



## **Update on Regulation of Branchless Banking in Brazil**

**January 2010**

Note: This update of CGAP's 2008 "Notes on Regulation of Branchless Banking in Brazil" incorporates research conducted by CGAP in January 2010 regarding relevant legal and policy changes through the end of 2009. It is one of 11 similar country updates produced by CGAP as a part of the work plan of the Access through Innovation Sub-Group of the G-20 Financial Inclusion Experts Group. However, CGAP alone is responsible for its content. Corrections may be forwarded to [yseltzer@cgap.org](mailto:yseltzer@cgap.org).



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### 1. Introduction

Brazil has a long history of bank outsourcing. This area has benefited significantly from the central bank's supportive regulation governing the use of agents, which has resulted in an increase in access to financial services such as bill payments, transfers, and deposits. Most significantly, there is at least one agent or branch office of a prudentially licensed and supervised bank in each of the country's 5,564 municipalities.

However, there are still obstacles to the expansion of banks' use of agents to deliver credit and savings to poor people. For example, "simplified accounts," which can be handled by agents, are subject to various transaction limitations that restrict profitability, interest rate caps and other account-related costs render microcredit unprofitable for banks, and there is poor credit information available for lower income borrowers. Additionally, unintended consequences of widespread outsourcing threaten the continuity of the agent model itself. There have been a variety of legal demands such as unions seeking wage equality between bank employees and agent employees and other government agencies dealing with matters such as physical security of agents. The central bank is analyzing the potential impact of these legal demands, but has not yet proposed or implemented changes addressing these or the other obstacles.

In contrast to the use of retail agents by banks (known as "bank-based branchless banking"), nonbank-based branchless banking is only in its incipient stage in Brazil. However, there is remarkable space for nonbanks to compete for customers with low-value accounts, since approximately 70 percent of the adult population still lacks access to bank accounts.<sup>3</sup>

### 2. Sector Overview

Most low-income and unbanked Brazilians participate in the country's enormous informal economy which employs approximately one-fourth of the urban population.<sup>4</sup> There is no integrated national identification system, and many people do not have official identification documents. (There are no official or recent estimates of this number.) The only nationwide document is the taxpayer number, which is commonly required for opening an account.

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<sup>1</sup> The 2008 "Notes on Regulation of Branchless Banking in Brazil" was based on an analysis of existing legislation and regulations relevant to branchless banking approaches and on the CGAP research team's insights from interviews with a range of stakeholders. The original diagnostic assessment was carried out under the auspices of CGAP's Technology Program, which is co-funded by the Bill & Melinda Gates Foundation. The Brazilian diagnostic assessment was one of seven that provided evidence for CGAP & DFID's Focus Note 43, *Lyman, Timothy, Mark Pickens, and David Porteous. 2008. "Regulating Transformational Branchless Banking: Mobile Phones and Other Technology to Increase Access to Finance."* Washington, D.C.: CGAP & DFID, January."

<sup>2</sup> In September 2009, the G-20 called for the establishment of a Financial Inclusion Experts Group with two subgroups, one of which is the ATI Sub-Group. CGAP is a member of an experts group assembled to assist the ATI Sub-Group. CGAP's work will include updating information previously published on the policy and regulatory framework for branchless banking in various developing countries.

<sup>3</sup> This is based on anecdotal evidence; there are no official sources to verify this number.

<sup>4</sup> Instituto Brasileiro de Geografia e Estatística—IBGE: *Economia Informal Urbana 2003*.



The penetration of technology in the daily life of poor people is increasing. Internet access increased from 3 percent in 2003 to over 37 percent in 2008. The ability to own personal computers has been hindered by high prices, and the number of broadband Internet subscribers is still low (5.26 percent of total population).<sup>5</sup> However, as of January 2010, 88 percent of Brazilian municipalities have broadband, and the number of Internet users is expected to increase exponentially.<sup>6</sup> The most pervasive form of communication technology is prepaid mobile phones, which have been heavily subsidized by mobile network operators (MNOs)—mobile phones can be purchased for as little as US\$ 0.50 (although calls are still relatively expensive for the poor).

There is a preference for paper, and there is little understanding of electronic means of payments. Many factors contribute to this paper-based culture and a population that has a high percentage of uninformed and unbanked: low levels of literacy, lack of identification in low-income segments, high bank fees, relatively high prices for mobile phone calls, non-interoperable retail payment systems (especially point-of-sale [POS] networks), a long inflationary history that nurtured the cash culture, and some distrust of banks remaining after numerous bank crises.

In a cash-based society like Brazil, demography plays a crucial role in the economic viability of the agent model. The population is concentrated in urban areas which are, in turn, highly concentrated along the coastline. Banks subsidize losses (usually linked to the costs of cash management) of the agents in remote locations with the gains of numerous profitable agents in densely populated areas. The use of technology—such as electronic accounts stored in mobile phones to substitute cash—has great potential to lower the costs of cash handling in this context and enlarge the agent network.

## 2.1 Financial Inclusion

The government's policy for financial inclusion (which has not been formalized in a document), rests on two pillars: microfinance and retail agents. Initiatives by the government to expand the credit offer to low-income customers (traditionally offered by credit cooperatives<sup>7</sup> to their more than 3 million members) includes (i) the requirement (imposed since 2003) that commercial banks direct 2 percent of their demand deposits to microcredit (as defined in specific regulation) and (ii) the regulation of payroll consigned loans.

