America and the Caribbean has continued to grow in parallel with payment system reform. Such progress has been complemented by financial institutions’ greater

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\(^3\) The Committee of Payment and Settlement Systems is made up of the following countries: Germany, Saudi Arabia, Belgium, Brazil, Canada, China, Korea, the U.S., France, Hong Kong, India, Italy, Japan, Mexico, the Netherlands, the U.K., Russia, Singapore, South Africa, Sweden, Switzerland and Turkey. Figures used in this essay were obtained from the annual “Red Book: Statistics on payment and settlement systems in the CPSS countries - Figures for 2009 - Preliminary release”
interest in competing with other payment service providers for a larger number of customers, leading to an increase in the access point network.

On this topic, information from the WHF shows the growth of physical infrastructure other than branches and windows available to financial users for making payments. For instance, the number of automated teller machines (ATMs) and electronic fund transfer points of sale (EFTPOS), as well as the volume and average value of operations made at these access points, are key indicators of a payment system’s entry capacity and, therefore, access to finance. Graph 2 shows the evolution of these indicators in the region during the period 1999-2009. As can be seen, the ATM infrastructure doubled during that period, while that of EFTPOS increased fivefold.

A steady increase in the average value of ATM and EFTPOS operations can also be seen in response to the greater use of cards (credit or debit). Increased card use is particularly reflected in EFTPOS, due to the fact that ATM transactions include many operations which are simply cash withdrawals.

Despite the positive aspects of these regional figures, it is important to emphasize that the development of infrastructure varies significantly from one country to another. For instance, while in Brazil there is around one ATM per thousand inhabitants (0.855 ATM/1,000 individuals); in Paraguay the ratio is just 84 per million, i.e. ten times less than in Brazil.

The physical infrastructure in LAC is also less developed than in advanced economies. In 2009, there were 1.09 ATMs per thousand inhabitants in developed CPSS member countries, while the ratio was just 0.49/1,000 in LAC. Such difference was even greater in the case of point of sale terminals, given that the region had only 0.13 EFTPOS per thousand inhabitants, while in developed countries the number was 15.64. On the other hand, it is important to mention that the growth of the financial infrastructure has been more dynamic in the region than in advanced economies in recent years. Thus, during the 2005 to 2009 period, the number of ATMs in LAC grew 24%, figure much higher than the 12.6% percent increase observed in developed countries. Figures for EFTPOS show even greater activity, with growth rates close to 100% in LAC and just 15% in developed countries.
It is evident, then, that despite the progress made in strengthening the physical infrastructure in the region and, to a lesser extent, in the use of retail payment instruments other than cash, there is still a need to achieve wider coverage and access. Furthermore, greater promotion and knowledge of these payment instruments, which given their newness are not always immediately accepted by users, is also necessary.

Objectives of authorities and retail payment service providers

Retail payment systems include providers, other than banking institutions, as well as different financial and business organizations who have developed a wide range of services. Although these systems were not initially considered to be systemically important, their growth and the fact that while individual operations can be small their total volume results in significant amounts, mean they could affect financial system stability and confidence in the banking system. Furthermore, it is important to take into account that some important cross border financial transactions (e.g. international remittances) also form part of low-value operations in the region’s economies, and that this type of transaction does not necessarily fall under the control of local authorities.

The use of technologies such as internet has simplified the work of platforms – both public and private- used for transferring funds between participants and has also become a broad channel for offering different payment services. The private sector (commonly responsible for providing these services) has developed new instruments leveraging available technology to reduce costs and make transactions more efficient. One clear example of this is mobile banking which simplifies low-value operations for end users, who with the right technology can carry out different financial transactions ranging from paying services to making real time deposits in the accounts of third parties in financial institutions other than their own.

All this brings additional challenges for authorities in the area of retail payments, related to the differences originating from the private sector’s objectives –as payment service providers- and the authorities –in their role as regulators and overseers-. Thus, central banks (and to a lesser extent other regulators) should decide if, once a legal framework has been established (be it a payments system law or the necessary regulations), it is necessary to intervene to support the development of the retail payments market. In the same way, it is also important to have a policy framework which encourages the innovation and development of retail payment services, ensuring they are efficient and secure. To achieve this objective, it is necessary to at least: a) allow technological advances to be used for increasing efficiency; b) encourage regulations which foster the development of this market; c) provide the framework for participants’ competition and access; d) ensure best practices –e.g. governance and prices- among service providers; and e) oversee the smooth functioning of the market. If the authorities believe the development of the retail payment system should be mostly left to market forces, it is important they evaluate carefully if the legal framework is sound enough to avoid asymmetries, disloyal practices and potential failures in fund transfers or those resulting from regulation loopholes.

