

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
- Directive 1/2006 (May 4th, 2006)

- **July 2006**

- Agreement BC – SDE – SEAE

- **September 2006**

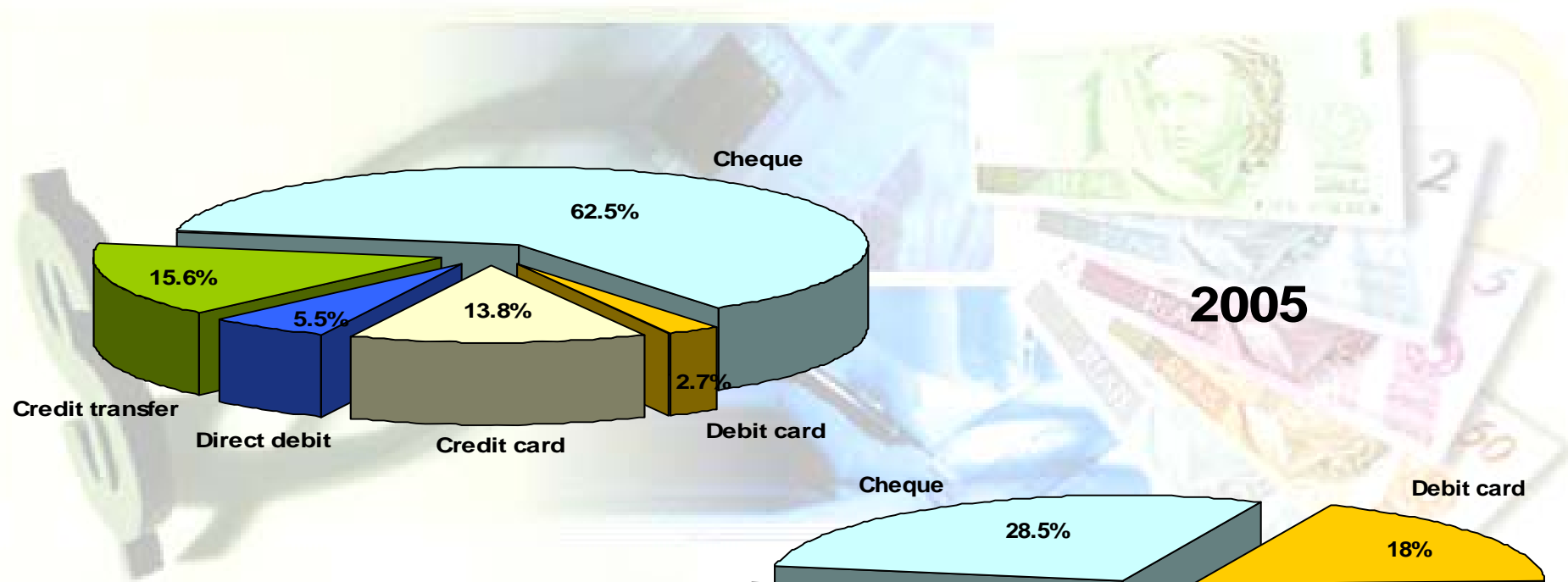
- Payment card industry data collection

Report on the Brazilian Retail Payment System

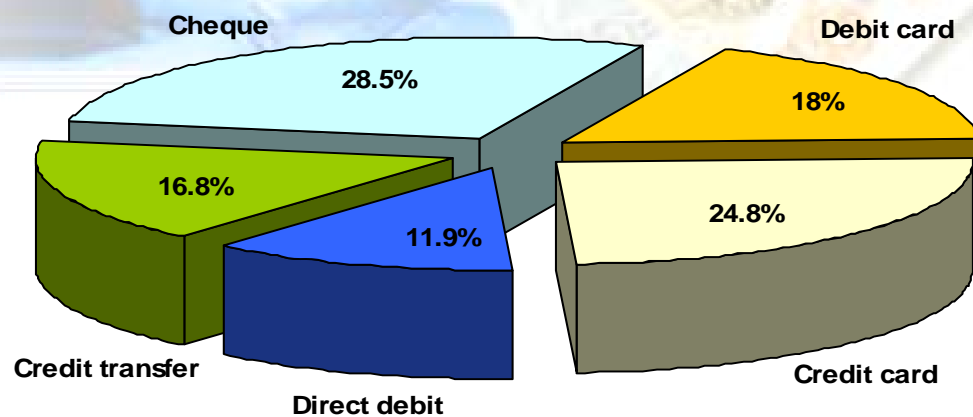
- Describes and analyses the Brazilian Retail Payment System aiming at finding the determinants for its modernization and serving as a benchmark for policies and directives
- Main findings:
 - Large-scale usage of paper-based instruments
 - Infrastructure for clearing and settlement of retail payments is fragmented
 - Low infrastructure interoperability among payment instruments distribution channels