Banks can satisfy the directed lending requirement by originating microloans, transferring the amount to other institutions for the same purpose (using Interbank Microcredit Deposit Certificate), or acquiring microcredit portfolios from other entities, including nongovernment organizations. The amount that a bank fails to invest must be deposited in CBB without remuneration. In addition, the government has issued rules to enable banks to make payroll-consigned loans, the fastest growing line of business, which are channeled chiefly through nonbank agents.<sup>8</sup>

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<sup>5</sup> International Telecommunications Union, 2010 data. <http://www.itu.int/ITU-D/icteye/DisplayCountry.aspx?countryId=27>

<sup>6</sup> Anatel, Notícias. 88 percent dos municípios brasileiros têm infraestrutura de banda larga, 13 de January de 2010. <http://www.anatel.gov.br/Portal/exibirPortalInternet.do#>

<sup>7</sup> There are approximately 1,450 credit cooperatives, which are prudentially regulated and supervised by CBB. Although cooperatives in Brazil are considered part of the microfinance movement, they often fail to cater to the lowest income levels.

<sup>8</sup> Law 10820/2003 (Crédito Consignado). A payroll-consigned loan is repaid directly out of the borrower's salary.



However, there is a low level of compliance with the 2 percent earmark.<sup>9</sup> The banking sector states that the interest rate ceiling is too low in light of (i) the lack of comprehensive credit information on low-income borrowers,<sup>10</sup> (ii) high reserve requirements (approximately 45 percent of demand deposits), and (iii) the high interbank rate (although it has been decreasing considerably in the last few years). These hurdles and other challenges (e.g., high administrative costs across the banking sector and frequent robberies of branches) produce an average banking spread (i.e., the difference between the applicable interest rate and the interbank rate) that is one of the highest in the world.

Parallel to efforts on the credit side, in 2004 CBB permitted a new special type of bank account—the simplified account—which is primarily offered by retail agents.<sup>11</sup> In 2004, 4.16 million simplified accounts were opened. These accounts, which can be held only by individuals who do not have other bank accounts, have a maximum balance of R\$1,000 (approximately US\$500) or, if the depositor has a microcredit account, then the maximum is R\$3,000 (US\$1,500). In addition, banks cannot charge for the first 12 transactions per month, and there is no maintenance fee. The accounts are subject to a relatively relaxed customer due diligence procedure compared to regular checking accounts.

According to private and government banks, these accounts are unprofitable due to (i) the complex transactional limitations imposed by the regulation (which require system and process adaptations by banks), (ii) the absence of fees, and (iii) the limitations of the microcredit business (only microloans can be channeled through simplified accounts).<sup>12</sup> As a result, the overwhelming majority of simplified accounts have been opened by Banco Popular (a brand of Banco do Brasil) and Caixa Econômica Federal (Caixa), both state-owned banks, given their commitment to the government's financial inclusion effort. As of October 2009, 5.76 million of a total of 10.25 million accounts were active, 99.73 percent of which were checking accounts with an average balance of R\$36.55 (US\$ 19.9).<sup>13</sup>

The Ministry of Development has an ambitious financial inclusion plan targeting Bolsa Familia, the largest conditional cash transfer program in Brazil, and their families (around 45 million people). Bolsa Familia delivers monthly allowances to the poorest 12 million families, mainly by using Caixa's agents. The Ministry believes that financial access could help beneficiaries build up assets through savings and credit, to a point where they are able to exit the cash transfer program. The first step will be to offer simplified bank accounts and roll out information campaigns. Over 1 million beneficiaries opened a simplified account since the beginning of the project in 2009. The Ministry believes 6 million new accounts will be opened by the end of 2010. The second phase of the program will offer credit to eligible microentrepreneurs within the target population. The Ministry also will be conducting a baseline survey on financial capability and gathering data on the use of formal and informal financial services by poor people in Brazil.

## 22 The Banking Sector

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<sup>9</sup> Marques, Marden S. e Sobrinho, Abelardo D. de M. (2007), *Microfinanças: O Papel do Banco Central do Brasil e a importância do cooperativismo de crédito*. Brasília.

<sup>10</sup> There is no specific legislation for credit bureaus and their ability to collect payment information from entities outside the financial system, such as public service companies, for example. Many bills address this issue, but none is expected to pass soon.

<sup>11</sup> Resolution CMN 3211/2004, Resolution CMN 321 3/2004, and Resolution CMN 3260/2005.

<sup>12</sup> The following factors affect the appeal of the microcredit business: (i) interest rate caps set by regulation, (ii) size and term limitations set by regulation; (iii) poor credit information on potential microcredit borrowers; and (iv) other indirect costs on lending overall, such as the high reserve requirements imposed on commercial banks.

<sup>13</sup> CBB, Microcredit Statistics, October 2009, available at <http://www.bcb.gov.br/?MICROFIN>. Accessed on January 19, 2010.



The Brazilian banking industry is generally regarded as one of the most technologically advanced in the world. Hyperinflation and high interest rates in the 1980s led to the development of a communication system that enabled fast and reliable check clearing and bill payments. Brazil is a bank-centric economy, with most of financing and payments streaming from the 156 banks operating in the country.<sup>14</sup> However, only approximately 30 percent of the adult population has bank accounts (there were 125.7 million checking accounts<sup>15</sup> in 2008 and an estimated 40 million account holders—including the accounts of legal persons—against a total population of 191.9 million).

Over 90 percent of the total noncash bank retail payment transactions in 2008 were processed via electronic channels, with increased use of the card as a payment instrument. The numbers of automatic teller machines (ATMs) and POS devices per 100,000 inhabitants (40.5 and 1,667, respectively) are significantly higher than in most Latin American countries, but the number of POS relative to the total population is still below the average in industrialized economies. The Central Bank of Brazil (CBB) has been using persuasion instead of regulation to push for interoperability of POS and ATM networks to increase coverage, but progress has been slow. Noncompetitive pricing is thought to have adversely affected the expansion of POS networks. Consequently, CBB led a joint study with the competition authorities to investigate pricing practices in the card industry. The report was made public in March 2009, but it does not recommend any specific regulatory action.<sup>16</sup>

Internet and mobile banking are currently restricted to bank account holders.<sup>17</sup> All of the largest banks provide mobile phone banking, yet interoperability is hindered by disagreement between banks and MNOs regarding both technology and profit-sharing. The discussion on technology revolves around three options: (i) MNOs using a common platform; (ii) banks having to purchase and install different platforms for different MNOs; and (iii) banks having to use third-party switch services. In terms of profit-sharing, the discussion centers around whether an MNO will receive anything beyond the charge for telecommunications services, which in fact is all that MNOs are currently providing. Interoperability in mobile banking is a topic being negotiated between bank associations and MNOs without CBB involvement.

