Some thoughts on the development of retail payment systems

Gregor Heinrich
Opening remarks at the CEMLA-BIS workshop on retail payment systems, hosted by the Central Bank of Trinidad and Tobago, Port of Spain, 8–10 February 2011.

It is an honour for me to have been invited to participate in the opening of this workshop on retail payment systems in the Caribbean and Latin America. I would like to thank the Central Bank of Trinidad and Tobago for hosting the event, and in particular Governor Williams and Deputy Governors Joan John and Shelton Nicholls. Marc Hollanders, a special adviser in the Monetary and Economic Department of the Bank for International Settlements (BIS) and an expert on payment system issues, should also be commended for his work in preparing a large part of this workshop, and I would also like to thank Javier Guzman, Director of the Center for Latin American Monetary Studies (CEMLA), for providing once again the framework for a regional seminar/workshop within the programme of this important regional association of central banks.

Contributions from the region to cooperative processes among central banks.

In a certain way, the work of the BIS and of CEMLA is perfectly complimentary. As you know, all regional central banks are members of CEMLA, whose main objective is cooperation amongst its members in order to promote a better knowledge of monetary and financial topics in the region.\(^1\) By contrast, only a few regional central banks are members of the BIS, an international organisation that fosters international monetary and financial cooperation and serves as a bank for central banks.\(^2\) A majority of central banks in the region (and of the world, actually) entrust part of their foreign exchange reserves to the BIS; furthermore the BIS hosts a number of so-called standard-setting bodies and important forums for high-level discussions among central banks, not the least the Committee on Payment and Settlement Systems (CPSS).\(^3\) In fact, some of the larger central banks from the region are formal members of these committees.

But the BIS’s work also benefits from input given by BIS non-members, as well as from institutions that are not formal members of these high-level committees. Central banks from the Caribbean and Latin America, as well as smaller countries in the region, thus contribute to the increasing wealth of knowledge and information available to the central banking community.

Such contributions take many different forms. To mention a few, there are comments on consultative papers by BIS-based committees (such as the Basel Committee on Banking Supervision\(^4\) or the CPSS), participation at several levels in policy discussions or meetings

\(^1\) See http://www.cemla.org
\(^2\) See http://www.bis.org
\(^3\) See http://www.bis.org/cpss
\(^4\) See http://www.bis.org/bcbs
hosted by the BIS, the compilation of banking data, eg from offshore centres, for the BIS International Banking Statistics\(^5\) or the provision of Governors’ speeches to BIS publications.\(^6\) Another form of contribution is via open discussions among regional institutions in seminars such as this one on retail payment systems, where any concern you might have, or insights you might be able to provide, will certainly make their way back to relevant institutions, be they CEMLA, the World Bank, the BIS or, in the specific case of this workshop, the CPSS.

This workshop on retail payment systems can be of particular relevance for the region. Unfortunately, the bank accounts, and electronic payment, clearing and settlement systems that the population takes for granted in developed countries, and to which most people there have direct or indirect access, simply do not exist for almost half of the world’s population; thus, the further development of payment instruments and the infrastructure that supports these have been high on the agenda for Caribbean and Latin American Central Banks too.\(^7\)

**Issues for discussion**

Allow me to mention a few points that from my personal perspective might be interesting to discuss in this workshop.

- What are retail payment systems?
- Why should central banks worry about retail payments, instruments and retail payment systems? Should they not rather just focus on so-called systemically important systems? When could retail payment systems become systemically important, and, when considering this question, are there particular elements in smaller, developing or emerging economies that would result in a different conclusion than would perhaps be the case in a large and highly developed economy?
- Are events like these just a platform where each representative individually receives information from speakers/experts, or is there any particular scope for cooperation beyond the attendance of occasional seminars, and perhaps even for closer institutional coordination or even technical interconnectivity?\(^8\)
- How can institutions such as CEMLA, the World Bank or the BIS be helpful in this regard?

In this introduction I can not give all the answers; I would like rather just to put forward a few thoughts.

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\(^5\) See [http://www.bis.org/statistics](http://www.bis.org/statistics)

\(^6\) Such speeches are published at [http://www.bis.org/list/cbspeeches/index.htm](http://www.bis.org/list/cbspeeches/index.htm) and have included many contributions from Caribbean Governors in the past.