Non-Cash Payment Instruments – Volume Relative Share – Brazil

1999

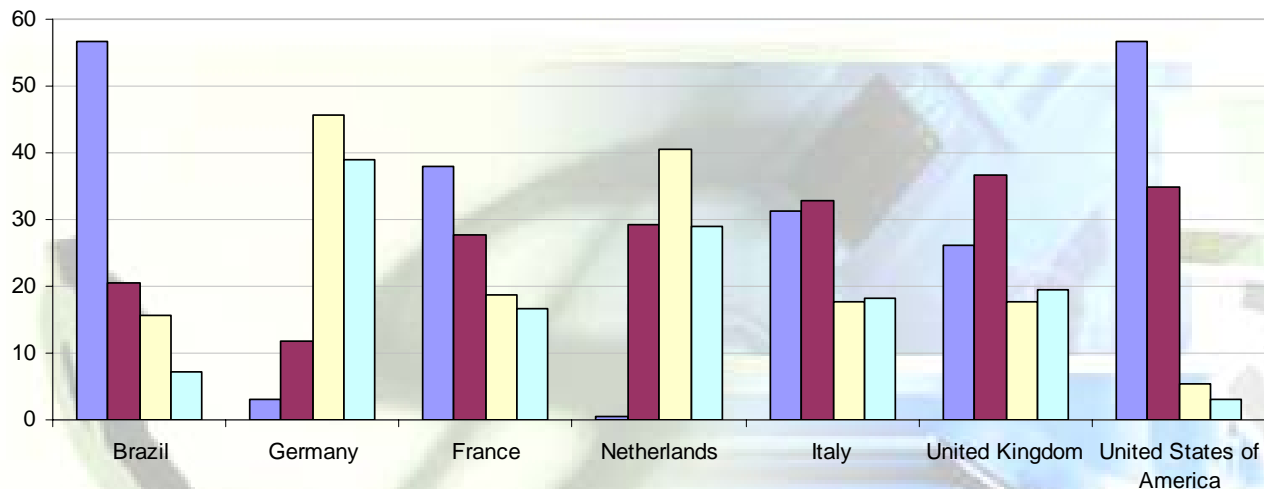


2005



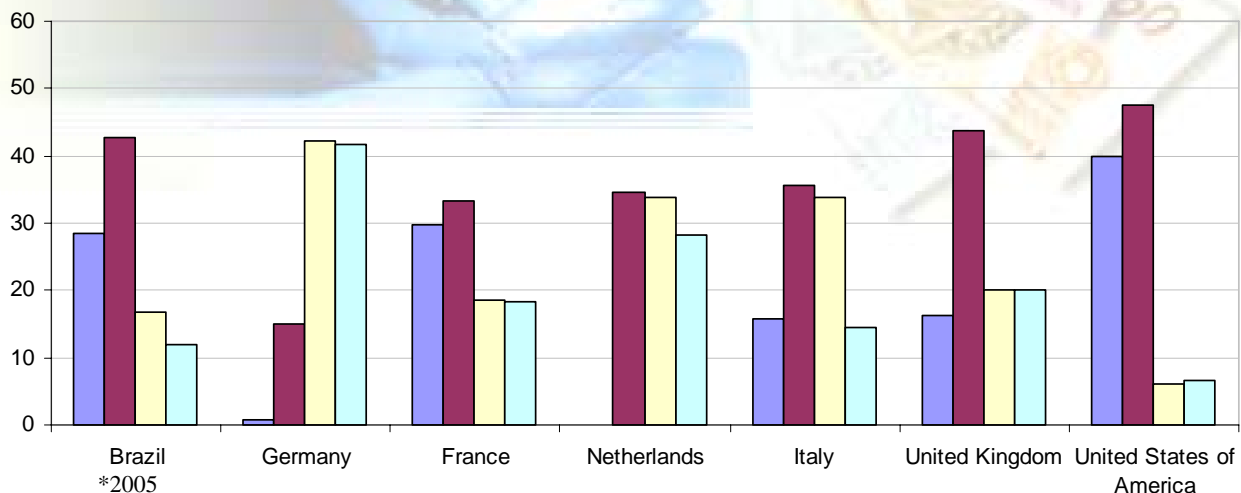
Non-Cash Payment Instruments – Volume Relative Share – Selected Countries

2000



2004

- Cheque
- Plastic Cards
- Credit transfer
- Direct Debit



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

Directive 1/2006, May 4th, 2006

- **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 \Rightarrow knowledge of banking services and mission of guaranteeing National Financial System's soundness
- BC, SDE e SEAE \Rightarrow in charge of regulating antitrust issues: anti-competitive conducts and merger actions

BC – SDE – SEAE's Agreement – Objectives

- **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

Report on Payment Cards Industry

- 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**

Report – Data Collection – Target Population (cont.)

- **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

Report – Data Collection – Preliminary Meetings (Cont.)

