Payment Systems in Latin America: Advances and Opportunities

By Nancy Russell, NLRussell Associates

The Latin American region still remains one of the more complex in which to manage cash, liquidity and risk. However, many countries within the region have made significant progress since 2000 in modernizing their national payment systems. These new payment systems do not make it easier for companies to move cash on a cross-border basis from countries such as Brazil or Venezuela nor do they eliminate the challenge of the financial transaction taxes that are in effect today in many countries, but they can help make in-country cash and working capital management more efficient.

Regional Initiative

During the late 1990s, at the request of the regions' finance ministers, the World Bank and Center for Latin American Monetary Studies began working with central banks in countries around the region to assess the national payment systems and identify and recommend areas for improvement in their safety, efficiency and integrity. This effort, which began in 1999, has resulted in major advances in the development and modernization of payment and settlement systems and contributed to strengthening the liquidity and stability of financial markets in many Latin American countries.

High-value Payment Systems

In terms of liquidity and systemic risk, high-value payment systems are the most important due to the large value and time-sensitive nature of the payments. Referred to as real-time gross settlement (RTGS) systems, the transactions are settled irrevocably and unconditionally on a gross real-time basis. They are used for interbank and commercial funds transfers, as well as securities, foreign exchange and other financial transactions.

The Core Principles for Systemically Important Payment Systems, which were published in 2001 by the Bank for International Settlement's Committee on Payment and Settlement Systems, establish international standards for the design and operation of payment systems and help central banks around the world to establish the legal, regulatory and operational frameworks for the safe and efficient functioning of their national payment systems. While progress varies among countries, most of the central banks in Latin America have adopted, or begun to adopt, the Core Principles published in 2001. This includes making the necessary legal changes that permit, among other things, central banks to authorize, supervise and regulate private clearing houses for high-value and low-value payments.

To illustrate some of the progress that has been made, consider that the central banks in more than half the countries in the region have now implemented RTGS systems. These countries include: Argentina (1997), Bolivia (2003), Brazil (2002), Chile (2004), Colombia (1995), Costa Rica (1999), Ecuador (2004), Guatemala (2006), Mexico (1995 and 2004) and Peru (2000). Several other central banks in Central and South America are also planning to implement RTGS systems in the next few years.

The central banks of Argentina, Brazil and Chile also authorized the establishment of private sector high-value clearinghouses. Today there are three privately owned systems of this type in Latin America - Interbanking in Argentina (1998), Câmara Interbancária de Pagamentos (CIP-Sitraf) in Brazil (2002) and Cámara de Compensación Interbancaria (Combanc) in Chile (2005) – all supervised and regulated by their respective central banks. These private sector clearinghouses use a model similar to that of the Clearinghouse Interbank Payments System (CHIPS) in the United States. Because they utilize prefunding, bilateral and multilateral netting, banks are better able to manage their liquidity costs. End of day settlement of net positions is affected through participants' accounts at the central banks using their respective RTGS systems.

In Argentina, Interbanking is widely used by companies to make same-day interbank funds transfers, and more recently, to make federal tax payments. In 2005, when Argentina's federal tax authority (AFIP) made it compulsory for all large companies to make tax payments electronically, Interbanking became the primary channel through which most electronic tax payments are made.

Today approximately 80% of the value of AFIP collections is made through Interbanking. In 2004, Brazil's central bank instituted a maximum value of BRL 5,000 for interbank credit transfers using a Brazilian credit transfer instrument called the DOC (*documentos de transferência de crédito*). Companies in Brazil which previously used DOCs now make interbank credit transfers (in amounts equal or greater than BRL 5,000) using electronic transfers, referred to in Brazil as TEDs (*Transferências Electrônicas Disponíveis*). TEDs are typically processed through the CIP-Sitraf. In Chile, Combanc is used today primarily for interbank funds transfers in amounts greater than CLP 50 million. During 2007, the number of interbank funds transfers processed by Interbanking, CIP-Sitraf and Combanc were 18.46 million, 51.94 million and 760,000 respectively.

Low-value Payment Systems

Low-value payment systems include two main groups of payment instruments: cash and paper-based instruments (such as checks) and electronic payment instruments (credit transfers, direct debits, debit cards and credit cards). These are sometimes referred to as 'retail' payment systems although some of the payment instruments are used by both companies and consumers. These payment systems process large numbers of transactions.

In Latin America, as in other regions, debit and credit cards are mainly used by consumers with the exception of corporate credit cards which are used by some companies for procuring supplies and/or travel related services. However, one of the challenges Latin America has faced historically is the large number of adults without bank accounts. As economies have improved, governments and banks have undertaken initiatives to help bring more individuals into the banking system. As a consequence, the number of debit cards (and credit cards) has increased significantly during the past five years in countries throughout the region. However, the number of unbanked still remains above 50% of the adult population in many countries.