CBB has had talks with the National Agency of Telecommunications (Anatel) about the entrance of MNOs into mobile banking in order to set minimum requirements, but there is little coordination on this subject among the various departments of CBB or between CBB and Anatel. In fact, Anatel has shown little interest in intervening in mobile banking precisely because CBB is the competent authority for financial services. Nonetheless, in 2006 Anatel conducted research (“Micro Top-up”) that analyzed mobile banking models in other countries and it published preliminary conclusions: (i) there are no technological barriers for micropayments and airtime transfers between users; (ii) these services are highly

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<sup>14</sup> Buscabanco, Federação Brasileira de Bancos—Febraban, 2009. <http://www.febraban.org.br/buscabanco/>

<sup>15</sup> Ciab Febraban 2009—“Bancarização” Coletiva—O Setor Bancário em Números. Federação Brasileira de Bancos—Febraban, 2009.

<sup>16</sup> Relatório sobre a Indústria de Cartões de Pagamentos, Banco Central do Brasil, Secretaria de Acompanhamento Econômico and Secretaria de Direito Econômico, 2009.

<sup>17</sup> Mobile phones cannot be used to perform foreign exchange transactions or to pay housing loans or other large value loans (the specific amount being determined by each bank in its sole discretion).



desirable in terms of social impact; and (iii) the lack of interoperability of mobile phone services poses challenges in the long run.<sup>18</sup>

*The use of retail agents.* The framework for retail agents was created in the 1970s and reformed in 1999 to increase efficiency in the area of welfare payments.<sup>19</sup> Prior to 1999, the following services could be outsourced to agents: receiving loan applications, analyzing credit and personal information of loan applicants, collecting loan payments, and processing data. The 1999 reforms expanded this list to include receiving account opening applications, performing deposits and withdrawals, and effecting bill payments. Based on the 1999 regulation, Caixa Econômica Federal partnered with over 9,000 lottery outlets in what became the first large-scale retail agent scheme in the country. Further regulatory changes in 2000 removed the prohibition on banks using agents in locations with bank branches.<sup>20</sup> In response, Caixa rapidly covered all municipalities in the country, signing up other types of retail agents beyond lottery outlets. By year-end 2000, the total number of agents being used by banks reached 64,000. New regulations were issued in 2003 as part of the government's financial inclusion policy, permitting any financial institution to hire any type of agent.

Today, there are more than 150,000<sup>21</sup> registered agents throughout the country delivering financial services on behalf of CBB-licensed and supervised entities, including credit cooperatives. (This figure represents a remarkable 60 percent increase in two years, from approximately 95,000 agents at the end of 2007.) Two major banks (Caixa and Banco Postal) cover every municipality in the country. Most agents are commercial establishments, such as grocery stores, post offices, notaries, and lottery outlets, but a financial institution may also act as an agent. Agents conducted 2.3 billion transactions in 2008.<sup>22</sup> This represents 5.24 percent of the 43.9 billion total bank transactions, up from 4.75 percent in 2003.<sup>23</sup> Branch transactions, which used to represent around 20 percent of all bank transactions, now represent only 10 percent. (ATMs are the most used electronic channel.)

Agents offer several types of services, from bill payments to account opening procedures, but less than 30 percent of the agents handle bank accounts.<sup>24</sup> Most specialize in receiving bill payments, which account for approximately 75 percent of all agent transactions (47 percent of which are utility bill payments).<sup>25</sup> Withdrawals and deposits account for 12.6 percent and are nearly equally divided into savings and current accounts (including simplified accounts). Only 0.16 percent of the transactions are account opening; 7.3 percent are government transfers.<sup>26</sup> Moving and protecting cash is costly, risky and time-consuming. According to research conducted by CGAP and the Fundação Getulio Vargas business school, 41 percent of agents have been robbed in the past three years.<sup>27</sup> To shield against this expense, banks have

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<sup>18</sup> Agência Nacional de Telecomunicações—Anatel, Gerência Geral de Comunicações Pessoais Terrestres: Projeto Micro-Recarga no Serviço Móvel Pessoal—SMP. Relatório Parcial—Produto I, Julho 2006. Two policy papers resulting from the study will be released soon.

<sup>19</sup> Resolution CMN 2640/1999.

<sup>20</sup> Resolution CMN 2707/2000. Previously, agents could be used only in places with no bank branches at all.

<sup>21</sup> CBB, as of January 2010.

<sup>22</sup> Febraban, "Dados do setor bancário, 2009."

<sup>23</sup> Ibid.

<sup>24</sup> CBB, Financial Inclusion Project.

<sup>25</sup> Data provided by Febraban (accumulated from January to June 2008).

<sup>26</sup> Ibid.

<sup>27</sup> "Agent Networks in Brazil." Powerpoint presentation by CGAP and the Brazilian business school, FGV (Fundação Getulio Vargas EAESP, Escola de Administração de Empresas de São Paulo), dated 15 Feb. 2010

instituted very low limits for cash that agents may have on hand. As a consequence, agents have to go to the bank several times per day.<sup>28</sup>

Caixa Economica Federal (Caixa) is the leader in opening accounts via its 13,712 agents.<sup>29</sup> Agents in the poorest regions (North and Northeast) specialize in bill payments and welfare payments, while those that also receive loan applications are preponderant in wealthier regions. Customers may or may not have a bank account and can transact in any point of assistance of the bank, typically using cash or debit cards, although only bank account holders can receive payment transfers.