- **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
 - Australia (2000), United Kingdom (2000), The Netherlands (2002)
 - In monitoring payment cards market
 - Spain (1999), US (1986), Chile (2004), Norway(2004)
 - In directly regulating payment cards market
 - Australia(2002), Chile(2004), The Netherlands(2004), Mexico(2004)
- 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

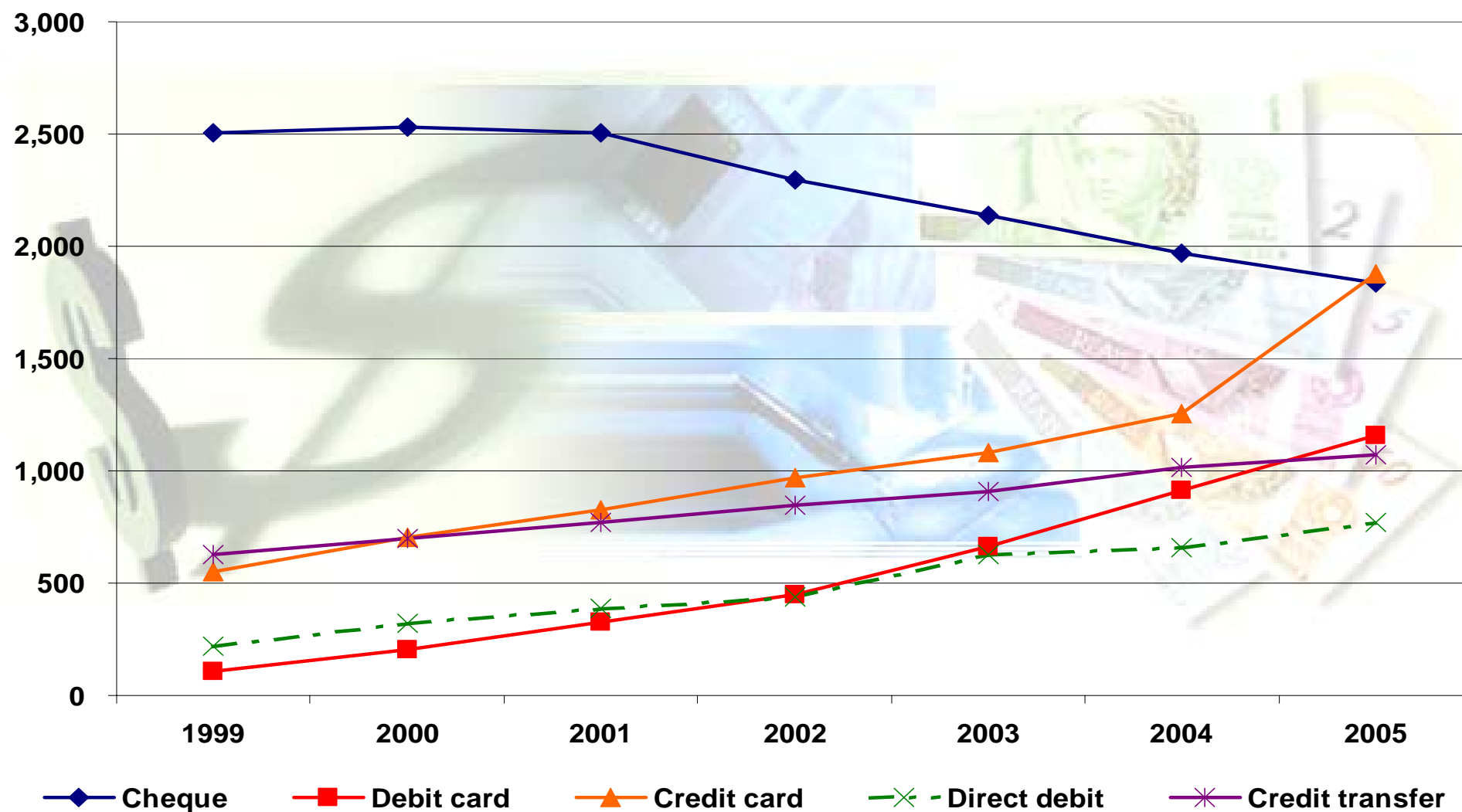
- Banco Central de Chile and *Fiscalia Nacional Econômica*
 - Banco Central de Chile is the payment cards system regulator – *Compendio de Normas Financieras* (1989)
 - Focus on market behavior (antitrust practices) and on market structure
 - Direct intervention in the Transbank S.A (only acquirer) owned 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

