Modernization of Retail Payment Instruments

9th Meeting – WGPS – LAC

Sydney - AU

October 4th, 2006
Retail Payment Instruments

• **Focus of the Banco Central do Brasil (BC)**
  - Promote economic efficiency in currency’s usage

• **Objectives**
  - Increase relative share of electronic instruments vis-à-vis paper-based instruments
  - Economic efficiency and a higher social welfare
Potential Efficiency Gains

• US’ Payment System annual cost is approximately 3% of GDP (Wells 1994)

• Electronic payments cost from one-third to one-half as much as the substitute paper-based alternative (cash and cheques) for 14 European countries (Humphrey et al. 1996)
Points that justify further analyses

- Indirect pricing of payment instruments, Bank-Customer relationship priced simultaneously with payment instruments (cross subsidies)
- Market failures in the supply side might impair innovation and growth of electronic payments
Banco Central do Brasil’s role

• To indicate policies, directives and objectives
• To foster private and cooperative solutions
• To coordinate investment decisions and expectations
• To act as a catalyst for the relationship between relevant parties and public authorities interested in the subject
• Regulation, when needed
Modernization of Retail Payment Instruments - Actions

• May 2005
  ▪ Report on the Brazilian Retail Payment System

• May 2006
  ▪ Included an Annex with Statistics in the Report

• July 2006
  ▪ Agreement BC – SDE – SEAE

• September 2006
  ▪ Payment card industry data collection
Report on the Brazilian Retail Payment System

- Describes and analyses the Brazilian Retail Payment System aiming at finding the determinants for its modernization and serving as a benchmark for policies and directives

- Main findings:
  - Large-scale usage of paper-based instruments
  - Infrastructure for clearing and settlement of retail payments is fragmented
  - Low infrastructure interoperability among payment instruments distribution channels
Non-Cash Payment Instruments – Volume
Relative Share – Brazil

1999

- Cheque: 62.5%
- Debit card: 15.6%
- Credit card: 5.5%
- Direct debit: 13.8%
- Credit transfer: 2.7%

2005

- Cheque: 28.5%
- Debit card: 18%
- Credit card: 24.8%
- Direct debit: 11.9%
- Credit transfer: 16.8%
Directive – Definition

- Describes certain aspects of a particular sector and expresses BC’s position, in order to guide its future actions
- Does not have the same status as a Norm
  - Does not establish either obligations or prohibitions
  - Does not imply any sanctions
- Greater transparency of BC’s policies

- **Focus: Payment Cards Industry**
- **Efficiency Aspects**
  - cooperation in Infrastructure
  - competition in payment services
  - innovation in product development
- **Persuasion of interested parties**
  - growth potential
  - externalities
- **Social Welfare Gains**
BC – SDE – SEAE’s Agreement – Main Points

• Object
  ▪ Technical Cooperation:
    ▪ Banco Central do Brasil (BC)
    ▪ Economic Law Office (SDE)
    ▪ Secretariat for Economic Monitoring (SEAE)

• Motivation
  ▪ Economic efficiency with innovation and social welfare promotion

• Authorities’ roles
  ▪ BC ⇒ knowledge of banking services and mission of guaranteeing National Financial System’s soundness
  ▪ BC, SDE e SEAE ⇒ in charge of regulating antitrust issues: anti-competitive conducts and merger actions
• Payment Card Industry Data collection
  ▪ Elaborate a report
  ▪ Identify inefficiencies

• Coordinate public policy actions
  ▪ Propose strategies and measures to authorities, seeking the best public action
  ▪ Evaluate the efficacy of potential actions by public authorities
• Price: interchange fees, merchant discount, and customer fee
• Concentration
• Profitability
• Governance
• Qualitative issues
Report – Data Collection – Target Population

• Payment Cards Issuers
  ▪ Credit Cards
  ▪ Debit Cards

• Acquirers

• Payment Card Associations

• Merchants
• Payment Card Societies
  - Visa (53%)
  - Mastercard (37%)
  - Others (10%)

• Issuers
  - 5 issuing banks hold 88% of the market share
  - 45 banks (40 conglomerates) issue Visa
  - 55 banks (36 conglomerates) issue Mastercard
  - 3 banks issue Amex

• Acquirers:
  - Visanet – Visa (53%)
  - Redecard – Mastercard and Diners Club (38%)
Report – Data Collection – Preliminary Meetings

• **Issuing banks (88%)**:  
  ▪ Expressed interest in the report  
  ▪ Presented no impediment to data collection  
  ▪ Difficulty in dividing debit function from credit function  
  ▪ Large participation of credit revenue on cards total revenue