Agents are used for various reasons. Usually the reasons include a mix of cost-cutting (agents have become the cheapest way to reduce congestion in branches and avoid the fines that are imposed when customers are left waiting in line for more than a certain amount of time) and enlargement of the client base through geographic expansion. Caixa and Banco Postal, a joint venture between Banco Bradesco (the second largest private bank) and the postal service, have the largest agent networks. As of December 2007, Banco Postal had opened more than 5 million new checking accounts since 2002 through over 5,460 postal points. Four of the largest banks transact extensively with agents, but some banks (notably Banco Itau, the largest private bank) have not incorporated agents into their commercial strategy. Banco do Brasil entered a partnership with Lemon Bank in July 2009 in which all Lemon Bank agents will provide services on behalf of Banco do Brasil and its Banco Popular brand (used by Banco do Brasil for its low income market). This will allow Banco do Brazil to expand its agent network by 70 percent.<sup>30</sup> ABN Amro and Banco Popular are experimenting with microcredit through this channel.

The agent networks can be managed directly by the bank or outsourced to a third party, which is then considered an agent by CBB (and referred to as a network manager). Network managers provide a wide range of services, including selection of agents, training related to Anti-Money Laundering/Combating Financing of Terrorism (AML/CFT), maintenance of POS, software development, cash handling, and marketing. The network managers often respond to the bank for the actions of the agents in their network.

The CBB collects information from several of the major agent schemes (on an ad hoc basis only, as the overall risk of the agent business is deemed low) as a means to inform regulatory action. It is currently preparing changes in the agency regulation that will address existing shortcomings as well as the main risks observed through supervision (such as reputational risk). Through its supervisory process, CBB has also identified breaches of some consumer protection rules in the agent business. These include agents charging extra fees and not disclosing fees, not disclosing their agent status, advancing cash to clients and guaranteeing loans, selling client's information to third parties, and committing fraud (e.g., keeping clients' funds and not making bill payments). In all cases identified so far, the banks have assumed responsibility for the misdoings of their agents. Although CBB does not consider these to be widespread problems, it has stiffened requirements on banks' internal controls with regard to agent operations and has issued additional consumer protection rules, such as requiring agents to have signage with the number of bank ombudsman (See 3.6). It also has recently conducted

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<sup>28</sup> Despite all this, many merchants feel they must be an agent to boost their foot traffic. 96 percent of agents say losing their status as an agent would have a negative impact on their main business. Id.

<sup>29</sup> CBB, as of January 2010.

<sup>30</sup> Banco do Brasil Acquires Banco Lemon Correspondent Branch Network. July 16, 2009: Business Wire. [http://www.businesswire.com/portal/site/home/permalink/?ndmViewId=news\\_view&newsId=20090716006343&newsLang=en](http://www.businesswire.com/portal/site/home/permalink/?ndmViewId=news_view&newsId=20090716006343&newsLang=en). Partnership still not in full implementation.

a data gathering exercise focused specifically on consumer protection issues in the agency business to identify regulatory gaps and proportionate approaches to addressing them.

The agent model has not only brought convenience and safety for low-income families that receive government benefits<sup>31</sup> and others accessing basic bank services such as bill payments, but it has also worked as an economic development tool for isolated communities. Instead of shopping in the cities where they would have traveled to receive their benefits, benefit recipients withdraw cash, pay bills, and shop locally. However, the model has not yet been as successful in channeling microcredit and savings. A few banks, notably ABN Amro and Banco Popular, are experimenting with microcredit through agents. The results of the main provider (Banco Popular) so far have been poor, particularly in terms of default rates.<sup>32</sup> The reasons (as identified by banks) behind this slow move toward credit include the regulatory limitations applicable to simplified accounts and microcredit mentioned earlier.

### 2.3 The Mobile Phone Industry

Four operators account for 95 percent of the market share (divided roughly equally among them) and GSM technology dominates the industry. Mobile subscriptions have increased by more than 50 percent in two years since 2007, from 114.7 million in November 2007 (80 percent of which were prepaid)<sup>33</sup> to 173.9 million by end 2009 (82.5 percent prepaid).<sup>34</sup> Online top-ups are customarily made both through a vast network of MNO agents as well as banking agents. Value-added services, such as text messages, are not regulated under (or defined in) the Telecommunications Law, although they are increasingly used as a customer retention tool.

The mobile industry has increased substantially in Brazil over the last few of years. In 2007, 2,200 municipalities did not have access to mobile phone services; however, as of January 2010, 90 percent (5,028) of municipalities were covered by mobile telephony.<sup>35</sup> This has been partly in response to Anatel's specific coverage requirements in auctions for third generation services: the winners of the most attractive areas were required to cover the least attractive ones, such as the Amazon region. Also, to increase competition, Anatel passed a regulation on number portability<sup>36</sup> which, although highly controversial among MNOs, is already in place in various cities, including Sao Paolo.

### 2.4 Payment Systems and Instruments

*Payment systems.* There are two high-value settlement systems, one operated by CBB and one operated by private banks. Ultimately, all payments end in CBB's Reserve Transfer System (RTS), which until March 2009 was available only to entities with reserve accounts held at CBB. CBB expanded access as of March 2009 to all types of institutions authorized to function by CBB. These include brokers, credit cooperatives, credit and financing societies, among others. CBB is also developing an additional platform that will allow access to RTS via the Internet. This access is currently being provided by private networks that comprise the National Financial System Network (Rede do Sistema Financeiro Nacional).

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<sup>31</sup> Caixa makes over 300 million benefits payments per year (more than US\$1 billion) to more than 16 million families through over 19,000 points of assistance, more than 13,000 of which are agents. Source: Caixa Econômica Federal, *Annual Report 2006*. Brasília.