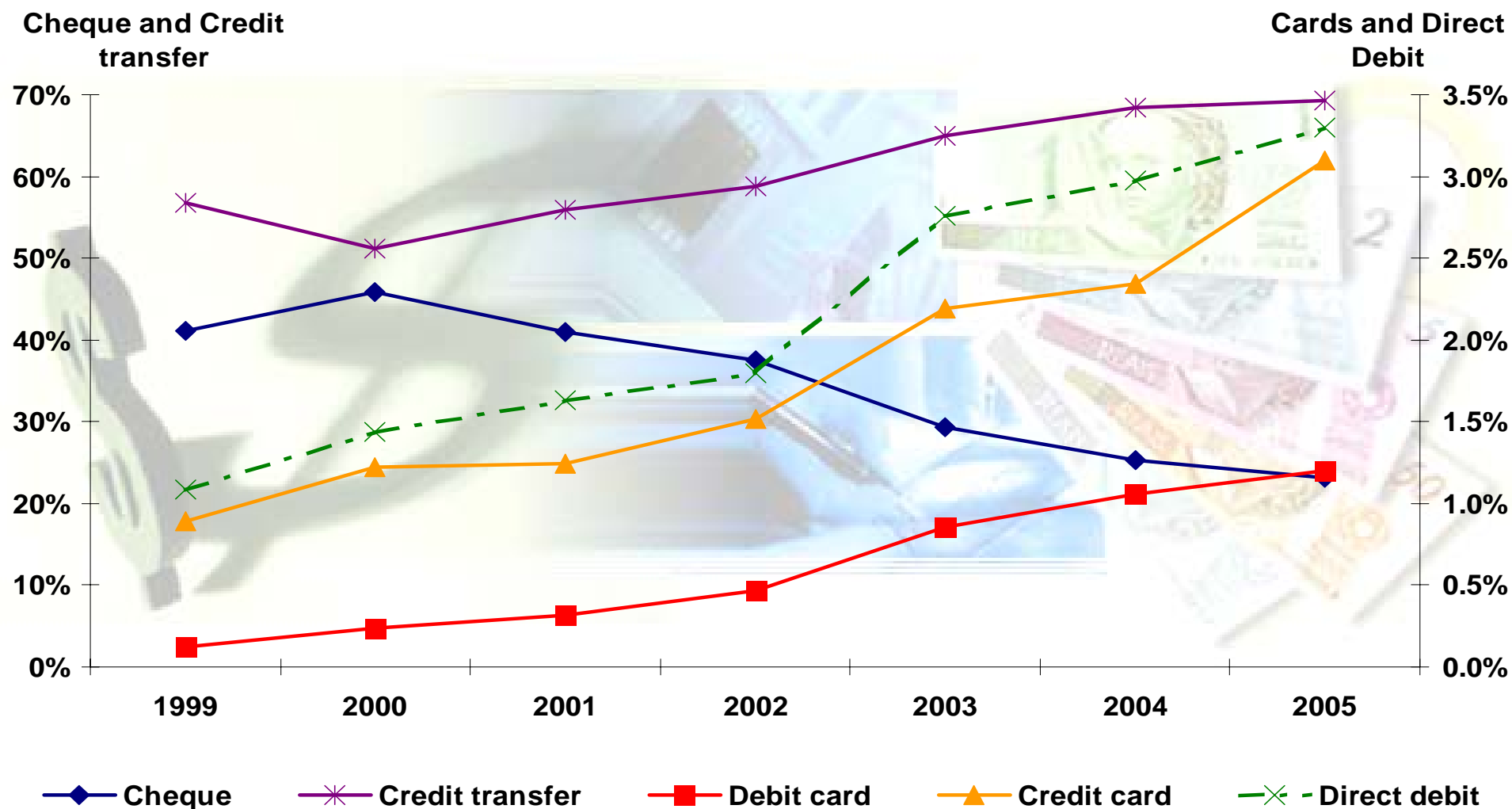
- *Reserve Bank of Australia (RBA) and Australia Competition and Consumer Commission (ACCC)*
 - Analysis and diagnosis of the market (RBA, 2000)
 - Focus on interchange fee and on merchant discount
 - RBA is the payment cards system regulator – *Payment Systems Act (1998)*
 - In 2003, regulation of the 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