\(^7\) See, for instance, general information and specific reports provided under the Western Hemisphere Payments & Securities Settlement Initiative launched by the World Bank in 1999: [http://www.forodepagos.org/english.htm](http://www.forodepagos.org/english.htm). CEMLA provides the regional technical secretariat for the Initiative: [http://www.cemla.org/payment_systems.htm](http://www.cemla.org/payment_systems.htm)

Driving forces within central banks

For some central banks, worrying about retail payments, related systems, users of instruments and systems, or even competition, can be a direct statutory obligation and part of their institutional functions.\(^9\)

But, even when there is no statutory obligation, central banks have always had an intrinsic interest in the safe and efficient functioning of payment systems simply because they are essential for financial markets and the economy as a whole, as pointed out in the CPSS report on oversight of payment systems.\(^10\)

Financial stability is another concern of central bankers that draws their attention to payment systems. Furthermore, particularly in emerging markets, a more recent aim of central banks is to deepen markets in general and to foster policies that provide larger parts of the population with greater access to the financial system ("banking the unbanked"). Just to mention one example each from a large and a smaller regional central bank: the Central Bank of Brazil has recently issued its first report on financial inclusion,\(^11\) highlighting the current status, existing challenges and technical developments and projects underway in the country; and the Eastern Caribbean Central Bank is promoting on its website a payment system improvement initiative that aims, among other objectives, to “develop effective, efficient, reliable, accessible and secure payment systems that serve the needs of the Eastern Caribbean Currency Union and support a competitive private sector environment.”\(^12\)

Of course, I should also mention today the Payment Systems Council established by the Central Bank of Trinidad & Tobago in 2002 to “... support the achievement of sound and efficient payments clearance and settlement systems in the country and to participate in regional and international efforts aimed at maintaining ordered conditions in regional and international payment systems.”\(^13\)

Driving forces outside central banks

The impetus for improving payment systems can also come from outside the central bank. It can be driven by many forces, coming from both the domestic market as well as from outside the country.

It is certainly not just because a consultant or an international organisation is promoting an idea that it needs to be implemented in a country. The list of key standards published by the Financial Stability Board (FSB),\(^14\) and which are used by the IMF and World Bank in the Financial Sector Assessment Programme,\(^15\) mentions only the CPSS Core Principles for

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\(^9\) For instance, Article 2 of the Central Bank Law of Mexico specifically tasks the central bank with promoting the healthy development of the financial system and furthering the sound functioning of payment systems. [http://www.banxico.org.mx/disposiciones/marco-juridico/ley-del-banco-de-mexico/texto-vigente.html](http://www.banxico.org.mx/disposiciones/marco-juridico/ley-del-banco-de-mexico/texto-vigente.html).


\(^13\) The key standards were first published by the Financial Stability Forum (FSF), the predecessor of the FSB; see [http://www.financialstabilityboard.org/cos/key_standards.htm](http://www.financialstabilityboard.org/cos/key_standards.htm). 

Systemically Important Payment Systems\textsuperscript{16} and these do not automatically include the retail payments environment. Furthermore, these Core Principles mention in Article VIII that a system should be “practical for its users and efficient for the economy”.

For me, it is therefore of particular interest to see which criteria a central bank actually uses when making an assessment as to the relevance of a particular system or infrastructure. Even though the CPSS has published several recommendations,\textsuperscript{17} I have yet to find a very detailed analysis or “implementation handbook”. Indeed, as regards retail payment systems, such a judgment may be a particular challenge. So you might wish to take the opportunity of this workshop to discuss this aspect, too.

Perhaps some information could be gleaned from statistics that do not seem to be directly related to payment systems or technological developments: for instance, capital flows to a country or region, tourist arrivals, or – to take an entirely different tack – a comparison of the rates charged for payment cards as compared to other rates.

(i) If we take capital flows: it is highly possible, although not yet fully supported by hard evidence, that strong capital flows to a country or region will bring down longer-term interest rates and that this can increase liquidity in the financial system. Very large and persistent inflows and related increases in central bank foreign assets almost always expand the balance sheet of the banking system and this can, in turn, support credit and asset price booms.\textsuperscript{18} Particularly in emerging markets this could have the effect that banks, which have traditionally served mainly the developed industrial sector, will pay more attention to the parts of the population that have lacked access to financial products or even a bank account. In particular, if general lending continues to be below expectations, and as now, after the financial crisis,\textsuperscript{19} continues to be depressed in some regions such as Central America, while bank assets in that region have gradually increased in the last years,\textsuperscript{20} banks may try to find new business opportunities, for instance, in the profitable credit and debit card business. The interest in further development of the retail payments infrastructure would thus be more supply-driven.

(ii) As to tourist arrivals, for instance to Caribbean countries, I would presume that most tourists come from regions that have a fairly well developed retail payments infrastructure. Such tourists are likely to expect to find and use a similar infrastructure in their destination country. And if the number of tourist arrivals is relatively large vis-à-vis the size of the country, I would suspect that this will have an impact on the demand for retail payment systems too.\textsuperscript{21} Pressure for further development of retail payments infrastructure would in this scenario be demand-driven.

\textsuperscript{16} http://www.bis.org/publ/cpss43.pdf
\textsuperscript{17} For instance, in CPSS, General guidance for national payment system development, 2006, http://www.bis.org/publ/cpss70.htm, also available in Spanish.
\textsuperscript{19} See in this context in general, “The global crisis and financial intermediation in emerging market economies”, BIS Papers, no 54, December 2010, http://www.bis.org/publ/bppdf/bispap54.htm
\textsuperscript{21} The Caribbean Center on Money and Finance, based in Trinidad and Tobago, recently published comparative tourist arrival statistics on its website at http://www.ccmf-uwi.org/?q=node/1283
(iii) A closer look at prevailing interest rates could highlight inefficiencies that might be slowing down the development of a retail payments infrastructure, and where a central bank might feel the need to intervene. While there is no objective or “correct” benchmark, one could, for instance, compare in any given country, inflation rates, central bank policy rates, average bank lending or real estate mortgage rates and average credit card rates. If credit card rates seem abnormally higher than other rates, even taking into account the existing risk against the percentage of non-performing loans, there are probably some underlying inefficiencies that warrant closer analysis.