<sup>32</sup> According to Banco Popular, the default rate in microcredit was 24 percent in 2002, when the bank started operating.

<sup>33</sup> Anatel: "Notícias, 23 de novembro de 2007".

<sup>34</sup> Anatel: Notícias, 29 de janeiro de 2010.

<sup>35</sup> Portal Anatel: [Consolidação Serviços Móveis no Brasil](#), Jan 2010

<sup>36</sup> "Number portability" refers to the consumer's ability to change service providers while keeping the same telephone number.



All clearing and settlement services providers are banks or entities controlled by banks. The largest ATM and POS networks are also controlled by the largest banking conglomerates. The rules for accessing these systems are set in self-regulation (which is analyzed by CBB). Interoperability within the 25 ATM networks or the six POS networks is almost nonexistent. (For example, to accept transactions with Visa and Mastercard cards, a merchant must acquire two POS devices.) This is expected to change in July 2010 when an exclusivity arrangement between Visa and Cielo (formerly known as VisaNet) ends. From then on, it is expected that the infrastructure will be shared.<sup>37</sup> However, there is currently a fair level of interoperability among bank branches (customers of one bank can make deposits via another bank's branch). The dominance of large banks and the inefficiency created by lack of interoperability in POS and ATMs has been driving small and medium banks to create an independent automated clearinghouse (ACH) for low-value electronic transactions, including mobile banking. The project is encouraged by CBB, but it is in its infancy.

*Payment instruments.* Cash is the primary medium for small-value payments. The extensive agent and ATM networks have increased the convenience of cash and its use in recent years. Person-to-person payments and transfers are the most used type of noncash transaction (47.2 percent of volume in 2008). They commonly rely on the "boleto", a bar-coded payment order (paper or electronic) issued by a bank that can be paid by any person at any bank (although the recipient of a payment transfer must have a bank account with the issuer of the boleto). The use of credit and debit cards is increasing, but the low penetration and high costs of POS networks are considered significant barriers for increased and rapid uptake.<sup>38</sup> Prepaid cards are present but relatively confined to specific-purpose cards, such as phone, meal, gift, and travel cards. Even gift cards are not widely used, given the lack of a regulatory framework for these instruments. Visa International and smaller participants have been experimenting with open-purpose prepaid cards, but the use of these has not yet reached significant scale.

The paper-based culture is only partly explained by clients' preferences and level of sophistication. It is also linked to inefficiencies and lack of innovation in the retail payment system, according to CBB's Department of Banking Operations and Payments System. Since cash handling is the main cost of agents in remote areas, the evolution of this branchless banking model will necessarily require CBB to push for innovation, efficiency, and interoperability of electronic payment systems to diminish the use of cash. Banks with large agent networks are aware that going cashless is essential to providing a wider array of services at agents.

CBB's Department of Banking Operations and Payments System is open to new models within the retail payment system and is currently considering regulations and/or guidelines on electronic stored-value accounts based on the experience elsewhere, such as in the Philippines, South Africa, South Korea, and the European Union. However, CBB has not issued any position or taken any measure regarding open-use prepaid instruments issued by nonbanks. This lack of regulatory framework and the particular dynamics of the Brazilian market (the stage of competition in the mobile phone sector and the lobby exercised by banks) have hindered the development of nonbank-based branchless banking models.

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<sup>37</sup> Interview with Central Bank of Brazil, January 2010.

<sup>38</sup> Interviews with the Payment System Department of the Central Bank, July 2007.



*Mobile payments.* Competitors touting virtual wallets in mobile phones that will substitute for plastic cards and POS terminals are emerging outside the banking and the mobile phone sectors. An example is OiPaggo, a joint venture between Paggo, a technology provider, and Oi (an MNO) that services credit card companies. Once a credit card issuer enters into an agreement with Paggo, the credit card is “inserted” into a virtual wallet that is stored in the SIM card of customers’ mobile phones.<sup>39</sup>

Although it is designed to process prepaid accounts and e-money, Paggo currently does not issue prepaid cards because of the lack of clarity regarding whether a prepaid scheme constitutes deposit-taking (which may be undertaken only by CBB-licensed banks and credit cooperatives). (As discussed below, if a prepaid scheme clearly involves the issuer collecting repayable funds, the issuer *must* be a CBB-licensed institution.) This fact requires merchants to have a bank account to participate in the Paggo system. Consequently, a great part of the informal urban economy is excluded. However, other mobile payments businesses are emerging that could cater to informal merchants, such as the one led by Sebrae/RJ, which provides a mobile phone-based payment platform for (informal) merchants working on the beaches of Rio de Janeiro.<sup>40</sup>

### **3. Current Legal Framework for Branchless Banking**

#### **3.1 Bank Agents**

All CBB-licensed institutions are permitted to offer the following services through legal entities functioning as agents: deposits, withdrawals, and transfers; consultations; prepaid mobile phone top-ups; bill payments; receiving, reviewing, and forwarding applications for account openings, loans, and credit cards; preliminary credit analysis; loan collection; and international transfers. Until last year, CBB authorization was required if an agent were to engage in “banking services”—namely checking and savings account transactions (e.g., account opening applications, deposits, withdrawals, investment funds, and payments). However, CBB does not need to authorize agents anymore. The process is simple, and banks are required to register their agents online. Other services (not explicitly permitted by regulation) may also be outsourced to agents if authorized by CBB. With the intent of reducing the risk of agent fraud, CBB regulations prohibit the use of an agent whose primary or sole activity consists of services that are considered “banking services” as defined earlier.

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<sup>39</sup> To use OiPaggo’s services, both the merchant and the customer must be registered and must possess a mobile phone from Oi. To effect a sale, the merchant uses his mobile phone to input the purchase information and the customer’s mobile phone number in Paggo’s system and provides a personal password. An SMS is immediately sent by the merchant to the customer, who confirms the transaction and provides her password, triggering another SMS to the merchant with the confirmation. From this point on, everything works exactly like any credit card: the customer receives statements to be paid in a bank and the merchant is paid on a monthly basis. Paggo bills the customer and pays the merchant on behalf of the issuer.