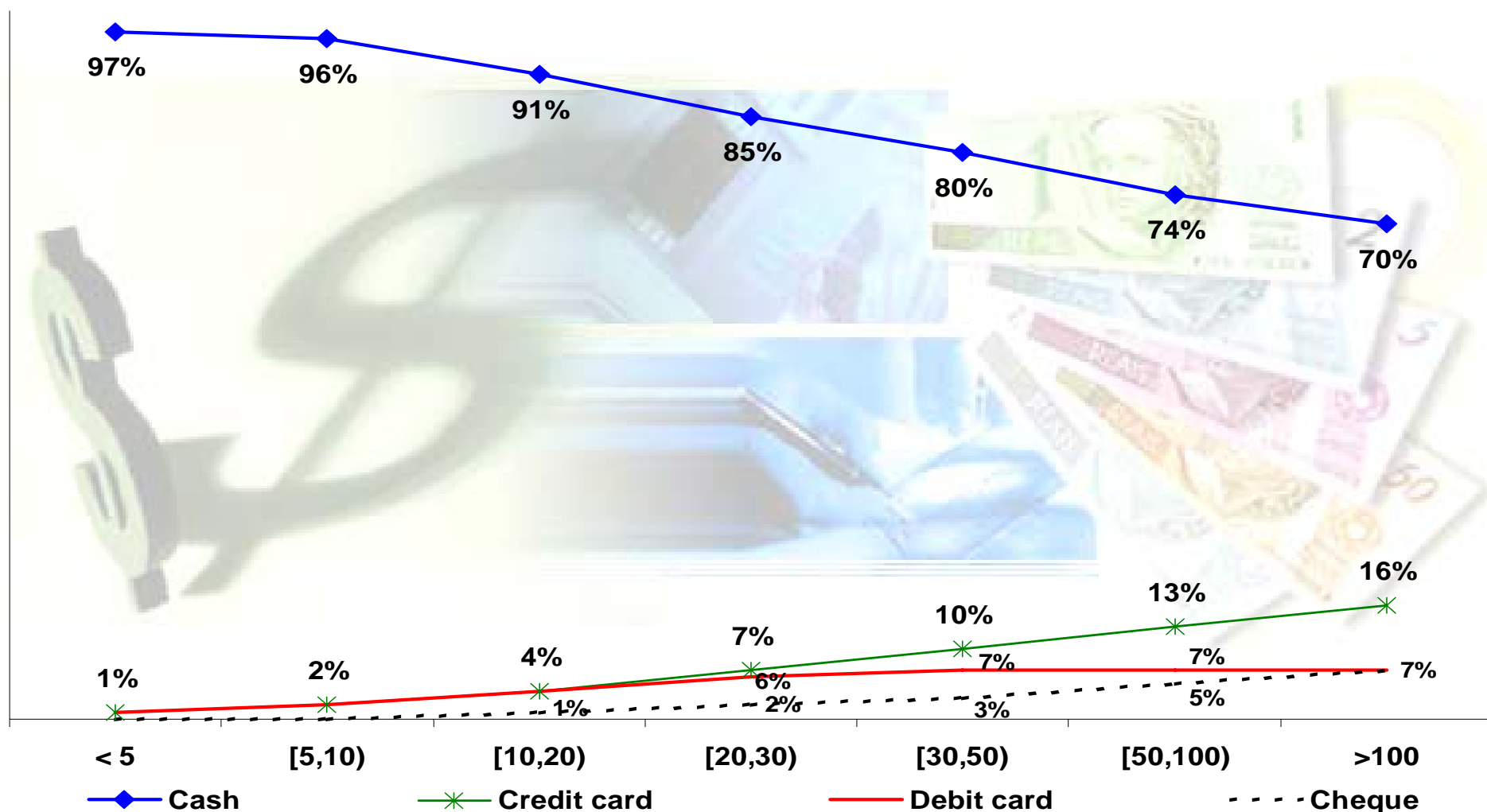
Total volume in millions – Brazil



Non-cash instruments – Value Relative share – Brazil



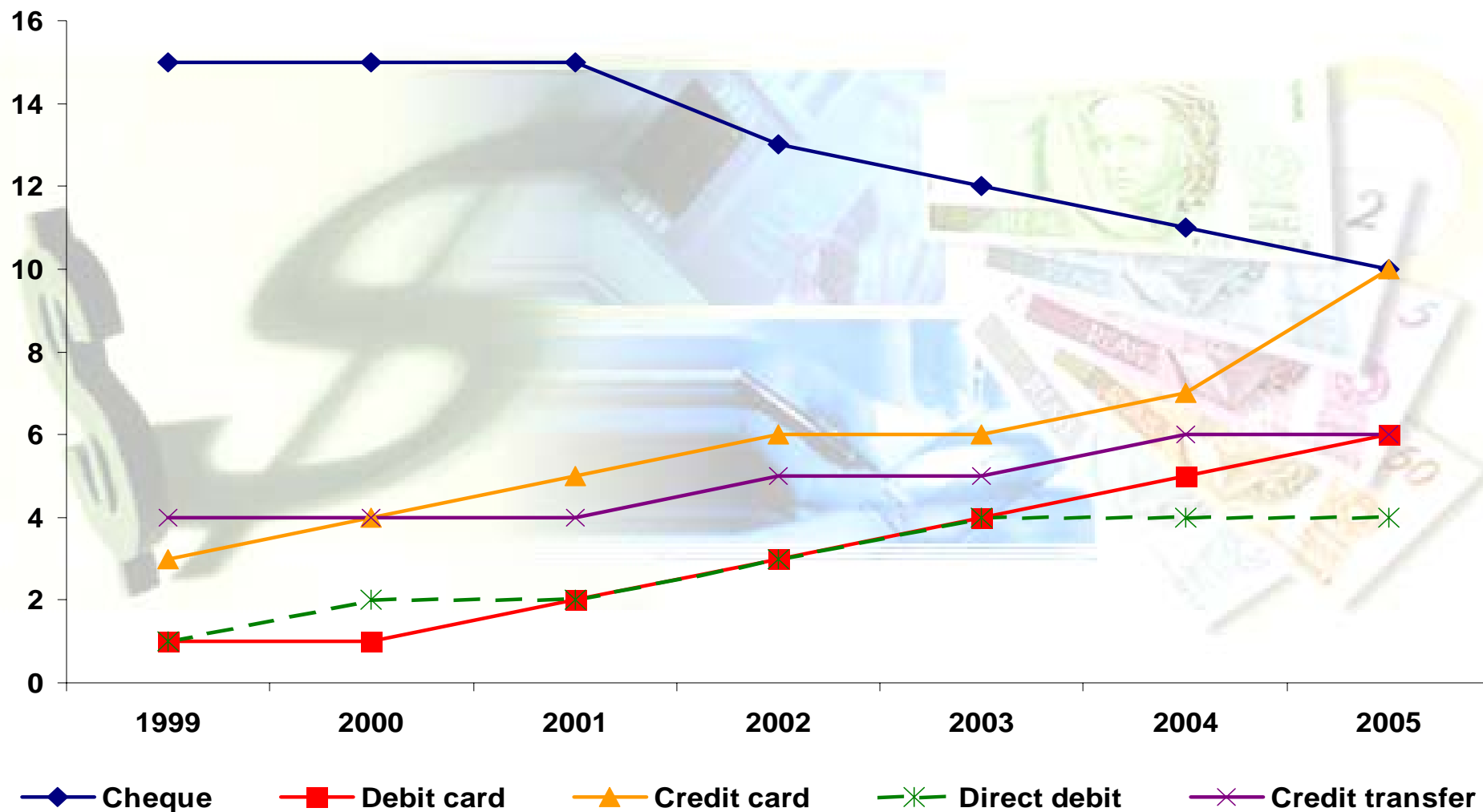
Payment instruments – Relative share per value