In any case it is essential that authorities establish communication and follow-up channels, enabling market oversight. In this regard, the Committee of Payment and Settlement Systems suggested alternative practices for encouraging the smooth development of this component of the financial infrastructure in its report Policy Issues for Central Banks in Retail Payments. International experience has highlighted two of these alternatives as effective mechanisms for the efficient and secure development of payment systems: the role of oversight and the creation of a payments’ committee.

Regarding oversight, the authorities must have the regulatory power to enable them to fulfill this function, as well as the cooperation and recognition of the private sector. In many cases this probably requires greater familiarization and intervention by the authorities in order to coordinate such functions and, when necessary, introduce the regulatory changes to allow them to have an oversight role, which in many cases is not included in the body of legislation.
The creation of payments’ committees, on the other hand, is an alternative for influencing the development of instruments, mechanisms and circuits for private sector retail payments given that they encourage a permanent dialogue between the public and private sectors. In addition, the participation of the private sector fosters financial education.

In short, it is also the responsibility of the private sector and, to some extent, of the users of retail payment services, to encourage the acceptance, functioning and use of these instruments and circuits. However, for these joint efforts to work, the policy framework and regulations in general should be properly balanced, giving service providers the capacity and incentives necessary to develop more efficient payment systems, following standards and best practices which guarantee security for users and, therefore, for the market as a whole.

LAC has shown significant progress in the area of complementary public-private sector actions to improve retail payment systems. This is seen in a recent study on the oversight of payment systems in the region, which shows that 93% of central banks have the formal mandate to exercise oversight, of systemically important and retail payment systems, an aspect reflecting significant efforts in this matter. Nevertheless, there is still a considerable margin for adopting international standards for private sector operated payment and settlement systems, in light of the fact that only 27% of such systems are based on international best practices.

As for experience in creating payment committees, in 2008, at least 13 of the 23 countries in the region had a national payment system committee (or periodic talks with the private sector) as part of cooperation efforts between the most important financial infrastructure participants. Collaboration bodies have also increased in other regions of the world. For instance, 44% of countries in Eastern Europe and Central Asia have a formally established committee, while fifteen of the European Union’s twenty seven member countries (55%) have national payments committees.

Conclusions

The short term scenario for retail payment systems in the region is encouraging as well as challenging in some respects. Considerable progress has undeniably been made in: the development of physical infrastructure; improving legal frameworks and strengthening financial culture, particularly during the last ten years; recognizing that retail payment systems are a tool for improving financial access and stability; and fostering the interest of payment service providers in offering more efficient instruments in response to end user demands.

In sum, a set of appropriate conditions for progress to be made in the smooth development of retail payment systems does exist and these would be empowered by policy actions which not only harmonize the objectives of system participants, but also continue to strengthen the key aspects for the development of retail payment systems.

Some actions which could form part of such efforts are: 1) recognize and bolster interdependencies between high and low-value payment systems, particularly when both subsystems are systemically important; 2) support and regulate the entrance and participation of non-bank entities as payment system providers; 3) support, unify, standardise and regulate the implementation of innovative retail payment instruments; 4) apply and, when necessary, create the authorities’ role as overseer, as a tool to supervise payment market development, and 5)

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4Payment committees normally include the central bank, payment service providers, consumer protection agencies and other institutions involved in public policy making.
5The regional study named Payment and Securities Settlement System Oversight of LAC Central Banks was prepared in 2010 by Banco Central do Brasil within the framework of the WHF and included the participation of 15 out of the 19 WHF member countries.
6In particular the Core Principles for Systemically Important Payment Systems, CPSS 2001. The regional study includes both, large and low value payment systems, when addressing the oversight function in LAC. Despite the fact that the Core Principles were intended for large value payment systems, local authorities may consider those retail payment systems as systemically important (e.g. hybrid systems that usually operate both large payments and several bulks of retail payments that could affect liquidity market).
7Information from the Global Payment Systems Survey, World Bank, 2008.
take into consideration the lessons learned from successful experiences, such as the Single Euro Payments Area.

To conclude, it is also important to emphasize that international organizations have an important role to play in supporting actions taken by the authorities to achieve more efficient and secure payments and settlement systems.

References


[5] Committee on Payment and Settlement Systems, September 2000, Clearing and Settlement Arrangements for Retail Payments in Selected Countries