<sup>40</sup> Rede Ello Empreendedor. [http://www.acrj.org.br/article.php3?id\\_article=2456/](http://www.acrj.org.br/article.php3?id_article=2456/) <http://www.elloempreendedor.com.br/>



## Use of Agents—Regulatory Evolution

Year	Resolution and description
Before 1999	Only banks can have agents and only in places where there are no bank branches. Services allowed: <ul style="list-style-type: none"> <li>- loan applications</li> <li>- credit and personal data analysis</li> </ul> Subagents are not allowed.
1999	<u>Resolution CMN 2640/99</u> Additional services allowed: <ul style="list-style-type: none"> <li>- receiving account opening applications (original documents should be analyzed by bank staff)</li> <li>- deposits/withdrawals (subject to CBB's authorization)</li> <li>- bill payments</li> </ul>
2000	<u>Resolution CMN 2707/00</u> Limitation on location is lifted. Agents can be located anywhere, regardless of whether there is a bank branch.
2002	<u>Resolution CMN 2953/02</u> <ul style="list-style-type: none"> <li>- Agents permitted to analyze identification documents for account opening.</li> <li>- In addition to banks, consumer credit companies allowed to hire agents.</li> </ul>
2003	<u>Resolution CMN 3110/03</u> <ul style="list-style-type: none"> <li>- All financial institutions are allowed to hire agents.</li> <li>- Subagents are allowed.</li> </ul>
2003	<u>Resolution CMN 3156/03</u> <ul style="list-style-type: none"> <li>- All other CBB licensed entities allowed to hire agents.</li> </ul>
2008	<u>Resolution CMN 3,568/2008</u> <ul style="list-style-type: none"> <li>- permitted agents to offer international transfers on behalf of a financial institution, limited to US\$3,000 per transaction, subject to a simple online CBB registration process.</li> </ul>
2008	<u>Resolution CMN 3,654/2008</u> <ul style="list-style-type: none"> <li>- Lifted need of previous authorization by CBB for banks to hire agents.</li> <li>- Financial institution willing to deliver services through agents is only required to register each agent in CBB's online system.</li> </ul>

The principal is fully responsible for the services rendered by its agents. CBB requires the principal (i) to control the activities of each of its agents by setting transaction limits and implementing mechanisms to block transactions remotely when necessary and (ii) to ensure compliance with all applicable legal and regulatory provisions, such as AML/CFT, customer protection, and data privacy. An agent must post a notice in its establishment that it acts on behalf of the bank.

The agency agreement and all supporting documentation related to the services rendered by the agent are open to scrutiny by CBB, which conducts onsite and offsite inspections through the principal. If necessary, CBB may conduct inspections directly (e.g., if customers



are charging an agent with fraud or if the principal's controls are deemed weak). Although the systemic risk of the agent business is deemed low by CBB, there is concern with avoiding large-scale wrongdoing.

In response to demands from banks, Resolution CMN 3,568/2008 permitted agents to offer international transfers on behalf of a financial institution, limited to US\$3,000 per transaction, subject to a simple registration process in CBB's online system. This measure is aimed at increasing competition in and reducing costs of low-value foreign exchange transactions, which are considered very high in Brazil.<sup>41</sup>

#### **Regulatory provisions to minimize agent risks and permit supervision by CBB**

- All agents must be registered in CBB's online system.
- If banking services are delivered, being an agent cannot be the main or only business of the agent.
- An agent cannot use the word "bank" in its name without CBB authorization.
- CBB has unrestricted access to all information and documents related to agents and subagents. CBB can also directly inspect agents if necessary.
- Regulation sets obligatory clauses to be included in service agreements.
- Financial settlement between the agent and the bank must occur at least every two business days (accounting settlement is real time for every transaction).
- Agents cannot give cash advances to clients, guarantee transactions, or charge extra fees.
- An agent is required to post (and the bank is required to ensure compliance of this requirement) the following:
  - signage indicating its status as a service provider for the bank
  - telephone numbers of the bank ombudsman and bank customer care representative
  - fees for all services available at the agent

CBB monitors and evaluates the largest agent networks by focusing on the bank's internal controls and information technology infrastructure as well as its policies and procedures for hiring and managing agents, which must include criteria for setting transactional limits for each agent and implement mechanisms to remotely block transactions when needed.

Although the framework for the use of agents by financial institutions is based on CBB's regulations, CBB does not have a clear mandate under law to regulate outsourcing. The Labor Law therefore has precedence over CBB's regulations on agents. As a consequence, there are several actions against banks (brought by agents and by bank employee unions) demanding wage equality between bank employees and agents. Most rulings so far have been in favor of the banks, but the continuity of the agent model is threatened by these demands, since the model's core feature—low cost—is potentially in jeopardy.

Also threatening the agent model are draft laws applying branch security requirements to agents (one of them being pushed by the Federal Police), in addition to a recent regulation by the National Health Surveillance Agency that questions the use of pharmacies and drugstores as bank agents. CBB has been analyzing these threats and possible actions, but no concrete

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<sup>41</sup> Note that agents can handle domestic currency only. They are not permitted to handle foreign currency. The foreign exchange transactions are conducted by a bank, which is responsible for anti-money laundering controls, including setting limits for the number of this type of transaction each agent can conduct.



action has been taken. The two bank associations have been pushing for a law that would define the agent business and give clear powers to CBB to regulate it without the risk of being questioned by other regulatory bodies, but it is pending approval by legislators and does not have formal support from CBB (by principle and tradition, CBB does not offer support to draft laws).

CBB and banks agree that these legal issues threaten the viability of the agent business. A disruption in the agent business could have disastrous consequences for consumers, particularly for low-income people in isolated areas who rely on local agents to conduct their financial transactions, but also for millions of urban poor.