In terms of interbank electronic credit transfers and direct debits, many countries in the region have established automated clearinghouse (ACH) systems. In most Latin American countries, the ACH systems are privately owned and operated but authorized and regulated by the central banks. The exceptions are Colombia, Costa Rica, Ecuador and Venezuela where the central banks serve as operator of the ACH systems. In Colombia, besides the government-run ACH, there is a second privately operated system which is owned by the banks – ACH Colombia.

Countries that have implemented ACH systems for interbank electronic credit transfers and/or direct debits include: Argentina (2002), Bolivia (2006), Chile (1999), Colombia (1999), Costa Rica (2001), Ecuador (2002), Honduras (2007), Mexico (1996), Panama (1998), Peru (2001) and Venezuela (2007). Guatemala's new ACH system is in the testing phase and expected to become operational during the second half of 2008.

While the check is still a predominant payment instrument and widely used by companies in most countries (the exception being Brazil where companies commonly use the *bloqueto*), the new ACH systems have paved the way for private and public sector companies and governments to move from checks to electronic payments and collections. However, for a variety of reasons, the use of ACH systems established in the region during the late 1990s and early part of this decade got off to a slow start. Momentum was stalled by in-country or regional financial crises, absence of legislation governing electronic payments, cultural issues, resistance on the part of some banks to promote the ACH, and/or lack of interest on the part of companies and governments accustomed to paying vendors and employees by check (and even cash).

Because companies (and governments) are the main drivers and largest originators of ACH transactions in terms of both the number and value of transactions originated, they play a key role in increasing the usage of these systems. ACH systems also mean that companies are not restricted to making electronic payments in cases only where the company and its employee and/or supplier maintain accounts in the same bank.

The table below shows the number of interbank electronic credit transfers which were sent using ACH systems during 2004 and 2007. The growth trends of the last several years are positive and indicate that more companies and governments are migrating from checks to electronic payments.

Number of ACH Credit Transfers (in millions)

	2004	2007
Argentina	4.5	8.6
Chile	12.0	24.5
Colombia	12.9	42.0
Costa Rica	5.4	6.4
Ecuador	6.4	15.4
Mexico	12.6	18.8
Peru	0.2	1.1

Source: Central banks and ACH organizations

Despite the challenges, there are opportunities for companies and governments to increase the use of electronic payments.

It is important to note that the size of each country's economy, as measured by gross domestic product, varies significantly across countries in Latin America. And each country's banking system has its own unique characteristics and local practices. Consequently, country by country comparisons are difficult to make. For example, in 2007, Peru's banks reported some 56 million intrabank electronic transfers. Countries, like Peru, with a smaller number of banks and/or a large percentage of total banking sector assets concentrated with a few large banks will often have a larger number of intrabank payments than other countries. Nevertheless, the overall growth in ACH transactions, particularly in interbank electronic credit transfers, continues to increase steadily each year.

In the area of direct debits, frequently used by companies with a large consumer customer base (cable, insurance, water, gas, electric, etc.), the number of interbank direct debit transactions processed via ACH systems compared to the number of ACH credit transfers is significantly lower in all countries in the region. Many direct debits are still initiated by companies that send separate files to multiple banks within a country. As an alternative to direct debits, companies are also encouraging consumers with credit cards to make monthly payments via credit card.

Opportunities

Besides the introduction of new payment systems and cash management services, the players in the local banking sectors in many countries have changed considerably during the last five years. International banks such as BankBoston and ABN-Amro that were once prominent in providing local country and regional cash management services sold their South American operations while Citibank, HSBC and Scotiabank have expanded their presence through the acquisition of local banking groups in a number of Central and South American countries. Other international banks in the region offering local and regional cash management services include Spain's Santander and BBVA. At the same time, many of the region's large domestic-owned local country banks have consolidated and expanded their positions through acquisitions or mergers.

Local governments and companies operating in Latin America, including multinational companies with subsidiary operations in the region, need to assess and review their in-country cash management operations on a regular basis to be sure they are taking advantage of the most efficient payment and collection methods available. For multinational companies, it is also a good idea to evaluate local country and regional cash management banking partners on a regular basis. Despite the challenges, with all the positive changes in the region, there are almost always opportunities to increase the use of electronic payment methods and to reduce costs. ■

This article was published on *GT News* in June 2008.

About the Author

NLRussell Associates (NLR) is an international cash and treasury management consulting firm that specializes in working with companies and banks that have operations in Latin America and/or the United States. The company was founded in 1999 by Nancy Russell with the objective of providing clients with a unique and specialized consultancy.

Prior to 1999, Ms. Russell worked at BankBoston where she served as Division Executive, Global Cash Management Sales and Regional Director, Latin American Cash Management from 1991 through 1998. She also held senior management positions at Mellon Bank and Chase Manhattan Bank.

Ms. Russell has been working in the Latin American region since 1994 and continues to travel and work in countries throughout the region. She is fluent in Spanish.

NLR clients include some of Latin America's largest and most prestigious local and international banks as well as multinational companies with subsidiary operations in Latin America.

Phone: 1-617-247-2664
Fax: 1-617-424-6361
www.nlrussellassociates.com