range in R\$ – Brazil – 2005



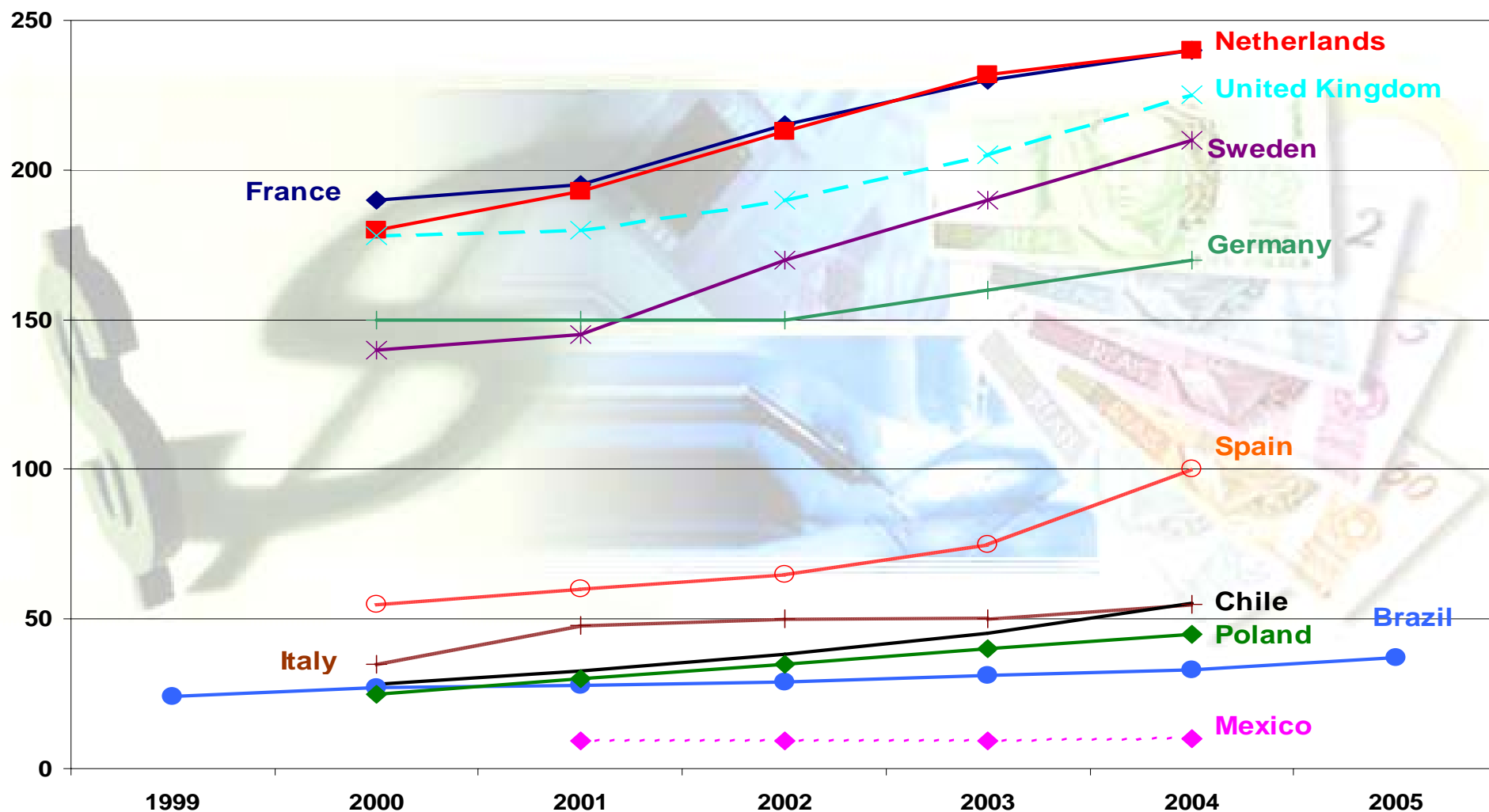
Source: Survey "O brasileiro e sua relação com o dinheiro", performed by DataFolha, in August, 2005. Average Exchange rate, 2005: R\$/US\$=2,43