• **Payment Card Societies (100%)**:  
  ▪ Expressed interest in the report  
  ▪ Presented no impediment to data collection  
  ▪ Suggested being the source of information concerning interchange fees  
  ▪ Showed huge interest in the results of the Report
• **Acquirers (100%)**:
  - Expressed interest in the report
  - Expressed concern about handling data within the time schedule
  - Showed huge interest in the results of the Report

• **Merchant (main commercial associations)**:
  - Expressed interest in the report
  - Complimented authorities on the initiative
  - Showed interest in reducing their final costs
  - Complained about infra-structure, fees etc.
International Experiences

• Central Banks and Competition Authorities Cooperation
  – In identifying market failures
  – In monitoring payment cards market
  – In directly regulating payment cards market
• Focus on market structure and rule of reason
• Focus on price structure (interchange fee and merchant discount)
United Kingdom’s Case

- HM Treasury, Bank of England and Office of Fair Trading
  - Analysis and diagnosis of the market (Cruickshank, 2000), (OFT, 2003), (BofE, 2000)
  - Public declaration that industry is taking advantage of its market power (OFT, 2003), (OFT, 2005)
  - Focus on interchange fees and on access rules
  - Persuasion as the main instrument of action
  - Continuous oversight by the Bank of England
The Netherlands' Case

- *De Nederlandsche Bank and Competition Authority*
  - Analysis and diagnosis of the market (DNB, 2002), (NMA, 2004)
  - Focus on market structure and on merchant discount
  - Direct intervention in the Interpay (only acquirer) owned by banks in 2004
  - After 2004, “non-vertical integration”:
    - Interpay: management of the network infrastructure
    - Banks: affiliation and definition of the commercial relations
  - Currently, Central Bank monitors the market and the effects of the measures adopted in the merchant discount
Mexico’s Case

- Banco de México and Comisión Federal de Competencia
  - Banco de México is the regulator of banking fees – Ley de Instituciones de Credito (2004)
  - Focus on market behavior (antitrust practices) and on merchant discount
  - Market with three acquirers owned by banks
  - Free establishment of merchant discount
  - Total interoperability of point of sale (POS) network
  - CFC direct intervention (1994) in the market, because of collusion practice for the establishment of the merchant discount
  - Continuous oversight by Banco de México
Chile’s Case

• Banco Central de Chile and *Fiscalía Nacional Económica*
  – Banco Central de Chile is the payment cards system regulator – *Compendio de Normas Financieras* (1989)
  – Focus on market behavior (antitrust practices) and on market structure
  – Direct intervention in the Transbank S.A (only acquirer) owned by banks
  – After 2004, agreement between Transbank and FNE:
    • Transbank: management of the network infrastructure
    • Entrance depends solely on the payment of a network access fee
    • Banks: affiliation and definition of commercial relations
    • Reduction of the merchant discount in up to 2%
Australia’s Case

- Reserve Bank of Australia (RBA) and Australia Competition and Consumer Commission (ACCC)
  - Analysis and diagnosis of the market (RBA, 2000)
  - Focus on interchange fee and on merchant discount
  - RBA is the payment cards system regulator – *Payment Systems Act* (1998)
  - In 2003, regulation of the interchange fee, determined by a cost-based methodology, established by the RBA
  - SCCI creation, a non-banking company authorized to act as an independent acquirer.
  - The average interchange fee decreased from 0.95% to 0.55% and the average merchant discount diminished from 1.40% to 0.92%
  - Cost adjustment occurred at customer side
Non-cash instruments
Total volume in millions – Brazil
Non-cash instruments – Value
Relative share – Brazil

Cheque and Credit transfer

Cards and Direct Debit

0.0% 0.5% 1.0% 1.5% 2.0% 2.5% 3.0% 3.5%

0% 10% 20% 30% 40% 50% 60% 70%

1999 2000 2001 2002 2003 2004 2005

Cheque  Credit transfer  Debit card  Credit card  Direct debit
Payment instruments – Relative share per value range in R$ – Brazil – 2005

Payment instruments
Yearly average quantity per inhabitant – Brazil

![Graph showing the yearly average quantity per inhabitant for payment instruments in Brazil between 1999 and 2005. The graph compares the use of cheques, debit cards, credit cards, direct debits, and credit transfers.](image-url)
Non-cash payment instruments – Yearly average number of transactions per inhabitant – International Comparison

Source: World Payment Report 2006, Capgemini ABN-AMRO/EFMA, Banco Central do Brasil and Yellow Book
Coins and notes held by the public (% of GDP) International Comparison – (2003 versus 2004)

Source: World Payment Report 2006, Capgemini ABN-AMRO/EFMA and Banco Central do Brasil
POS – Quantity of terminals with the function activated
Total at end of period
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