### Inflation and key interest rates (as of January 2011)

<table>
<thead>
<tr>
<th>Country</th>
<th>Inflation</th>
<th>Interbank rate</th>
<th>Treasury rate</th>
<th>Mortgage rate</th>
<th>Credit card rate</th>
<th>Consumer credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mexico</td>
<td>4.40</td>
<td>4.50</td>
<td>4.04</td>
<td>11.3–17.3</td>
<td>24–65</td>
<td>27.5–52.2</td>
</tr>
<tr>
<td>Brazil</td>
<td>6.24</td>
<td>11.17</td>
<td>10.83</td>
<td>11–22</td>
<td>130–238</td>
<td>40.6</td>
</tr>
<tr>
<td>Chile</td>
<td>2.98</td>
<td>3.24</td>
<td>4.20</td>
<td>5.1–7.9</td>
<td>6–50.4</td>
<td>9.6–50.5</td>
</tr>
<tr>
<td>T&amp;T</td>
<td>13.14</td>
<td>0.75</td>
<td>6.01</td>
<td>8.5</td>
<td>25.2–49</td>
<td>14–24</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>5.82</td>
<td>...</td>
<td>3.42</td>
<td>19.32</td>
<td>18.3–52</td>
<td>9–34</td>
</tr>
<tr>
<td>Spain</td>
<td>2.99</td>
<td>0.68</td>
<td>1.13</td>
<td>2.6–3.1</td>
<td>13.5–24</td>
<td>6.0–8.5</td>
</tr>
</tbody>
</table>

1 December 2010. Annual changes, in per cent. 2 One-day rate. 3 At least one-month. 4 Average rate.

Sources: national data; Bloomberg.

### CPSS efforts

Just let me mention briefly that interest in retail payments and retail payment systems is not limited to central banks of smaller or medium-sized countries. For instance, the CPSS, which now counts all G20 member central banks among its members, has recently embarked on a review of practices and know-how as regards retail payments. The last similar exercise was undertaken well over 10 years ago, when, in three different projects, all resulting in a publication, the Committee studied, first, retail payment instruments in selected countries (1999), then looked at the clearing and settlement arrangements for retail payment instruments in selected countries (2000) and finally looked at whether there were particular policy issues for central banks in retail payment systems (2001).

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22 [http://www.bis.org/publ/cpss33.htm](http://www.bis.org/publ/cpss33.htm)
23 [http://www.bis.org/publ/cpss40.htm](http://www.bis.org/publ/cpss40.htm)
24 [http://www.bis.org/publ/cpss52.htm](http://www.bis.org/publ/cpss52.htm); extracts of this report are also available in Spanish at [http://www.bis.org/publ/cpss52es.pdf](http://www.bis.org/publ/cpss52es.pdf)
While certainly some of the more general observations still hold today, there have in the meantime been many technical innovations, and also the group of countries or international organisations that is directly or indirectly connected to the CPSS has increased considerably. Thus, the recent work by the CPSS, launched in 2010, involves an extensive fact-finding phase in some 40 countries. It will not take a segregated view on the existing arrangements, as was done over 10 years ago, but a holistic view, and it will study simultaneously the user end, ie the products that are visible to the consumer in general, the clearing infrastructure, and the settlement of payments that are effected by retail instruments. The Committee hopes to finalise that work by January 2012.

Conclusion

In the forthcoming days you will certainly look at all of these aspects in more detail, and some of this will be quite technical in nature.

At the same time, you might also wish to consider some of the wider implications of a secure, efficient and effective payments infrastructure, at the interbank payment level and at the retail payments level. The recent financial crisis, which admittedly hit some countries more than others, provides a good opportunity to review some of the higher-level issues, and to evaluate the progress already made against this real-life stress test.

We saw that, during the crisis, payment and settlement systems were highly resilient. In fact, many of the risk-reducing measures recommended by many central banks and the CPSS many years ago have paid off. I am thinking here of recommendations for the desirability of final, end of day settlement in a systemically important payment system, or for measures in systems that use multilateral netting that allow for timely completion of settlement even if the participant with the largest single settlement obligation is unable to fulfil its obligations.

However, despite all the progress made in the past, how resilient would the infrastructure have been in the recent crisis with a larger number of defaults than those actually experienced? Therefore, further improvements will be necessary.

A most valuable contribution that the region can make to working on such improvements will be the discussions that will take place in this seminar, the experiences that you can share with your central bank colleagues, and the insights that Marc will report back to the BIS in Basel and to the CPSS Secretariat.

Thank you very much