Payment instruments

Yearly average quantity per inhabitant – Brazil

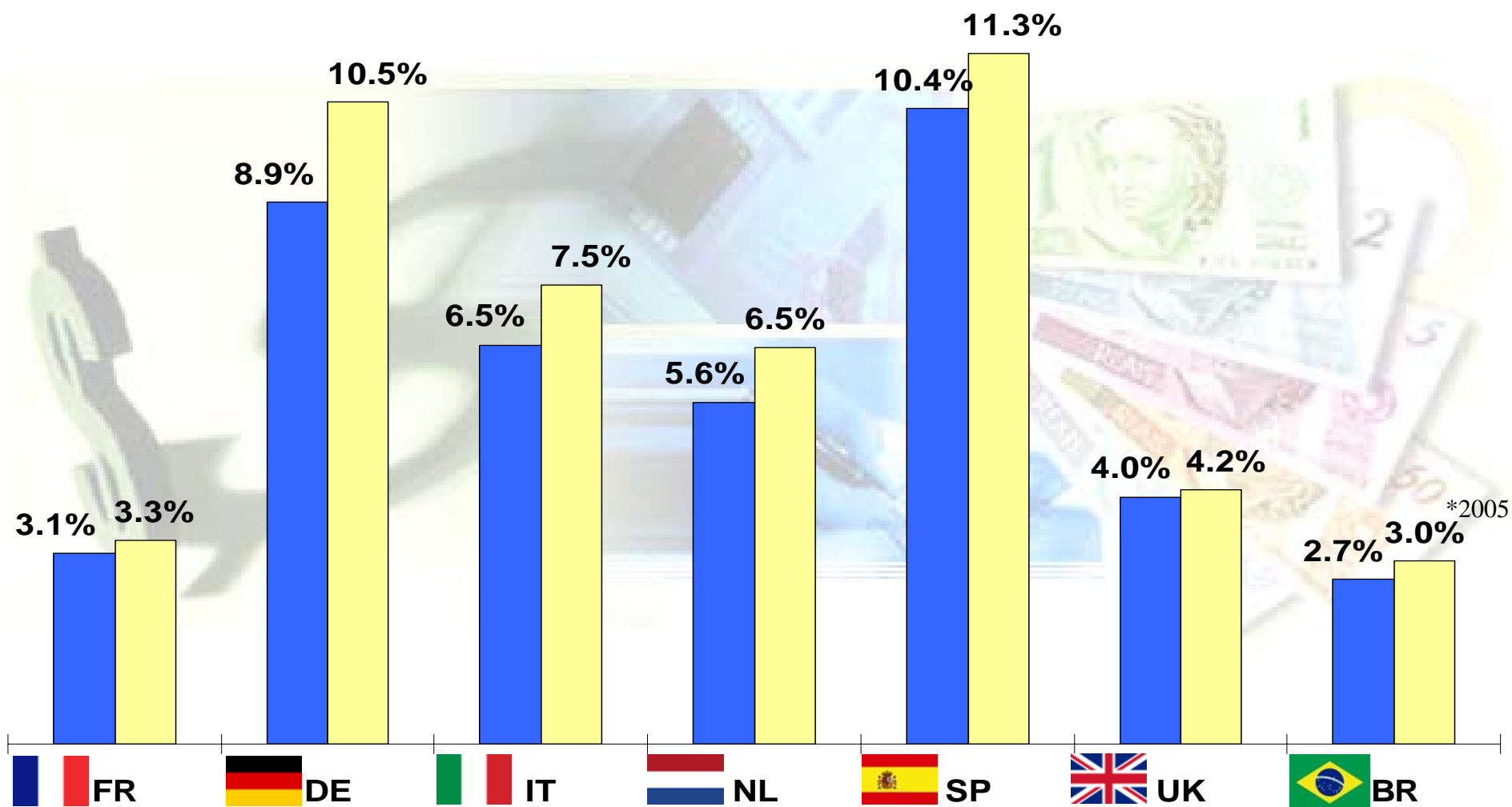


Non-cash payment instruments – Yearly average number of transactions per inhabitant – International Comparison