## **32 AML/CFT**

The Conselho de Controle de Atividades Financeiras (the Financial Intelligence Unit [FIU]), centralizes and analyzes reported transactions and suspicious transaction reports related to all sectors covered by the AML/CFT Law. The Law applies to a wide variety of legal entities, including banks and other financial sector institutions, as well as other legal entities engaged, or dependent upon those engaged, in the financial sector, the stock exchange, or the insurance market.<sup>42</sup> CBB is responsible for setting and enforcing AML/CFT rules applicable to CBB-supervised entities. (FIU has online access to CBB's AML/CFT reporting system.)

To open a bank account, a customer is required to present to the bank or its agent government-issued official identification, a taxpayer card, marital status, parents' names, profession, date and place of birth, address, and telephone number.<sup>43</sup> For the opening of a simplified account, a bank may accept alternative supporting documents and identification, such as records made available by government agencies responsible for welfare payments. The customer must present government-issued identification within six months of the account opening; otherwise, the bank must close the account.<sup>44</sup> (Regardless of the flexibility given by the regulation, banks require a taxpayer card to open simplified accounts.) To counterbalance the relaxed customer due diligence requirements, simplified accounts are subject to a monthly balance limit of US\$500 (although if the depositor has a microcredit account, then the limit is US\$1,500). If the balance or the total sum of deposits exceeds US\$500 more than twice within a year, the account must be automatically blocked by the bank. Whether the account is opened at a branch or an agent, records must be kept by the bank for at least five years.

Most banks do not apply the prescribed relaxed customer identification procedures to open simplified accounts because they believe that the procedures will increase costs and increase the risk of not promptly identifying fraud. As a result, to open a simplified account, a client must present official identification (which low-income customers may not have), taxpayer number, and for some banks, proof of address. Caixa has an exclusive partnership with the internal revenue agency to provide taxpayer cards to those who want to open a simplified account at the time of application. It is the only bank that can offer this service.

MNOs are currently not covered by the AML/CFT Law. FIU believes that as MNOs increase their participation in the banking business they should be required to report suspicious transactions to CBB.

### **3.3 Banking business and e-money**

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<sup>42</sup> Law 961 3/1 998.

<sup>43</sup> Resolution CMN 2025/1993 and amendments.

<sup>44</sup> Resolution CMN 3211/2004.



Two primary legal principles govern banking and e-money. First, pursuant to the Banking Law, the business of collecting, intermediating, or investing funds from third parties is reserved for CBB licensed, regulated, and supervised entities.<sup>45</sup> Based on this provision, three groups of entities fall under the umbrella of CBB:

- Financial institutions that collect demand deposits (banks and credit cooperatives)
- Other financial institutions (deposit-taking or not), such as investment banks
- Other intermediaries and fund managers, such as brokers

Second, all deposit-taking entities are subject to licensing and supervision. The basic concept of deposit, as set forth in the Civil Code, is a contract through which the depositor hands funds to a third party and has the right to reclaim the funds at a later date.<sup>46</sup> Demand deposits are repayable at any time, and time deposits are repayable after some agreed upon period of time, but all deposits are repayable funds.

Although prepaid cards may not fall under the definition of deposit (because the prepaid funds may not be repayable), the requirement of the Banking Law that only CBB-licensed and supervised institutions are permitted to *collect* funds from third parties is generally viewed as prohibiting nonbanks from issuing e-money or other stored-value instruments, such as electronic accounts stored in mobile phones.

CBB has not issued regulations or other guidance on nonbank prepaid schemes. There are conflicting interpretations of the Banking Law regarding (i) what constitutes collection of funds, (ii) whether prepaid schemes could involve collection only or intermediation, and (iii) how this fits with the legal requirement that only licensed financial institutions may engage in collection and intermediation of funds. The lack of such clarity has hindered the development of nonbank-based branchless banking initiatives and even the implementation of simple payment features, such as “cash-back” at retail points.

### 3.4 Payment Systems

The Payment System Law gives CBB a clear mandate to supervise the National Payment System, defined as including entities, systems, and procedures linked to funds and securities transfers or payment processing, clearing, and settling. The law also authorizes CBB to license certain types of service providers. Pursuant to CBB regulation,<sup>47</sup> clearinghouses and other entities engaged in clearing and settlement services are subject to CBB authorization and supervision, while other participants of the payments system (i.e., payment service providers handling payment transfers as well as providers of payments infrastructure, technology, and other accessory services) may be supervised at CBB’s discretion based on the importance of the service, both in terms of transaction volume and number of customers. Based on these criteria, the largest ATM and POS networks (which are controlled by banks) are supervised by CBB while the small ATM and POS networks (which are not controlled by banks) are not.

The regulation sets out guiding principles for the infrastructure, governance, and risk management for all participants in the payments system and gives CBB a high degree of discretion to establish minimum standards. Clearing and settlement service providers operating systemically important systems (a status open to CBB’s judgment based on legal criteria) are subject to stricter minimum capital, liquidity, and operational standards than other participants because they are a central counterparty for all transactions.

<sup>45</sup> Banking Law (Law 4595/1 964), Articles 17, 18, and 44 and the Financial Crimes Law (Law 7492/1 986), Article 1.

<sup>46</sup> Civil Code (Law 10406/2002), Articles 627 and 586.

<sup>47</sup> Resolution CMN 2882/2001 and Circular BCB 3057/2000.



There is a low level of interoperability of POS and ATM networks in Brazil and a slow response from banks and other payment service providers. Interoperability has the potential to increase considerably the number of merchants and retail agents connected to Visa, Mastercard, and other card networks without imposing undue costs on merchants.