Source: *World Payment Report 2006*, Capgemini ABN-AMRO/EFMA, Banco Central do Brasil and *Yellow Book*

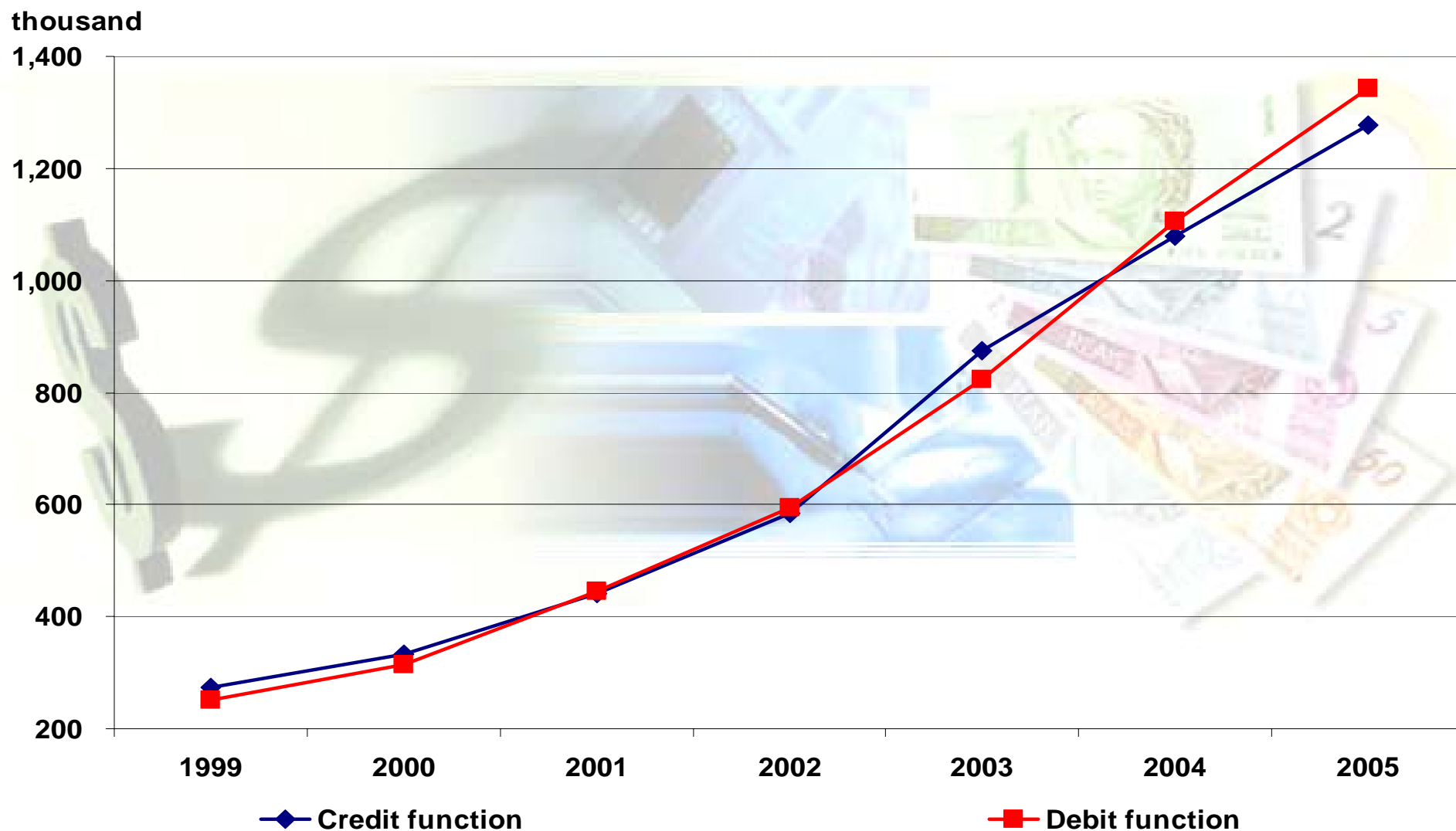
Coins and notes held by the public (% of GDP) International Comparison – (2003 versus 2004)



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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