### **3.5 Money Transfer Services**

There is no legal or regulatory provision that specifically addresses the provision of money transfer services. However, pursuant to the Banking Law, international and domestic transfers both require the involvement of a CBB-licensed institution (except for the postal service, as noted below). Consequently, money transferors, such as Western Union and Money Gram, may offer their remittances and domestic transfer services only in partnership with CBB-licensed institutions. For foreign remittances, the CBB-licensed institution must be licensed to operate in foreign exchange (banks, exchange houses, and brokers).<sup>48</sup> The postal service has a special dispensation to operate in foreign exchange without a CBB foreign exchange license; however, it is permitted to send and receive remittances to and from other national postal services only, which limits considerably its potential to expand the service.<sup>49</sup>

CBB's foreign exchange regulation also requires the exchange rate to be set upon receipt of funds. This is deemed a barrier to foreign remittances because most jurisdictions apply the "fix on send" rule, not to mention that it requires the receiver to deal with a topic that can overwhelm many customers. Finally, money transferors typically require immigrants (whether they are sending or receiving) to present their taxpayer card and prove their legal status in Brazil, since foreign exchange providers are responsible for ensuring the legality of each transaction in accordance with CBB regulations. Western Union believes this keeps 80 percent of the outbound remittances in the informal and illegal markets in Brazil.

The private sector has urged CBB to create, in its regulation, a new category for money transfer services (both foreign and domestic) to differentiate these from foreign exchange and bank transfers. CBB has been receptive to discussing the issue, but no regulatory change has occurred to date. As mentioned previously, a 2008 regulation allows agents that have registered in CBB's online system to offer international transfers (limited to US\$3,000 per transaction) on behalf of financial institutions. However, the agents can handle domestic currency only.

### **3.6 Consumer Protection**

There is no specialized financial consumer protection body, but an active network of government entities, known as Procon, enforces the Consumer Protection Code (CPC) in the financial sector. In addition, CBB issues regulations dealing with specific areas of consumer protection, such as bank fees, and has the power to require prompt action in case of noncompliance. CBB regulations require banks to have, in addition to their customer service, an internal ombudsman to resolve client complaints and act upon identified areas of weaknesses of the client service area.

CPC and CBB regulations make no distinction between branchless banking clients and branch clients in regard to their applicability—i.e., requirements and principles apply in the same way to branchless banking as they do to traditional channels. However, given the singularity of the agency business, which client interface with third parties and their staff, CBB has issued

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<sup>48</sup> Forex Regime (Resolution CMN 3265/2005 and amendments).

<sup>49</sup> Postal Services Law (Law 6538/1978).

specific rules to deal with and clarify some consumer-focused issues in the agency business. Resolution 3,110/2003 holds the financial institution fully liable for services provided through agents and for their acts. Should fraud or other misdeed be conducted by an agent, the bank will be responsible for covering losses and damages caused to consumers, although the bank will have recourse against the agent. This liability also is in CPC, which states that the provider is jointly liable for the acts of their agents or autonomous representatives.<sup>50</sup> (The client has the right of redress against both the agent and the bank.)

Second, the agent is required to post a visible sign informing their agency status. The regulation prohibits agents from providing cash advances based on a transaction that has not yet been approved or finalized by the bank, such as a loan.

To help maintain price transparency, the regulations require agents to post the fees for all of the financial services they provide and prohibit agents from charging additional fees that would render a different final price than that being disclosed.<sup>51</sup> Finally, the principles of data privacy set in CPC are applicable to branchless banking, and agents may face criminal and civil charges for not complying with bank secrecy rules or for misusing client's information (as do MNOs, in the case of mobile banking, and any third party in other types of outsourcing).<sup>52</sup>

Banks must post at "all service points" (which include bank agents) the telephone number for their ombudsman.<sup>53</sup>

CBB has introduced many changes in the consumer-oriented rules in the last few years and has been reorganizing its supervisory process with focus on this area. For instance, CBB issued stiffer regulations on price transparency that also apply to agents, such as standardization of the names of bank fees and the disclosure of the effective annual interest rate on loans.

Further efforts may be needed to increase coordination among regulatory agencies (CBB, Anatel, and Procon) in the enforcement of financial sector consumer protection rules and in the design and implementation of nationwide financial consumer capability initiatives.

### **3.7 E-Commerce**

The Civil Code provides for recognition of electronic signatures. Digital certificates are issued by certifying authorities licensed by a Root Certification Authority. However, the E-signature Law<sup>54</sup> does not expressly establish criteria for validation of authenticity and integrity of electronic documents. Instead, each certifying authority sets its own standards. Although this absence of uniform standards has no major impact today (only one certifying authority—Certisign—issues the vast majority of the certifications in the country), it could become problematic as the market expands and competitors enter the certification business.

According to banks and payment service providers, the greatest obstacle to the security of electronic commerce is not the lack of validation standards, or regulation on security measures, but the lack of a legal framework for prosecuting crimes related to electronically authorized transactions. E-security crimes (identity theft, phishing, spam, and viruses) have escalated exponentially. Some successful prosecutions brought charges under the Penal Code and

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<sup>50</sup> CPC, art. 6 and 34.

<sup>51</sup> Resolution CMN 3,518/2007 and Resolution CMN 3,110/2003.

<sup>52</sup> Law 9296/1 996 Law 9296/1 996.

<sup>53</sup> Resolution CMN 2303/1996 amended by Resolution CMN 2343/1996 and Resolution CMN 2747/2000. This framework will be substituted by Resolution CMN 351 8/2007 and Circular BCB 3371/2007 from April 2008.

<sup>54</sup> Provisional Measure 2200/2001.



under laws on wiretapping, bank secrecy, and AML/CFT; however, the process has been slow and costly. At least 15 draft laws on e-crime have been waiting for years in Congress. A robust legal framework would increase certainty in electronic financial transactions, allowing banks and nonbanks to invest in cost-effective alternative electronic delivery channels with the potential to increase access by low-income clients.